

These notes refer to the draft clauses published to inform responses to HM Treasury's consultation document "Financial sector resolution: broadening the regime" (August 2012)

EXPLANATORY NOTES

INTRODUCTION

1. These Notes have been prepared by HM Treasury to assist consideration of the draft clauses published to inform responses to HM Treasury's consultation document "Financial sector resolution: broadening the regime", published in August 2012.
2. The notes need to be read in conjunction with the Bill. They are not, and are not meant to be, a comprehensive description of the Bill. So where a clause or part of a clause does not seem to require any explanation or comment, none is given.
3. The clauses have been prepared on the basis that the Financial Services Bill, as introduced to the House of Lords on 23 May 2012, has been enacted and that it is in force.

TERRITORIAL EXTENT AND APPLICATION

4. The draft clauses would extend to England, Wales, Scotland and Northern Ireland.

COMMENTARY

Banks

Clause 1: Special resolution regime: additional objectives and condition

5. Section 4 of the Banking Act 2009 ("the Act") sets out the special resolution objectives¹. The Treasury, the FSA and the Bank of England are required to have regard to these objectives in using or considering the use of the stabilisation powers in Part 1 of the Act (which are: transfer to a private sector purchaser, transfer to a bridge bank and transfer to temporary public ownership), the bank insolvency procedure in Part 2 of the Act and the bank administration procedure in Part 3 of the Act. The special resolution objectives include the protection of depositors (objective 3), but do not currently include protection of investors.
6. *Clause 1(3)* adds two new special resolution objectives to section 4 of the Act: objective 6 is to protect client assets and objective 7 is to minimise adverse effects of

¹ Explanatory Notes for the Banking Act 2009 are available at: <http://www.legislation.gov.uk/ukpga/2009/1/notes/contents>.

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a resolution on financial market infrastructure. These new objectives will apply both to banks and, by virtue of the amendments made by *clause 3*, to investment firms which are not banks or other institutions to which Part 1 of the Act already applies.

7. *Clause 1* also adds reference to protection of client assets at relevant places in the Act, including the conditions set out in section 8 of the Act which are to be satisfied for a transfer to a private sector purchaser or a bridge bank.

Clause 2: Bank holding companies: sale and transfer to bridge bank

8. *Clause 2* amends the Act to permit the Bank of England to transfer the holding company of a bank to a private sector purchaser or to a bridge bank.

9. *Subsection (3)* inserts a new section 81B which sets out the powers and the conditions which must be met. The conditions replicate those which must be met for the transfer of the bank itself to a private sector purchaser or to a bridge bank; the powers are only exercisable in relation to a UK holding company; and the Bank must be satisfied that it is necessary to exercise powers in relation to the holding company rather than the bank. *Subsection (5)* modifies relevant references to banks in Part 1 of the Act in their application to holding companies, and in the Financial Services and Markets Act 2000 ("the 2000 Act") as regards recovery of the costs of the resolution through the Financial Services Compensation Scheme.

10. *Subsection (8)* imposes a new requirement on both the Bank and the Treasury when exercising a stabilisation power in respect of a holding company, to have regard to the need to minimise adverse effects on other companies in the group.

Investment firms

Clause 3: Application of Banking Act 2009 to investment firms

11. *Clause 3(1) to (5)* amend the Act so that the special resolution regime set out in Part 1 of the Act applies to investment firms. *Subsection (6)* amends the Act to apply the bank administration regime set out in Part 3 of the Act to investment firms. *Subsection (7)* inserts the definition of "investment firm" into the Act, that is, a UK institution which is an investment firm within the meaning of the Capital Adequacy Directive (2006/49/EC) but is not an institution already capable of resolution under Part 1 of the Act. *Subsection (9)* amends the 2000 Act to provide for the recovery of the costs of the resolution of investment firms through the Financial Services Compensation Scheme.

Clearing houses

Clause 4: Special resolution regime for UK clearing houses

12. *Clause 4* amends the Act so that the special resolution regime set out in Part 1 of the Act applies to UK clearing houses (as defined by new section 89G of the Act). *Subsection (6)* inserts new sections 89B to 89G of the Act.

