

EXPLANATORY MEMORANDUM TO
THE BANKING ACT 2009 (THIRD PARTY COMPENSATION ARRANGEMENTS FOR
PARTIAL PROPERTY TRANSFERS) (AMENDMENT) REGULATIONS 2014

2014 No. 1830

- 1.** This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 This instrument is laid in draft together with:

- the Banking Act 2009 (Restriction of Partial Property Transfers) (Recognised Central Counterparties) Order 2014
- the Banking Act 2009 (Exclusion of Investment Firms of a Specified Description) Order 2014
- the Banking Act 2009 (Banking Group Companies) Order 2014

2.2 These instruments underpin the extension of the special resolution regime (SRR) to central counterparties (CCPs), investment firms and banking group companies (BGCs). The Banking Act 2009 ('the Act') established a SRR for banks and building societies. The SRR gave the UK authorities a permanent framework and tools for dealing with failing UK banks and building societies. The Financial Services Act 2012 amended the Act to extend the scope of the SRR to CCPs, BGCs and investment firms.

2.3 This instrument amends the Banking Act 2009 (Third Party Compensation Arrangements for Partial Property Transfers) Regulations 2009 ('the principal Regulations') to apply third party compensation arrangements for partial property transfers to transfers made in respect of investment firms.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None

4. Legislative Context

4.1 The SRR provides the Authorities with tools to deal with banks that get into financial difficulty. Part 1 of the Act describes special resolution objectives and how the SRR is triggered. It sets out three stabilisation options (transfer to a

private sector purchaser, transfer to a bridge bank and transfer to temporary public sector ownership). The options are exercised through stabilisation powers, which are the powers to effect the transfer of securities or property, rights and liabilities by operation of law. Part 1 also provides for assessing compensation for transferors and third parties affected by a transfer.

- 4.2 The principal Regulations were made under section 60 of the Act to specify provisions which must, or which may, be included in a third party compensation order made in accordance with section 59 in the case of a partial property transfer (as defined by section 47). They relate in particular to the treatment of those who were creditors of a banking institution immediately before a partial property transfer took effect.
- 4.3 A partial property transfer is a property transfer instrument which provides for the transfer of some, but not all, of the property, rights and liabilities of a bank. Property transfer instruments may be made by the Bank of England to effect a transfer to a private sector purchaser or to a bridge bank.
- 4.4 The principal Regulations apply to partial property transfers of the property of a 'banking institution', which includes a bank. The amendment will ensure that they also apply to partial property transfers of the property of an investment firm. It is not necessary to amend the principal Regulations to achieve the same effect for BGCs because the provisions to be commenced to extend the SRR to BGCs achieve this automatically (section 81C of the Act provides that where a stabilisation power is exercised in respect of a BGC, provisions relating to the stabilisation powers "and any other enactment", which includes the principal Regulations, apply as if the BGC were a bank.

5. Territorial Extent and Application

- 5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

- 6.1 The RT Hon Andrea Leadsom MP has made the following statement regarding Human Rights:

In my view the provisions of the Banking Act 2009 (Third Party Compensation Arrangements for Partial Property Transfers) (Amendment) Regulations 2014 are compatible with the Convention rights.

