

2018 No.

FINANCIAL SERVICES

BANKS AND BANKING

BUILDING SOCIETIES

**The Banks and Building Societies (Priorities on Insolvency)
Order 2018**

<i>Made</i> - - - -	***
<i>Laid before Parliament</i>	***
<i>Coming into force</i> - -	***

The Treasury are designated (a) for the purposes of section 2(2) of the European Communities Act 1972(b) in relation to financial services.

The Treasury make the following Regulations in exercise of the powers conferred by section 2(2) of the European Communities Act 1972.

PART 1

Introductory Provisions

Citation and commencement

1.—(1) This Order may be cited as the Banks and Building Societies (Priorities on Insolvency) Order 2018.

(2) This Order comes into force on 1st December 2018.

Extent

2. The amendments made by this Order have the same extent as the enactments amended.

Transitional provision

3.—(1) This Order has no effect in relation to insolvency proceedings which are commenced before the date on which this Order comes into force.

(a) S.I. 2012/1759.

(b) 1972 c.68. Section 2(2) was amended by section 27 of the Legislative and Regulatory Reform Act 2006 (c.51) and by section 3 of, and the Schedule to, the European Union (Amendment) Act 2008 (c.7).

(2) For this purpose—

(a) “insolvency proceedings” means—

- (i) proceedings under the Bankruptcy (Scotland) Act 2016;
- (ii) proceedings under the Insolvency Act 1986;
- (iii) proceedings under the Insolvency (Northern Ireland) Order 1989;
- (iv) proceedings under the Insolvent Partnerships Order 1994;
- (v) proceedings under the Insolvent Partnerships Order (Northern Ireland) 1995;
- (vi) proceedings under the Investment Bank Special Administration Regulations 2011; or
- (vii) proceedings under Part 2 or 3 of the Banking Act 2009 (including proceedings under either of those Parts as applied to building societies by section 90C of the Building Societies Act 1986);

(b) insolvency proceedings commence on—

- (i) the date of presentation of a petition for a winding-up order, bank insolvency order, special administration (bank insolvency) order, building society insolvency order, bankruptcy order or award of sequestration;
- (ii) the date on which an application is made for an administration order, bank administration order, investment bank special administration order, special administration (bank administration) order or building society special administration order;
- (iii) the date on which notice of appointment of an administrator is given under paragraph 18 or 29 of Schedule B1 to the Insolvency Act 1986 or paragraph 19 or 30 of Schedule B1 to the Insolvency (Northern Ireland) Order 1989;
- (iv) the date on which a proposal is made by the directors of a company for a company voluntary arrangement under Part 1 of the Insolvency Act 1986 or Part 2 of the Insolvency (Northern Ireland) Order 1989 or by an individual debtor for an individual voluntary arrangement under Part 8 of the Insolvency Act 1986 or Part 8 of the Insolvency (Northern Ireland) Order 1989;
- (v) the date on which a resolution for voluntary winding-up is passed.

PART 2

Amendments of the Insolvency Act 1986

Introduction

4. The Insolvency Act 1986 is amended in accordance with this Part.

Non-preferential debts in company voluntary arrangements

5. In section 4 (decisions of the company and its creditors), in subsection (4)—

- (a) in paragraph (b), omit the final “or”;
- (b) after paragraph (c) insert “or
 - (d) in the case of a company which is a relevant financial institution (see section 387A), any non-preferential debt is to be paid otherwise than in accordance with the rules in section 176AZA(2) or (3).”;
- (c) in the words after paragraph (c), omit “preferential”.

Non-preferential debts in winding up of companies

6. After section 176 insert—

“Non-preferential debts

Non-preferential debts of financial institutions

176AZA—(1) This section applies in the winding up of a company which is a relevant financial institution.

(2) The company’s ordinary non-preferential debts shall be paid in priority to its secondary non-preferential debts.

(3) The company’s secondary non-preferential debts—

(a) shall be paid in priority to its tertiary non-preferential debts, and

(b) rank equally among themselves after the ordinary non-preferential debts and shall be paid in full, unless the assets are insufficient to meet them, in which case they abate in equal proportions.

(3) See section 387A for definitions relevant to this section.”.

Non-preferential debts in individual voluntary arrangements

7. In section 258 (approval of debtors’ proposal), in subsection (5)—

(a) in paragraph (b), omit the final “or”;

(b) after paragraph (c) insert “or

(d) if the debtor is a relevant financial institution (see section 387A), any non-preferential debt is to be paid otherwise than in accordance with the rules in section 328(3A) (reading references to the bankrupt as references to the debtor),”;

(c) in the words after paragraph (c), omit “preferential”.

