

Financial
Markets
Law
Committee

c/o Bank of England
Threadneedle Street
London
EC2R 8AH

Telephone: (+44) (0)20 7601 3918
Fax: (+44) (0)20 7601 5226

Email: fmlc@bankofengland.co.uk
Website: www.fmlc.org

CHAIRMAN:
THE RT.HON. LORD HOFFMANN

22 January 2010

Mr Mario Nava
DG Internal Market and Services, Banking and Financial Conglomerates Unit
European Commission
SPA2 04/12
B-1049 Brussels

Dear Mr Nava

The Commission's communication paper entitled "An EU Framework for Cross-Border Crisis Management in the Banking Sector" (the "Paper")

The remit of the Financial Markets Law Committee ("FMLC") 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 risk and to consider how such issues should be addressed.

The FMLC welcomes the opportunity to explore ways to strengthen financial stability and improve the regulatory framework for dealing with banks in distress across the European Union. As the Paper does not offer concrete legislative proposals but mainly invites views on matters of policy, which by definition are outside the FMLC's remit to address issues of legal uncertainty, the FMLC at this stage would merely like to highlight its extensive experience in considering legal issues that may be consequential upon the reform of resolution arrangements for banks. To this end, I draw your attention to various documents prepared by the FMLC during the consultative process on the UK Banking Bill as well as subsequent to the Bill becoming the UK Banking Act 2009, highlighting various areas of potential legal uncertainty raised by the legislative proposals as they evolved. We list those in the Annex to this letter, and these are available on the FMLC website at <http://www.fmlc.org>. The Commission may find it helpful to review these in connection with its preparation of future proposals in relation to early intervention in and resolution of failing cross-border bank groups.

The FMLC is represented on the Banking Liaison Panel ("BLP"), established by the Banking Act 2009 as a standing body of public and private sector experts tasked to advise the UK Treasury on the effect of the special resolution regime (SRR) under the Banking Act 2009. One of the first tasks of the BLP was to advise the Treasury on amendments to the secondary legislation (generally referred to as the "Safeguards Order"), which came into effect on the same day as the Banking Act 2009, protecting netting, set-off, security and title transfer collateral arrangements from the operation of stabilisation powers under the SRR. With the help of this advice, the Treasury made an order amending the Safeguards Order and eliminating most of the difficulties identified by the BLP, with effect from July 2009. Work continues on certain aspects of the Safeguards Order.

The Banking Act 2009 covers only commercial banks and building societies, but includes a power of the Treasury to make secondary legislation introducing a resolution regime for investment firms. A working group of public and private sector expert was formed to assist the Treasury in developing its proposals in this regard. The FMLC is also represented in relation to this work. Much of this work, of course, is inspired by the collapse of the UK Lehman Brothers entities, in particular, Lehman Brothers International Europe ("LBIE").

An important issue of uncertainty arising out of LBIE's entry into administration proceedings was the suspension of matched cash equities settlement instructions in the CREST System operated by Euroclear UK and Ireland that were open (that is, had not proceeded to final settlement) at the time of LBIE's administration. This suspension created considerable uncertainty and risk for counterparties to LBIE because it endured for over three weeks before it was resolved *ad hoc* by EUI after consultation with the UK public authorities.

After consultation with a variety of stakeholders affected by this situation, including EUI, the FMLC published a memorandum describing the relevant issues and difficulties and outlining possible solutions. The memorandum, entitled 'Unsettled OTC Trades - Legal Proposal for normative changes to address the risk of market instability in the event of the insolvency of an investment firm, with particular reference to the problem of unsettled OTC cash equity trades', was issued in September 2009 and is available on the FMLC website. Although the Commission Communication focuses on the resolution of deposit-taking credit institutions operating in cross-border bank groups, it may make sense for the Commission to consider extending the scope of that work to encompass investment firms and other financial institutions. In that case, the Commission will want to consider the lesson learned from the collapse of LBIE and may find the FMLC memorandum helpful on the issue of open cash equities settlements.

By way of further background, the FMLC has been looking at other areas of actual or potential legal uncertainty raised by the financial crisis. A prominent example of this work is the FMLC's memorandum prepared for the UK Treasury on the Landsbanki Freezing Order, discussing a number of the difficulties raised by the order made by the Treasury under primary legislation primarily (although not exclusively) intended to address terrorist threats. The Landsbanki Freezing Order, issued by the Treasury in October 2008, applied overly broadly to financial market dealings, prohibiting many ordinary and prudent activities of counterparties to Landsbanki and making breach of the Order a criminal offence. The subsequent issuance by the Treasury of general and specific licences to cut back on the breadth of the original Order was not sufficient to address fully substantial uncertainties created by the Order. The memorandum may also be relevant to some aspects of the Commission's work following the Commission Communication, depending on the course of the consultation process, and so we draw the Commission's attention to that as well. The memorandum, entitled "Landsbanki Freezing Order 2008: Legal assessment of the impact on the financial markets – Report", was issued in May 2009 and is available at the FMLC website.

Finally, the Commission may also find useful the recent UK Financial Services Authority's Discussion Paper 09/2 entitled "A Regulatory Response to the Global Banking Crisis" (see at http://www.fsa.gov.uk/pages/Library/Policy/DP/2009/09_02.shtml), which provides an in-depth analysis of the causes of the financial crisis and recommends steps that the international community should take to enhance regulatory standards, supervisory approaches and international cooperation and coordination.

I would be delighted to place the expertise of the FMLC at your disposal as you consider how to take forward the policy issues outlined in your communication paper. If I, or the Committee, can be of any service to you in this regard, please do not hesitate to contact me via the FMLC Secretary at the address above.

Yours sincerely



Lord Hoffmann

FMLC correspondence, memoranda and reports relating to UK Banking Bill and the UK Banking Act 2009 (each appearing under the heading “Issue 133: Banking Reform, Depositor Protection” on the FMLC website at <http://www.fmlc.org>)

Letter from Lord Woolf to Banking Reform Team, HM Treasury (April 2009)

The Special Resolution Regime: Safeguards for Partial Property Transfers - Report (January 2009)

Link to the FMLC submission to the Banking Bill:
<http://www.publications.parliament.uk/pa/cm200708/cmpublic/banking/memos/ucm402.htm>

The Special Resolution Regime – Report (September 2008)

The Special Resolutions Regime: Legal assessment of the safeguards that are necessary for a SRR - Report (July 2008)

Response to the Tripartite Consultation Paper (April 2008)