

5 October 2015

Suzy Kantor
Resilience and Resolution
Financial Stability Group
HM Treasury
1/34, 1 Horse Guards road
London, SW1A 2HQ

FINANCIAL
MARKETS
LAW
COMMITTEE

Dear Ms Kantor,

Bank Recovery and Resolution: power to appoint temporary administrators

The role of the Financial Markets Law Committee (the "FMLC" or the "Committee") is to identify issues of legal uncertainty, or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks, and to consider how such issues should be addressed.

A number of "early intervention" powers are to be conferred by national legislatures on competent authorities under the EU Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms (the "BRRD") to intervene in the event of a deterioration in the financial situation of an institution by taking measures prior to resolution to bolster or reform its governance, management, legal or operational structures.¹ These powers are to include the power to require the appointment of a temporary administrator under Article 29. The BRRD also provides that the appointment of an administrator must be made public (under Article 29(1)).

The FMLC understands that HM Treasury is considering introducing specific measures to implement this power; notwithstanding authorities competent to supervise banks in the UK already have a power to impose a wide range of requirements on failing banking institutions under sections 55L and 55M of the Financial Services and Markets Act 2000.² The FMLC takes this opportunity to observe that in drafting provisions to confer this power, account should be taken of the widespread market practice of providing that the appointment of an administrator will constitute an event of default under financial contracts on market standard terms.

Market standard terms for financial contracts typically provide for a range of "bankruptcy" events of default, one of which stipulates that a party is subject to an event of default when it is "subject to the appointment of an administrator". The consequence of one party to a financial contract being subject to an event of default is, in the usual course, that the other party may terminate the contract. Where a party is subject to a "bankruptcy" event of default, the market consequence is normally that its

¹ There are a number of triggers for early intervention, one of which is that the institution is "likely in the near future" to breach capital adequacy requirements. The EBA is required to issue guidelines to promote the consistent application of triggers for the use of early intervention measures by competent authorities. The EBA published its [final report](#) on Guidelines on triggers for use of early intervention measures in May 2015.

² That is, wherever a bank is deemed likely to fail to satisfy the threshold conditions set out in Schedule 6 of the 2000 Act.

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counterparties in the markets in which it is active will all independently exercise their right to terminate agreements with the insolvent party, thereby depriving it of further access to funding and to the markets.

It is this outcome which the BRRD seeks to avoid for the purposes of recovery and resolution by providing, in Article 68, that a crisis prevention measure—such as the appointment of a temporary administrator—or a crisis management measure “shall not, *per se*, make it possible for anyone to: (a) exercise any termination, suspension, modification, netting or set-off rights...”, where the substantive obligations under the contract continue to be performed. So important is this provision that it is, by virtue of Article 68(6) accorded the status of a mandatory overriding provision for the purposes of the European choice of law rules set out in Regulation 593/2008 on the law applicable to contractual obligations (“Rome I”):

The provisions contained in this Article shall be considered to be overriding mandatory provisions within the meaning of Article 9 of [Rome I].

While this provision represents an important statement of intent under the BRRD, uncertainty remains as to its effect on market contracts. That is because Article 9(2) of the Rome I Regulation exclusively preserves the application of the overriding mandatory provisions *of the law of the forum* and the provisions contained in Article 68 of the BRRD, which are set out in a directive rather than a regulation, do not form part of Member States’ law until they are implemented.³ Thus, it is unclear whether courts in the UK would regard the rules in Article 68 (i.e. rules against a crisis prevention or management measure constituting an event of default or giving rise to termination rights) as overriding mandatory provisions of English law, absent further implementation.

The BRRD has been implemented in the UK by amendments to the Banking Act 2009. One of those amendments is the introduction of Section 48Z (*Termination Rights etc.*) of the Banking Act which implements Article 68 and provides that a “crisis prevention measure” is to be disregarded in determining whether a default event provision applies. Here, “default event provision” includes contractual termination provisions. The statutory definition of “crisis prevention measure”, however, as set out in Subsection 48Z(1), does not include the appointment of a temporary administrator under Article 29 of the BRRD.

The FMLC wishes to draw attention to this lacuna and to note that the temporary appointment of an administrator as may be required by a competent authority—whether under the existing provisions of the Financial Services and Markets Act 2000 or under specific measures yet to be introduced—is likely to constitute an event of default for the purposes of market contracts on standard terms unless consequential amendments are introduced into the Banking Act 2009. This is an outcome which is contrary to the legislative intent of the BRRD and which might lead to a significant degree of unintended market disruption if it were to materialise in the context of

³ Article 9(3) of Rome I stipulates that “effect may be given to the overriding mandatory provisions of the law of the [place of performance]” but Article 9 does not anywhere provide for effect to be given to the overriding provisions of European law other than through the operation of the law of a Member State.

measures to prevent a crisis in respect of a systemically significant EU banking institution.

I and Members of the Committee would be delighted to meet you to discuss the issues raised in this letter. Please do not hesitate to contact me to arrange such a meeting or should you require further information or assistance.

Yours sincerely,

A handwritten signature in black ink that reads "Joanna Perkins". The signature is written in a cursive style with a large, sweeping initial 'J'.

Joanna Perkins

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