Non-preferential debts in bankruptcy proceedings

8.—(1) Section 328 (priority of debts) is amended as follows.

(2) After subsection (3) insert—

“(3A) If the bankrupt is a relevant financial institution, subsection (3) does not apply but—

(a) the bankrupt’s ordinary non-preferential debts shall be paid in priority to the bankrupt’s secondary non-preferential debts,

(b) the bankrupt’s ordinary non-preferential debts rank equally among themselves after the secondary preferential debts and shall be paid in full, unless the bankrupt’s estate is insufficient to meet them, in which case they abate in equal proportions,

(c) the bankrupt’s secondary non-preferential debts shall be paid in priority to the bankrupt’s tertiary non-preferential debts, and

(d) the bankrupt’s secondary non-preferential debts rank equally among themselves after the ordinary non-preferential debts and shall be paid in full, unless the bankrupt’s estate is insufficient to meet them, in which case they abate in equal proportions.

See section 387A for definitions relevant to this subsection.”.

(3) In subsection (4), after “subsection (3)” insert “(or in the case of a relevant financial institution, which are referred to in subsection (3A)(a) to (d))”.

9. In section 329 (debts to spouse or civil partner), in subsection (2)(a)—

(a) omit “debts and”;

(b) for “328(3) and (4)” substitute “328(4)”.

Interpretation

10. In the heading of Part 12, after “Preferential” insert “and non-preferential”.

11. After section 387 insert—

“Financial institutions and their non-preferential debts

387A.—(1) In this Act “relevant financial institution” means any of the following—

- (a) a credit institution,
- (b) an investment firm,
- (c) a financial holding company,
- (d) a mixed financial holding company,
- (e) a financial institution which is—
 - (i) a subsidiary of an entity referred to in sub-paragraphs (a) to (d), and
 - (ii) covered by the supervision of that entity on a consolidated basis in accordance with Articles 6 to 17 of Regulation (EU) No 575/2013, or
- (f) a mixed-activity holding company.

(2) The definitions in Article 4 of Regulation (EU) No. 575/2013 apply for the purposes of subsection (1).

(3) In this Act, in relation to a relevant financial institution—

- (a) “ordinary non-preferential debts” means non-preferential debts which are neither secondary non-preferential debts nor tertiary non-preferential debts;
- (b) “secondary non-preferential debts” means non-preferential debts issued under an instrument where—
 - (i) the original contractual maturity of the instrument is of at least one year,
 - (ii) the instrument is not a derivative and contains no embedded derivative, and
 - (iii) the relevant contractual documentation and any prospectus related to the issue of the debts explain the priority of the debts under this Act, and
- (c) “tertiary non-preferential debts” means—
 - (i) debts under Common Equity Tier 1 instruments, Additional Tier 1 instruments and Tier 2 instruments (all within the meaning of Part 1 of the Banking Act 2009), and
 - (ii) other subordinated debts.

(4) In subsection (3)(b), “derivative” has the same meaning as in Article 2(5) of Regulation (EU) No 648/2012.

(5) For the purposes of subsection (3)(b)(ii) an instrument does not contain an embedded derivative merely because—

- (a) it provides for variable interest rate derived from a broadly used reference rate, or
- (b) it is not denominated in the domestic currency of the person issuing the debt (provided that the principal, repayment and interest are denominated in the same currency).”.

Moratorium where directors propose voluntary arrangement

12. (1) Schedule A1 (moratorium where directors propose voluntary arrangement), paragraph 31 (approval of voluntary arrangement) is amended as follows.

(2) In sub-paragraph (5) —

- (a) in paragraph (b), omit the final “or”;

(b) after paragraph (c) insert “or

(d) if the company is a relevant financial institution (see section 387A), any non-preferential debt is to be paid otherwise than in accordance with the rules in section 176AZA(2) or (3).”.

(3) In sub-paragraph (6), omit “preferential”.

Administration and secondary non-preferential debts

13. — (1) Schedule B1 (administration) is amended as follows.

(2) In paragraph 65 (distribution), in sub-paragraph (2), for “Section 175” substitute “Sections 175 and 176AZA”.