7. Policy background

What is being done and why

- 7.1 Since the financial crisis of 2007 to 2009, a wide programme of financial sector reform has been implemented at a domestic, European and G20 level. The reform has not only focused on banks, but also on investment firms and financial market infrastructure, which also have the potential to cause major wide-spread disruption to the financial system. The Financial Stability Board's (FSB) Key Attributes of Effective Resolution Regimes – endorsed by the G20 – has recommended that resolution regimes should be put in place for all systemically important financial institutions including investment firms and central counterparties.
- 7.2 The Bank Recovery and Resolution Directive (BRRD) has now been finalised and is expected to be adopted in May 2014. This establishes a framework for recovery and resolution for investment firms and holding companies, as well as banks and credit institutions across the EU. In addition the European Commission has recently consulted on “a possible recovery and resolution framework for financial institutions other than banks”, which included certain types of market infrastructure. However, given the uncertainty around the timetable for introducing any European legislation in this area, the UK government has actively sought to meet the FSB recommendations, by pressing ahead with domestic legislation.
- 7.3 In August 2012, HM Treasury launched a consultation entitled Financial Sector resolution: broadening the regime. The consultation proposed implementing resolution powers over institutions other than banks: investment firms; the parent and subsidiary undertakings of banks and investment firms; central counterparties (CCPs); other financial market infrastructures; and insurers. Following this, in the Financial Services Act 2012, the government legislated to extend the special resolution regime to investment firms, group undertakings ‘banking group companies’ and central counterparties.
- 7.4 This instrument ensures that creditors are no worse off as a result of resolution action taken by Authorities with respect to a failing investment firm, which results in the transfer of part of the failing entity, than they would have been if the entire entity had entered resolution. The Banking Act 2009 (Third Party Compensation Arrangements for Partial Property Transfers) Regulations 2009 which this instrument amends, extends compensation rights where there is a partial property transfer relating to the business of an investment firm. This brings investment firms into line with banks and other institutions covered by the SRR, including BGCs for which no amendment is required (see under legislative context above).

- Consolidation

7.5 No consolidation is necessary.

8. Consultation outcome

- 8.1 The consultation on this instrument opened on September 26th September 2013 and closed on the 21st November 2013. The consultation lasted 8 weeks. HM Treasury received 10 written responses from industry including CCPs, banks, law firms and trade associations. The Treasury was satisfied that 8 weeks would be sufficient for effective consultation because, having consulted on these policies previously, when developing the primary legislation, it was satisfied that stakeholders would be familiar with the issues at hand.
- 8.2 The full details of the responses to the consultation and the government response will be published on the GOV website¹.
- 8.3 Respondents agreed that the compensation safeguard should apply to investment firms and BGCs but argued that CCPs should also be included in the scope of the compensation regulations. In response Government has included an equivalent safeguard in the Banking Act 2009 (Restriction of Partial Property Transfers) (Recognised Central Counterparties) Order 2014 (one of the draft instruments laid with the draft of these Regulation).

9. Guidance

- 9.1 It is not considered necessary to issue specific guidance in connection with these Regulations. However, under section 5 of the Act, the Treasury is obliged to issue a code of practice about the use of the stabilisation powers. The Code of Practice will contain further material on the Regulations and other instruments being laid in draft with them, including text on how partial property transfers will be carried out.

10. Impact

- 10.1 The impact on business, charities or voluntary bodies in terms of direct costs is zero as it doesn't require affected firms to take any action, and will only have an impact on relevant business (banking and associated activity) in the unlikely event that SRR powers need to be exercised. The potential impact on business cannot be quantified, but there is a large potential positive impact on public finances (see below), which is similarly unquantifiable.
- 10.2 The impact on the public sector is that having a robust resolution regime for CCPs, investment firms and banking group companies will allow authorities to manage the orderly failure of systemic firms. This reduces the probability and severity of financial crises that may result in the expenditure of public funds to bail out failing firms. The benefits are potentially very significant, as financial crises have been estimated to cost up to £40bn per year.

¹ <https://www.gov.uk/government/consultations/secondary-legislation-for-non-bank-resolution-regimes>

10.3 The Impact Assessment prepared for the Financial Services Act 2012, which inserted provisions in the Act extending the SRR to investment firms, CCPs and BGCs, still applies and is up to date.

11. Regulating small business

11.1 The legislation does not apply to small business.

12. Monitoring & review

12.1 The Act requires the Treasury to make arrangements for a panel to advise the Treasury about the effect of the SRR on banks, persons with whom banks do business and the financial markets. In particular the panel may advise the Treasury about the exercise of powers to make certain statutory instruments. This panel, the 'Banking Liaison Panel', will keep the principal Regulations (as amended by this instrument) under review and, where appropriate, provide advice to the Treasury. The Treasury will also keep the principal Regulations under review.

13. Contact

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Elizabeth.Cowell@HMTreasury.gsi.gov.uk can answer any queries regarding these instruments.