

22 June 2016

Daniel Jones
Financial Stability
HM Treasury
1 Horse Guards Road
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Dear Mr Jones,

Reforms to the investment bank special administration regime

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.¹

The FMLC welcomes the opportunity to comment on proposals to strengthen the investment bank special administration regime ("SAR") set out in the consultation document on reforms to the investment bank SAR published by HM Treasury in March 2016 (the "**Consultation Document**"). The proposals seek to implement certain recommendations from a 2014 report by Peter Bloxham on his review of the SAR.² Published with the Consultation Document is a draft statutory instrument: the Investment Bank (Amendment of Definition) and Special Administration (Amendment) Regulations 2016 ("**Draft Regulations**"), which sets out the technical provisions related to the proposals.

The FMLC considers that the proposed changes when implemented will speed up and simplify the process of SAR administrations, bringing benefits to clients, creditors, and others involved in the insolvency process. The Committee has, however, identified in relation to the proposal on transfers of client assets covered in Chapter 2 of the Consultation Document a number of issues which may cause legal uncertainty and may also have the effect of hindering or interfering with the operation of the transfer of client assets and which should, therefore, be addressed. These issues are discussed in more detail below.

Regulation 10C of the Draft Regulations—a transfer of client trust assets

Releasing the SAR entity from its duties as trustee

The SAR establishes a set of "special administration objectives" which the administrator of an investment firm is required to pursue. Among these, the administrator's first objective is to return client assets as soon as is reasonably practicable. The administrator may meet this objective either by returning the assets directly to clients, or by transferring them from the

¹ Sonya Branch, Stephen Parker and Sean Martin took no part in the preparation or discussion of this letter and it should not be taken to represent the views of the Bank of England, HM Treasury or the Financial Conduct Authority.

² *Final review of the Investment Bank Special Administration Regulations 2011*, HM Treasury, January 2014, available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/506136/PU1896_SAR_Consultation.pdf

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failed firm to another institution. The SAR does not, however, provide a legal mechanism to facilitate these transfers or to override existing provisions of common law which may place obstacles in the way of such a transfer.

The Draft Regulations are intended to address this lacuna. Regulation 10C introduces a mechanism to facilitate the transfer of client relationships and assets. It includes provisions which allow for: i) the novation of client contracts and assets by operation of law as part of a wider business transfer; ii) a limited moratorium on the exercise of termination rights by custodians; and iii) the sharing of confidential client information.³

The regulation is drafted in terms similar to those found in sections 33 and 34 of the Banking Act 2009.⁴ These sections deal with a transfer of a bank's property which may be provided for by a property transfer instrument made by the Bank of England in the event of a bank resolution. Section 34(7) deals with transfer instruments which make provision in respect of trust property and permits the instrument to make sweeping changes to all aspects of the trust:

Where a property transfer instrument makes provision in respect of property held on trust (however arising) it may also make provision about—

- (a) the terms on which the property is to be held after the instrument takes effect (which provision may remove or alter the terms of the trust), and
- (b) how any powers, provisions and liabilities in respect of the property are to be exercisable or have effect after the instrument takes effect.

The intention of the proposed Regulation 10C is to effect a transfer of the trustee's legal title to client assets (along with, perhaps, some other financial contracts and property of the investment bank), in much the same way as may be done under a property transfer instrument, and to do so without the client's intervention. As drafted, however, the regulation does not do enough both to transfer the legal title without the beneficial title and to extinguish the investment bank's duties, *qua* trustee, some of which are statutory and some of which are personal.

In the course of a private trust, the replacement of trustees may be effected by the beneficiaries directing that it shall happen under a statutory power in the Trusts of Land and Appointment of Trustees Act 1996 but Regulation 10C is intended to obviate the need for such a procedure. In the view of the FMLC, it is doubtful whether the Draft Regulation—which, although it makes provision for the transfer of assets to take effect, does not otherwise permit the administrator or the transferee to make changes to the trust—does enough to release the SAR entity from the duties which it undertook *qua* trustee.

³ The mechanism introduced by Regulation 10(C) is additional to that available under Part VII of the Companies Act 1989. Part VII protects transactions cleared through a recognised central counterparty ("CCP") to the extent that they fall to be performed in England, Wales or Scotland. It also modifies the general law of insolvency to assist a "qualifying property transfer" in relation to such transactions. This is defined to include (i) a transfer of property made in accordance with Article 48(7) of Regulation (EU) No 648/2012 on O.T.C. derivatives ("EMIR") which requires the return of surplus collateral on client account after completion of the CCP's default process; or (ii) payment of money by a clearing member to an indirect client in accordance with Commission Delegated Regulation (EU) No 149/2013, which requires a clearing member to establish robust procedures to manage the default of a client who provides indirect clearing services; or (iii) a specified transfer of property made by a recognised CCP to a non-defaulting clearing member in place of a defaulting clearing member. Part VII of the Companies Act 1989, section 155A(1) and (4) and section 189A. Regulation 10(C) appears useful where the required action falls outside the scope of Part VII, including in the case of non-cleared transactions or transfers made by an administrator.

⁴ The drafting in Regulation 10C also bears superficial similarity to section 124. This latter, however, is concerned with deposits and, therefore, not with assets which the account-provider holds on trust.

The assignment of debts

The Law of Property Act 1925 provides that the assignment of a debt "by writing under the hand of the assignor" will take effect in law where the debtor is notified in writing. Where there is no such notice to the debtor, however, the assignment of a debt by a creditor to another creditor will take effect only in equity. The FMLC is concerned that Regulation 10C—which contemplates the assignment of client assets in circumstances that may include the assignment of closely-related debts owing from the client to the SAR entity—does not do enough to ensure that any assignment of debts takes effect in law.

There is certainly nothing in the draft of Regulation 10C which provides that a transfer of debts will take effect in law and in spite of the non-fulfilment of the requirement for notice. That is, neither legal effect nor the disapplication of a requirement for notice is expressly mentioned. The FMLC is concerned that in the absence of specific provision, an assignment by the administrator of debts owing to the SAR entity will take effect only in equity.

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,



Joanna Perkins

FMLC Chief Executive