(3) In paragraph 73 (protection for secured or preferential creditor)—

(a) in the heading, for “secured or preferential” substitute “priority”;

(b) in sub-paragraph (1), in paragraph (c), omit the final “or”;

(c) in that sub-paragraph, after paragraph (d) insert “or

(e) if the company is a relevant financial institution (see section 387A), would result in any non-preferential debt being paid otherwise than in accordance with the rules in section 176AZA(2) or (3).”.

PART 3

Amendment of Insolvent Partnerships Order

Amendment to the Insolvent Partnerships Order 1994

14. The Insolvent Partnerships Order 1994 is amended in accordance with this Part.

15. In subsection (3) of Article 4 (Voluntary arrangement of insolvent partnership), before paragraph (a) insert:

“(za) Section 176AZA in Part IV”.

16. In subsection (5) of Article 6 (Administration in relation to insolvent partnership), before paragraph (a) insert:

“(za) Section 176AZA in Part IV”.

17. Schedule 1 to the Insolvent Partnerships Order 1994 (modified provisions of Part 1 of, and Schedule A1 to, the Insolvency Act 1986 (company voluntary arrangements) as applied by Article 4), is amended as follows—

(a) in modified section 4(4) (Decisions of the members of the partnership and its creditors)—

(i) in paragraph (b) at the end omit the final “or”;

(ii) after paragraph (c) insert “or

(d) in the case of a company which is a relevant financial institution (see section 387A), any non-preferential debt is to be paid otherwise than in accordance with section 176AZA(2) or (3).”

(iii) in the words after paragraph (c), omit “preferential”.

Amendment to Schedule 2 to the Insolvent Partnerships Order 1994

18. Schedule 2 to the Insolvent Partnerships Order 1994 (modified provisions of Part 2 of, and Schedule B1 to, the Act (Administration) as applied by Article 6), is amended as follows—

(1) in paragraph 23, in modified section 65(2), for “Section 175(1) and (2)(a)” substitute “Section 175(1), (1A), (1B), and (3) and section 176AZA”;

(2) in paragraph 25—

(a) in modified section 73(1)—

(i) in paragraph (c) at the end omit “or”;

(ii) in paragraph (d) at the end insert “or

(e) if the company is a relevant financial institution (see section 387A), any non-preferential debt is to be paid otherwise than in accordance with the rules in section 176AZA(2) or (3).”.

Amendment to Schedule 4 to the Insolvent Partnerships Order 1994

19. Paragraph 23 of Schedule 4 to the Insolvent Partnerships Order 1994 (provisions of the Act which apply with modifications for the purposes of Article 8 to winding up of insolvent partnership on creditor’s petition where concurrent petitions are presented against one or more members), is amended as follows—

(a) In the opening words of paragraph 23, after “Sections 175” insert “, 176AZA”;

(b) in modified section 175A(2) (Priority of debts in joint estate), for paragraph (b) substitute—

“(b) the ordinary non-preferential debts;

(ba) the secondary non-preferential debts;”;

(c) in modified sections 175A(4), 175A(6) and 175B(2), for “paragraphs (a), (aa) and (b)” in each case substitute “paragraphs (a), (aa), (b) and (ba)”;

(d) after modified section 175A(5) insert—

“(5A) Where the joint estate is not sufficient for the payment of the secondary non-preferential debts in accordance with paragraph (ba) of subsection (2), the responsible insolvency practitioner shall aggregate the value of those debts to the extent that they have not been satisfied or are not capable of being satisfied, and that aggregate amount shall be a claim against the separate estate of each member of the partnership against whom an insolvency order has been made which—

(a) shall be a debt provable by the responsible insolvency practitioner in each such estate, and

(b) shall rank equally with the interest on the separate debts referred to in section 175B(1)(ba) below.”;

(e) in modified section 175B(1) (Priority of debts in separate estate), for paragraph (b) substitute—

“(b) the ordinary non-preferential debts (including any debt referred to in section 175A(5)(a));

(ba) the secondary non-preferential debts (including any debt referred to in section 175A(5A)(a));”;

(f) in modified section 175A(9), after “(5),” insert “(5A),”;

(g) after modified section 175A(9) insert:

“(10) Secondary non-preferential debt shall rank before any tertiary non-preferential debts of the partnership.”;

(h) in modified section 175C(3), after “175A(5)(a)” insert “, (5A)(a)”;

(i) in modified section 175C(4), for “debts which are neither preferential nor postponed debts” substitute “ordinary non-preferential debts and secondary non-preferential debts”;

(j) in modified section 175C(8)(b), after “175A(5),” insert “(5A),”.

