24 January 2019

Andrew Shore
Assistant Director of Policy, The Insolvency Service
4 Abbey Orchard Street
London SW1P 2HT

Dear Mr Shore

The Insolvency (Amendment) (EU Exit) Regulations 2018

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.

In June 2016, the U.K. voted by way of an in/out referendum to withdraw from the European Union ("**Brexit**"). On 29 March 2017, HM Government officially served notice to the E.U. of the U.K.'s intention to withdraw under Article 50 of the Treaty on European Union ("**TEU**"), beginning a two-year "notice" and negotiation period, and setting the date on which the U.K. will withdraw from the E.U. ("**exit day**") as 29 March 2019. As a post-Brexit longer-term relationship is, as yet, undecided, preparations in the U.K. have focused on a "no deal" eventuality. A key element of such preparations is the European Union (Withdrawal) Act 2018, which aims, *inter alia*, to incorporate into U.K. law all applicable E.U. legislation and gives powers to Ministers to make any such amendments to retained law as are necessary to deal with any deficiencies arising from withdrawal. In furtherance of these aims, HM Government has begun to publish drafts of statutory instruments ("**SIs**") which will "onshore" E.U. legislation. This letter concerns the draft Insolvency (Amendment) (EU Exit) Regulations 2018 (the "**draft Insolvency SI**").[1]

The draft Insolvency SI repeals parts of the retained Regulation (EU) 2015/848 on insolvency proceedings (the "**EUIR**") and makes consequential amendments to insolvency and related legislation in the U.K. The FMLC understands that the draft Insolvency SI has been laid before Parliament and considered by the appropriate Parliamentary Committees, including the Joint Committee on Statutory Instruments (the "**Joint Committee**"). The Joint Committee has reported regulations 4 and 5 of the draft Insolvency SI for "requiring elucidation, for defective drafting and for unexpected use of powers".[2]

Regulations 4 and 5 are concerned with "existing insolvency proceedings"—i.e., proceedings which are already in progress on exit day. Regulation 4(2) provides that where proceedings under the EUIR were opened before exit day, the amendments made by the draft Insolvency SI will not apply in respect of those proceedings or any secondary proceedings against the same debtor. Regulation 5 provides a "safeguard mechanism", allowing—in regulation 5(1)—courts in the U.K. to disapply the EUIR to existing proceedings if:

1 As with all the SIs published in pursuit of the aims of the Withdrawal Act, the FMLC understands that the draft Insolvency SI has been laid before Parliament with the intention of implementing a policy position arising from a "no deal" Brexit. The Committee does not comment on matters of policy or the form that future regulatory approaches, if any, should take and this letter should not be understood to constitute comments thereon.

2 See Joint Committee for Statutory Instruments, *Forty-second Report of Session 2017–19*, available at: https://publications.parliament.uk/pa/jt201719/jtselect/jtstatin/258/25803.htm#_idTextAnchor002. The Insolvency Service's response is available at: https://publications.parliament.uk/pa/jt201719/jtselect/jtstatin/258/25806.htm#_idTextAnchor008

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the court considers that the effect is or would be different to what would be the effect had a member State treated the United Kingdom as a member State under the relevant Regulation, and either—

a) the court considers that one or more of the following would be materially prejudiced—

(i) the interests of a creditor (whether alone or in common with some or all other creditors),

(ii) the interests of the debtor,

(iii) where the debtor is a body corporate, the interests of a member (whether alone or in common with some or all other members) of the debtor; or

b) the court considers it would be manifestly contrary to public policy to apply the relevant Regulation.

In this context, regulation 5(2) allows courts to instead:

a) apply any other relevant law of the part of the United Kingdom in which the matter is being determined (including the Cross-Border Insolvency Regulations 2006(a) or the Cross-Border Insolvency Regulations (Northern Ireland) 2007);

b) make any other order that it thinks fit.

The Joint Committee has reported regulation 5(1) for defective drafting—with an emphasis on the ambiguity introduced by phrases such as "materially prejudiced" and "manifestly contrary to public policy"—and regulation 5(2) for an unexpected use of the enabling power, highlighting the large discretion afforded to courts.

The FMLC notes that similar discretion has been provided to courts in other onshoring SIs which, too, offer both savings provisions for proceedings begun before exit day and "safeguard mechanisms" allowing U.K. courts to disapply the savings provisions.[3] By way of example, regulation 9(2)(b) of the draft Credit Institutions and Insurance Undertakings Reorganisation and Winding Up (Amendment) (EU Exit) Regulations 2018 (the "**draft CIIURW SI**") provides that courts in the U.K. may make an order disapplying the savings provisions if the U.K. creditors of the relevant institution would be materially prejudiced by the operation of Member State law in relation to: (1) its treatment of the U.K. as a state outside the E.E.A.; or (2) its different treatment of U.K. creditors in comparison to E.E.A. creditors. In a meeting with HM Treasury, the FMLC Secretariat had commented on an earlier version of the draft CIIURW SI, in which the "safeguard mechanism" was predicated on the *location* of creditors rather than material prejudice—in a meeting with HM Treasury. It had, at that stage, observed to HM Treasury that a "material prejudice" test would be more closely aligned with concepts of fairness to creditors than one based purely on location.

The FMLC would welcome attempts to redraft regulation 5 to contain more precise and technical language, which could provide U.K. courts with direction as to the criteria to which they might have regard in determining whether to disapply the savings provisions in respect of existing proceedings. The "safeguard mechanism" is,

3 The draft Civil Jurisdiction and Judgments (Amendment) (EU Exit) Regulations 2019 applies a different test, allowing, in regulation 93(2), it allows courts to disapply savings provisions to existing proceedings "if, and only if, it considers that it would be unjust not to do so."

however, an important protection for U.K. creditors involved in cross-border insolvency proceedings. The EUIR provides rules which govern the reciprocal recognition of insolvency proceedings across the E.U.[4] Part 1 of the Schedule to the draft Insolvency SI repeals many of the provisions which ensure the recognition of the rights of creditors and third parties across the E.U. One example is Article 8 of the EUIR which protects the rights *in rem* of creditors or third parties in respect of assets belonging to the debtor which are situated within the territory of another Member State at the time of the opening of proceedings. In the case of existing proceedings, were an E.U. court to consider that the protections in Article 8 no longer applied to assets situated in the U.K.—or if an E.U. court were otherwise to fail to apply the rules of procedure provided in the EUIR to U.K. creditors or assets—it could be necessary—and beneficial for market certainty—to provide U.K. courts with the ability to intervene.

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 should you wish to arrange a meeting or if you have any questions.

Yours sincerely,

Joanna Perkins
FMLC Chief Executive[5]

cc: Theodore Read, HM Treasury

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4 The FMLC has previously considered issues of legal uncertainties which may arise in consequence of Brexit in relation to cross-border insolvency proceedings. FMLC, *Issues of Legal Uncertainty Arising in the Context of the Withdrawal of the U.K. from the E.U.—the Impact on Cross-Border Insolvency Proceedings*, (25 August 2017), available at: http://fmlc.org/report-u-k-withdrawal-from-the-e-u-25-august-2017/.

5 In view of the role of the Bank of England, the Financial Conduct Authority and HM Treasury in the U.K.'s preparations for withdrawal from the E.U., Sinead Meany, Sean Martin and Peter King took no part in the preparation of this paper and the views expressed should not be taken to be those of the Bank of England, the FCA and HM Treasury.

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