



HM Treasury

Financial Services (Banking Reform) Bill

Government Amendments: Payment and Settlement Systems Special Administration Regime

Briefing for Peers

October 2013

This amendment establishes a special administration regime, to be known as 'financial market infrastructure (FMI) administration', for the operators of systemically important inter-bank payment systems and securities settlement systems in the event of their insolvency, or threatened insolvency.

Payment systems in the UK

A payment system is the infrastructure which enables the circulation of money around the economy. 'Payment system' refers collectively to two types of company: scheme companies (e.g. Bacs, CHAPS, CLS, Faster Payment Service), which manage the governance, rules and contractual arrangements including membership of payment schemes; and service providers (e.g. Vocalink), to whom the actual processing of payment and technical infrastructure, such as IT and telecommunications, may be outsourced. The scheme companies are recognised (and regulated) under the Banking Act 2009. These are:

- **Bacs.** Bacs is used for direct debits, salary, pension and benefit payments. The average number of Bacs payments made per month between January and March 2013 was 457 million with an average monthly total value of £338.6 billion.
- **CHAPS.** CHAPS payment system is one of the most commonly used systems for large transfers such as house purchases. Over 23 settlement days in July 2013, CHAPS processed £6.3 trillion worth of payments across its 3,156,258 transactions.
- **Continuous Linked Settlement.** This system provides a payment service to settle foreign exchange transactions. The average daily volume of payments in 2012 was 45,000 with an average daily value of £212 billion.
- **Faster Payments Service.** Faster payments service is used for telephone and internet banking and also standing orders. Between January and March 2013 there were 73 million transactions on average per month, worth £57.4 billion.

The scheme companies are owned and controlled by their members (the major banks), and are represented by the Payments Council.

Alongside these scheme companies are a number of service providers. It is to these service providers whom the actual processing of payment and technical infrastructure, such as IT and telecommunications, may be outsourced. In some cases, the scheme company and the infrastructure service provider may be part of the same company or group. FMI administration would cover both scheme companies and their service providers.

Securities settlement systems in the UK

A settlement system performs a number of crucial services that allow the registration, issuance, safekeeping, and settlement of securities in exchange for cash, which supports the efficient processing of securities transactions in financial markets. The FMI administration will apply to the operators of securities settlement systems and their service providers.

- **CREST.** Crest is the only securities settlement system in the UK. It settles gilts, equities, corporate bonds and money market instruments. The average daily volume of transactions in 2012 was 164,000 with a total average value of £420 billion. FMI administration will be capable of applying to CREST's operator: Euroclear UK and Ireland Ltd.

Purpose of amendment

A payment or settlement system can process millions of payments a day, which could be delayed if critical services were suspended due to the insolvency of the operator of the system, or indeed the insolvency of a key service provider to the system. This could cause significant cash flow problems for the systemic banks and their customers. For example, the payment of salaries, pensions, direct debits and standing orders would be delayed.

The amendments provide for a new special administration regime, FMI administration, which will ensure that such services continue to be provided in the event that the operator or the key service provider to the operator, of a systemically important payment or settlement system becomes, or is likely to become, insolvent.

Currently, in the unlikely event that the operator of a systemically important payment or settlement system were to become insolvent it would enter into ordinary administration. In an ordinary insolvency procedure the objective is to maximise returns to creditors while winding up the company. Under the FMI administration the appointed administrator would be required to prioritise the continuation of services. The interests of creditors are subordinate to this overarching objective.

Features of the FMI administration

The FMI administration has the following features which differ from a normal administration regime:

- **Power of direction for the Bank of England over the FMI administrator**

FMI administrator is appointed by the court, nominated by the Bank of England, to manage the affairs of the company entering FMI administration. The Bank of England will have a power of direction over the FMI administrator. The power of direction will allow the Bank of England, in appropriate cases, to direct the FMI administrator to take a particular course of action where the Bank is of the view that it is necessary for those steps to be taken in order to achieve the objectives of FMI administration. One example of where the power of direction might be useful is for the Bank of England to be able to direct the administrator to prioritise certain payment types when a system in administration cannot continue processing all transactions. For example, priority might be given to Direct Debit transactions for Bacs rather than ancillary services.

- **Transfer powers**

These powers give the FMI administrator the means to transfer all or part of the business to another company on an expedited basis. Transfers are made in order to achieve the overarching objective of maintaining critical services of the payment or securities settlement system. The transfers must be approved by the Bank of England and the Bank may modify transfers before approving it.

- **Restrictions on early termination of third party contracts.**

Under FMI administration, there will be restrictions on the early termination of third party contracts to ensure that suppliers of particular categories of goods and services do not terminate supply solely because the relevant infrastructure company has gone into FMI administration. This will further strengthen the protection provided to the payment and securities settlement systems' provision of systemically important services.

A special resolution regime exists for banks, building societies, investment firms, group companies and clearing houses. By their nature, these institutions are exposed to extremely large potential financial liabilities. If they were to become insolvent, a special administration procedure would not necessarily be capable of preventing contagion. For this reason, a pre – insolvency special resolution regime was considered appropriate. Payment and settlement systems are in a different position: they do not assume potential liabilities of this magnitude, and are only exposed to normal business risk.

Operation of FMI administration

Payment and settlement system operators tend to have a low assets value and do not to take on credit risk, meaning the operational cost of the administration is likely to be relatively small. In FMI administration, the FMI administrator initially can divert the money that would have otherwise been paid back to creditors to finance the continuing functioning of the firm's services.

Once these funds are exhausted, the FMI administrator could obtain funding to meet the relatively minor operational costs of maintaining critical payment and settlement services during FMI administration. This funding is likely to be in the form of a loan from member banks. Member banks have the incentive and capability to fund the administration as it is in their interest to maintain continuity of services as payment and settlement systems are central to the functioning of banks. As a last resort funding could come in the form of a loan from HM Treasury, to be recovered as and when a permanent successor arrangement is put in place. A loan from HM Treasury can only be made to the FMI administrator for the purposes of achieving the objective of FMI administration.

Further Enquiries

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