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13. *New section 89B* of the Act applies Part 1 to UK clearing houses as it applies to banks subject to a series of modifications contained in the table, along with any other necessary modifications. The key modifications are to the following provisions of the Act –

- a) *section 7* (where the general condition for use of the stabilisation powers conferred by Part 1 of the Act is modified so that such powers may be exercised if the Bank of England is satisfied that a UK clearing house is failing, or is likely to fail, to satisfy the requirements resulting from section 286 of the 2000 Act (requirements for recognition) and that the Bank of England is satisfied that it is not reasonably likely that action will be taken that will enable the UK clearing house to satisfy those conditions);
- b) *section 11* (which is modified so as to permit the Bank of England to sell all or part of the business of the UK clearing house to a commercial purchaser);
- c) *section 13* (which is modified so as to permit the Bank of England to transfer ownership of a UK clearing house to any person).

14. *New section 89C* provides that a property transfer instrument made by the Bank of England in respect of a UK clearing house may make related provision about the consequences of the transfer for the rules of the clearing house. For example, the instrument could amend the rules of the clearing house.

15. *New section 89D* provides that a property transfer instrument made by the Bank of England in respect of a UK clearing house may make provision about the consequences of the transfer for membership of the clearing house. For example, the instrument could modify the terms of membership.

16. *New section 89E* provides that the Bank of England may provide for a company to which the business of a UK clearing house is transferred under section 12(2) of the Act (as applied to UK clearing houses by new section 89B) to be treated as a recognised clearing house for the purposes of the 2000 Act for a specified period or until a particular event occurs. This ensures that the transferee may continue to operate the business which is transferred to it. *Subsection (3)* provides that the power may only be exercised with the consent of the Treasury.

17. *New section 89F* enables the Treasury to make provision for compensating those whose interests have been affected by transfers under Part 1 of the Act in relation to UK clearing houses. Section 89B applies (with modifications) certain provisions of the Act which relate to compensation (for example, sections 54 to 57 which relate to independent valuers) in connection with orders made under new section 89F.

18. *New section 89G* defines "UK clearing house" for the purposes of Part 1 of the Act. *Subsection (2)* makes it clear that a clearing house which is also a bank,

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building society, credit union or investment firm (and so subject to the provisions of Part 1 of the Act otherwise than by virtue of section 89B) are not to be treated as "UK clearing houses" for the purposes of Part 1 of the Act.

Clause 5: Public interest directions to UK clearing houses

19. *Clause 5(1)* inserts new section 296A into the 2000 Act. This enables the Bank of England to direct a UK clearing house to take, or not take, specified action. Such a direction may only be given if the Bank of England is satisfied that it is desirable to do so, having regard to the public interest in the factors specified in subsection (1). Directions are enforceable on the application of the Bank of England by injunction or, in Scotland, by an order for specific performance.

Clause 6: Insolvency etc.

20. *Clause 6* introduces the Schedule.

21. *Part 1 of the Schedule* amends Part 24 of the 2000 Act (which relates to the insolvency of authorised persons) so that it applies to recognised investment exchanges.

22. *Part 2 of the Schedule* amends Schedule 17A to the 2000 Act (which is provided for in Schedule 7 to the Financial Services Bill). The effect of the amendments is to apply Part 24 of the 2000 Act (insolvency) to the Bank as if any reference to an authorised person or recognised investment exchange (as provided for by Part 1 of the Schedule) were a reference to a recognised clearing house.

23. *Paragraph 3(3) of the Schedule* amends Schedule 17A to the 2000 Act to provide that an application for an administration order or a petition for a winding up order in relation to a UK clearing house may not be determined, a resolution for voluntary winding up of a UK clearing house may not be made and an administrator of a UK clearing house may not be appointed, unless the conditions in new paragraph 31A(5) to (7) (which include prior notification to the Bank of England of the proposed action) are satisfied.

24. *New paragraph 31B of Schedule 17A to the 2000 Act* (as inserted by paragraph 3(3) of the Schedule) enables the Bank of England to give a direction to a person appointed to act as an insolvency practitioner in relation to a company which is or which has been a UK clearing house. A direction may only be given if the Bank of England is satisfied it is desirable, having regard to the public interest in the matters specified in paragraph 31B(2). Before giving such a direction, the Bank must consult the Treasury and, if the clearing house is an authorised person, the relevant prudential regulator. Directions are enforceable on the application of the Bank of England by an injunction or, in Scotland, an order for specific performance. A person is not liable for damages in respect of action or inaction in accordance with directions (subject to the exceptions provided for in paragraph 31B(6)).