Amendment to Schedule 7 to the Insolvent Partnerships Order 1994

20. Paragraph 21 of Schedule 7 to the Insolvent Partnerships Order 1994 (provisions of the Act which apply with modifications for the purposes of Article 11 where joint bankruptcy petition presented by individual members without winding up partnership as unregistered company), is amended as follows—

- (a) in modified section 328A (Priority of debts in joint estate), for paragraph (b) substitute—
 - “(b) the ordinary non-preferential debts;
 - (ba) the secondary non-preferential debts;”;
- (b) in modified sections 328A(4), 328A(6) and 328B(2) for “paragraphs (a), (aa) and (b)” in each case substitute “paragraphs (a), (aa), (b) and (ba)”;
- (c) after modified section 328A(5) insert—
 - “(5A) Where the joint estate is not sufficient for the payment of the secondary non-preferential debts in accordance with paragraph (ba) of subsection (2), the responsible insolvency practitioner shall aggregate the value of those debts to the extent that they have not been satisfied or are not capable of being satisfied, and that aggregate amount shall be a claim against the separate estate of each member of the partnership against whom an insolvency order has been made which—
 - (a) shall be a debt provable by the responsible insolvency practitioner in each such estate, and
 - (b) shall rank equally with the interest on the separate debts referred to in section 328B(1)(ba) below.”;
- (d) in modified section 328B(1) (Priority of debts in separate estate), for paragraph (b) substitute—
 - “(b) the ordinary non-preferential debts (including any debt referred to in section 328A(5)(a));
 - (ba) the secondary non-preferential debts (including any debt referred to in section 328A(5A)(a));”;
- (e) in modified section 328A(9), after “(5),” insert “(5A),”;
- (f) after modified section 328A(9) insert:
 - “(10) Secondary non-preferential debt shall rank before any tertiary non-preferential debts of the partnership.”;
- (g) in modified section 328C(3), after “328A(5)(a)” insert “, (5A)(a)”;
- (h) in modified section 328C(4), for “debts which are neither preferential nor postponed debts” substitute “ordinary non-preferential debts and secondary non-preferential debts”;
- (i) in modified section 328C(8)(b), after “328A(5),” insert “(5A),”.

PART 4

Amendment to the Banking Act 2009

Amendments to the Banking Act 2009

21. In section 103 of the Banking Act 2009 (general powers, duties and effect), in the Table of applied provisions of the Insolvency Act 1986—

- (1) after the entry for section 175 insert:

“Section 176AZA	Non-preferential debts of EEA financial institutions”
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(2) before the entry for section 389, insert:

“Section 387A	Financial institutions and their non-preferential debts”
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	<i>Name</i>
	<i>Name</i>
Date	Two of the Lords Commissioners of Her Majesty’s Treasury

EXPLANATORY NOTE

(This note is not part of the Order)

This Order implements the obligations in Directive (EU) 2017/2399 of the European Parliament and of the Council amending Directive 2014/59/EU as regards the ranking of unsecured debt instruments in insolvency hierarchy. The Directive provides for a new class of non-preferred senior debt to be issued by credit institutions, investment firms and others. In insolvency proceedings debts in this class are to rank below ordinary unsecured debts but above own funds investments and subordinated liabilities that do not qualify as own funds instruments.

Institutions may issue this new class of secondary non-preferential debt to meet their obligation to have sufficient loss-absorbing and recapitalisation capacity to enable the resolution authority to implement the institution’s resolution strategy, preventing their failure from having an impact on financial stability. The new class of secondary non-preferential debt is a harmonisation measure which the EU intends should reduce the risk of distortion in competition in the internal market. A principle underlying the system of resolution of institutions under Directive 2014/59/EU is that creditors’ losses in resolution of the institution are to be no greater than the losses that they would have incurred under normal insolvency proceedings. The new class of debt will provide institutions with a new option for meeting requirements for their loss-absorbing and recapitalisation policy. As this new class of debt comes below other senior debt in the creditor hierarchy it should enhance legal certainty and thereby reduce the risk that any creditor is left worse off in the event of resolution of an institution than they would have been if the institution had instead entered normal insolvency proceedings.

An impact assessment of the effect that this instrument will have on the costs of business and the voluntary sector is available from Her Majesty’s Treasury, 1 Horse Guards Road, London SW1A 2HQ or on HM Treasury’s website (www.gov.uk/treasury), and is published with the Explanatory Memorandum alongside the instrument on www.legislation.gov.uk.