Opinion: final stage IA
Origin: Domestic
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Date of implementation: not provided

Regulatory Policy Committee

Reforms to the investment bank special administration regime

HM Treasury

RPC rating: fit for purpose

The IA is now fit for purpose as a result of the department's response to the RPC's initial review. As first submitted, the IA was not fit for purpose.

Description of proposal

The investment bank special administration regime (SAR) was introduced in 2011 when it became clear that normal insolvency legislation was not suitable for managing the failure of complex investment firms such as Lehman Brothers. The IA explains that such investment firms are seen as a core aspect of financial markets and play a critical role in providing market liquidity. Such a failure imposes a substantial strain on financial stability. Under the Banking Act 2009, the regime required an independent review to be made after two years. HM Treasury proposes to implement the recommendations of the independent Bloxham Review which identified inefficiencies and legislative gaps in the functioning of the regime. The amendments, which are designed to simplify and speed up the SAR process to reduce costs for clients and creditors, include the following:

- improving the bar date mechanism
- removing statutory interest on clients' claims on the general estate;
- facilitating the transfer of client positions to alternative financial institutions; and
- providing guidance on the allocation of costs in the SAR.

Impacts of proposal

Approximately 1,000 investment firms are eligible for entry into the SAR. The clients, creditors and counterparties of these firms are a mixture of individuals and businesses. HM Treasury explains that data on this split is not readily available and would be disproportionate to collect. However, evidence gathered by the FCA indicates that all investment firms have at least one creditor or counterparty that is a business.

HM Treasury provides a qualitative description of the impacts of the most significant reforms being proposed as follows:

Improving the bar date mechanism

The bar date mechanism empowers administrators to set a deadline for clients to submit claims for the return of their assets. HM Treasury proposes to amend this in a number of ways, most significantly, by applying the bar date mechanism to client money. This removes the need for administrators to have to go to court on an ad-hoc basis, saving the administrator time and speeding up the return of client money to clients.

Removing statutory interest on client claims on the general estate

The review highlighted that in previous administrations, clients have delayed making claims in order to wait and see which of the client estate and general estate is largest. They have then sought to make claims as creditors against the general estate rather than as clients against the client estate to benefit from the high 8 per cent rate of statutory interest that applies to creditor claims. HM Treasury expects the proposed reform to result in more of the money, which was actually held at the point of the firm's insolvency, being available for distribution.

Facilitating transfers of client positions

HM Treasury explains that transferring client assets from a failed firm to an alternative financial firm is often preferable to returning those assets to clients. While the transfer of client assets is already implicit in the SAR, the review noted that some practical and mechanical provisions are required to assist implementing them. In particular, HM Treasury proposes to remove the need for individual client consent before transferring their assets to a private sector acquirer removing an administrative burden on both clients and administrators.

Cost allocations

The review made a number of recommendations concerning the allocation of costs incurred during the course of a SAR which HM Treasury proposes to implement. These include putting into statute best practice guidance for cost allocation during the course of an administration. This will save administrators significant expense as they currently have to go through the courts to determine cost allocations.

In consultation with industry, HM Treasury estimates that the proposed reforms will result in cost savings of 5-20% per administration case. This range captures some of the uncertainties surrounding the impacts of the proposal. In particular, the extent to which businesses are affected and the fact that the size and complexity of administration cases varies considerably. HM Treasury notes that "*feedback from administrators during bilateral discussions during the consultation and policy*

development period is that they agree this figure is a sensible, if not conservative, estimate of the potential cost savings from the SAR reforms" (pages 7-8).

HM Treasury expects the reforms to generate no ongoing costs to business as this will make the regime simpler and easier to operate for all affected parties. HM Treasury also expects the reforms to generate no familiarisation costs to business. Evidence from stakeholders suggests that clients, creditors and counterparties are not likely to incur costs of familiarising themselves with the regime until an insolvency that affects them actually occurs. Therefore, these are the same costs that these parties would expect to incur under the current SAR if a firm failed.

To estimate the benefit of the proposal to business, HM Treasury calculates the total administration and legal fees incurred under the 10 SAR cases for which data is available, and makes a conservative assumption that 10 investment firms will enter the amended SAR over the ten-year appraisal period. Aggregating across the data and applying the expected cost reduction of 5-20% yields an estimated range of benefits to business of £1.9-£7.7 per year

The RPC verifies the estimated equivalent annual net direct cost to business (EANDCB) of -£4.7 million. This will be a non-qualifying regulatory provision (financial systemic risk) that will not score under the business impact target. This is on the basis that the proposed reforms to the SAR will reduce the systemic impact of investment firm failures, as observed during the financial crisis and assist in restoring market confidence. In particular, these amendments will address areas of inefficiency and legislative gaps in the SAR reducing the impact of firm failures, such as Lehman Brothers, by making the regime less disorderly and more effective.

Quality of submission

As initially submitted, the IA included four issues that meant that the RPC did not consider it fit for purpose. Following the RPC's initial review, HM Treasury has submitted a revised IA, which adequately addresses the issues as follows:

- HM Treasury explains, supported by stakeholders' confirmation, that clients, creditors and counterparties may all either be businesses or individuals.
- HM Treasury has provided sufficient justification in support of the significant assumptions used in the analysis. In particular, stakeholder evidence from consultations and bi-laterals with the Banking Liaison Panel (BLP) has been used to support the estimated cost saving of 5-20% per administration case under the proposed reforms.

- HM Treasury has provided sufficient evidence and justification, from discussions with business, to support the view that the proposed reforms impose no costs to business.
- HM Treasury has clarified that they have classified the proposal as a non-qualifying regulatory provision (financial systemic risk) and provided their justification to support this classification. The IA explains how reforms to the regime make management of such failures less disorderly, helping to reduce the systemic risk and restore confidence. However, the RPC considers that the IA would benefit from more explicitly describing the classification of the proposal in terms of the criteria for the financial systemic risk exclusion laid out in the July 2016 draft of the Better Regulation Framework Manual.

Departmental assessment

Classification	Non-qualifying regulatory provision (Financial systemic risk)
Equivalent annual net direct cost to business (EANDCB)	-£4.7 million (initial estimate) -£4.7 million (final estimate)
Business net present value	£41.4 million
Societal net present value	£41.4 million

RPC assessment

Classification	Non-qualifying regulatory provision (Financial systemic risk)
EANDCB – RPC validated[1]	-£4.7 million
Business Impact Target (BIT) Score[1]	N/A
Small and micro business assessment	Not required (deregulatory)
RPC rating (of initial submission)	Not fit for purpose

[1] For reporting purposes, the RPC validates EANDCB and BIT score figures to the nearest £100,000.

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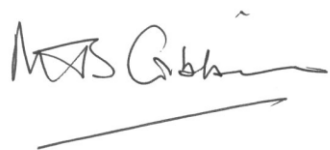

Michael Gibbons CBE, Chairman