



## BLP subgroup on reforms to the Special Administration Regime (SAR)

### **Subgroup on the Special Administration Regime (SAR) for investment firms**

#### **Advice to HM Treasury**

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**Subgroup members:** Joanna Perkins, Financial Markets Law Committee (FMLC); Richard Faulkner, Association of Business Recovery Professionals (R3); Richard Heis, Association of Business Recovery Professionals (R3); Peter Werner, International Swaps and Derivatives Association (ISDA); Susan Wright (The Investment Association)

**Observers** Stephen Atkinson, HM Treasury; Daniel Jones, HM Treasury; Chris Rusbridge, HM Treasury; Kate Davis, Financial Conduct Authority (FCA); Sam Duffett, FCA; Jane Moore, FCA; Oliver Dearie, Bank of England Andrew Gimber, Bank of England

#### **Background**

1. The remit of the Banking Liaison Panel (BLP) subgroup is to consider proposed reforms to the special administration regime (SAR) for investment firms and to provide advice to HM Treasury on behalf of the BLP under section 10 of the Banking Act 2009. Specifically, the sub-group was established to consider i) proposed reforms to facilitate the transfer of the business of a failed investment firm that has entered the SAR; and, ii) proposed provisions to protect set off and netting arrangements in the case of transfers of part of the failed firm's business. This advice sets out the concerns that the Treasury should give regard to when finalising its proposals.

#### **Set off and netting arrangements**

2. The Treasury's proposals include reforms to make it easier for an administrator to arrange the transfer of the business of a failed investment firm in the SAR to a solvent third party. This is because transfers may be preferable to returning clients assets in some circumstances. For example, in certain situations, clients whose assets are successfully transferred will be more likely to receive continuity of service which will reduce the market impact of firm failure. The subgroup's advice, therefore, has been formulated with the aim of facilitating the transfer of the business of a failed firm in mind.

3. Regulation 10D in the draft regulations sets out protections for set off and netting arrangements in the case of partial transfers which involve the transfer of some, but not all, of the property, rights and liabilities of a failed firm. These protections have been included for 2 reasons: first, Regulation 10C allows for the transfer in “spite of any restriction affecting what can or cannot be assigned or transferred by the investment bank” and, because set off or netting arrangements may be included in the restrictions, it is necessary to include these protections. Second, the protections are designed to prevent the cherry picking of assets or rights in the negotiation of the transfer which could lead to detriment to clients.
4. The subgroup believes that the protections will not fully prevent the cherry picking of assets, rights or liabilities that are subject to set off and netting arrangements. The protections prevent the transfer of rights or liabilities that are subject to contractual set off and netting arrangements, but do not extend to unexpressed, or inchoate arrangements, such as equitable or common law arrangements. This will include structural or other types of set off and netting arrangements that may exist between a firm and its clients for commercial reasons. Clients who are left behind in the failed firm following a partial transfer may be worse (or better) off as a result of assets or liabilities subject to an inchoate arrangement being transferred out of the failed firm. The subgroup notes that this is in contrast to partial transfers carried out under the Banking Act 2009, where the no creditor worse off (NCWO) protection ensures that creditors, which includes clients, are compensated for any losses.
5. The Treasury should consider the effect of any protections for set off and netting arrangements on transfers that involve the transfer of open positions to alternative central counterparty clearing houses (CCPs). In a transfer, positions relating to different business lines of the failed firm may go to different CCPs. Where the firm has assets and liabilities that are subject to set off and netting arrangements split across business lines, these arrangements may have to be broken in order to successfully complete a transfer. A protection which extends to these kinds of set off and netting arrangements could prevent transfers of this nature, which would be to the detriment of clients and lead to greater market impact.
6. The subgroup does not support a blanket protection which would extend to all types of set off and netting arrangements. First, an all-encompassing protection of this nature would lead to significant legal uncertainty and second, an administrator would be required to identify all of the protected arrangements, and this would be challenging to complete in practice, not least in the context of an unfolding insolvency process.
7. The subgroup recognises that there is a trade-off between introducing reforms that facilitate the transfer of the business of a failed investment firm, in order to benefit clients, and protections for commercial or other arrangements which may prevent the successful completion of these transfers or lead to detriment to clients. The Treasury should give regard to the issues outlined above when finalising its proposed reforms.