EXPLANATORY MEMORANDUM TO

THE BANKING ACT 2009 (RESTRICTION OF PARTIAL PROPERTY TRANSFERS) (AMENDMENT) ORDER 2009

2009 No. 1826

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 Order amends The Banking Act 2009 (Restriction of Partial Property Transfers) Order 2009 (No. 322) ('the safeguards order').

2.2 Parts 1 to 3 of the Banking Act 2009 ("the Act") establish a Special Resolution Regime (SRR). The SRR provides the Treasury, the Bank of England and the Financial Services Authority (collectively referred to as the "Authorities") with various options for dealing with a failing bank and certain other financial institutions.

2.3 Part 1 of the Act confers powers on the Bank of England and, in certain circumstances, the Treasury to transfer the securities in, and property of, a bank or certain other financial institutions where certain conditions (see sections 7-9) are satisfied. In certain circumstances, the Treasury or the Bank of England may make a transfer of some, but not all, of the property of a failing bank or financial institution ("a partial property transfer").

2.4 The existing safeguards order protects certain risk reduction arrangements, used by counterparties of banks and financial institutions, from disruption by providing legislative safeguards.

2.5 This Order makes a number of technical amendments to the safeguards order to address industry concerns (set out below).

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

3.1 None.

4. Legislative Context

4.1 This order is made primarily under sections 47 and 48 of the Banking Act 2009.

5. Territorial Extent and Application

5.1 This instrument extends to the United Kingdom.

6. European Convention on Human Rights

6.1 The Financial Services Secretary to the Treasury has made the following statement regarding Human Rights: 'In my view the provisions of the Banking Act 2009 (Restriction of Partial Property Transfers) Order 2009 is compatible with the Convention rights'.

7. Policy background

- ***What is being done and why***

7.1 If counterparties and creditors of UK banks do not have legal certainty as to how a partial property transfer made under the Act will affect their contractual interests, negative market reactions are likely.

7.2 The purpose of the safeguards order is to protect contracts relevant for regulatory capital purposes from disruption under a partial transfer carried out under the Act, insofar as this is compatible with the other special resolution objectives. It achieves this by restricting the transfer of some but not all of the relevant liabilities between the banking institution and its counterparty. The regulations were developed in consultation with industry and made on 23 February 2009.

7.3 The Government committed to make changes to the safeguards order to address industry concerns. Lord Myners told the House of Lords on 16 March 2009: "I am aware that some market participants are concerned that the scope of the safeguards order is not wide enough, in particular with regard to the protections provided for set-off and netting. I understand that these concerns are primarily related to technical drafting, rather than the property that the order clearly excludes as a result of government policy, and that there are varied legal interpretations on whether some relevant financial contracts have been excluded … I can announce that one of the first orders of business for the [Banking Liaison Panel] will be to review the safeguards order. If changes to the order are necessary and are compatible with the authorities' flexibility, the Government will make such changes before the Summer Recess. (Official Record, 16 Mar 2009 : Column GC2-GC3).

7.4 The Treasury has been engaging with industry about their concerns through the Banking Liaison Panel (BLP), a statutory advisory panel with a statutory role to advise the Treasury under section 10 the Act. The BLP set up a subgroup on partial transfers safeguards, which has provided advice to the Treasury. In the light of the BLP's draft advice the Treasury has decided to amend the safeguards order.

7.5 This Order amends the safeguards order to:

- Exclude from set-off and netting protection all publicly tradable securities where the relevant securities are not identified or described in a set-off, netting or title transfer financial collateral arrangement, while retaining the protection in respect of securities that are so identified or described and which parties do rely on for set-off or netting purposes.

- Ensure that in establishing which transactions are capable of falling within the protection in the safeguards order for set-off, netting or title transfer financial collateral arrangements, the safeguards order refers to a wider range of transaction types that can be or are typically covered in those arrangements.

- Clarify the legislative intention that the existence of any excluded right or liability under a set-off, netting or title transfer financial collateral arrangement does not exclude from protection under the safeguards order other rights and liabilities that are not excluded.

- Make express in respect of section 34(7) that a relevant partial transfer may only remove or alter the terms of a trust to the extent necessary or expedient to transfer the legal or beneficial title of the banking institution in the property held on trust to the transferee.

- Clarify that a relevant partial property transfer may not transfer the benefit of security without transferring the liability it secures.

- ***Consolidation***

7.2 In view of the minor changes being made to the safeguards order, the Treasury does not consider that consolidation is necessary at this stage but will consider doing so in the event that further amendments are made.

8. Consultation outcome

8.1 The Treasury has sought formal advice from the BLP subgroup,. The advice will be published on the Treasury's website in due course.

8.2 The first four of the five amendments described above respond directly to concerns raised by the BLP, which are outlined in detail in the subgroup's advice, which will be published in due course.

8.3 The BLP also proposes that small companies that are part of larger groups that have a group set-off or netting agreement with the banking institution should receive set-off and netting protection under the safeguards order. Having considered this matter carefully, the Treasury consider that extending this protection to such companies is not workable at the current time, and accordingly have not amended the safeguards order in this respect. However, we will ask the BLP to continue to consider this point.

8.4 The primary reason for this is that banking institutions do not generally hold the information necessary to identify a small company that is part of a large group that has a set-off or netting agreement with the banking institution; and given this lack of information, it is not currently possible to identify such a company quickly in the context of a resolution under the SRR to which the safeguards order applies. This uncertainty would lead to serious practical difficulties that might jeopardise the Authorities' ability to carry out a successful resolution of a failing institution. –

9. Guidance

9.1 It is not considered necessary to issue specific guidance in connection with this Order. However, the Code of Practice issued under section 5 of the Act on 23 February 2009 contains further material on the existing safeguards order and on how partial property transfers will be carried out. The Code of Practice will be updated in due course to reflect the changes to be made to the safeguards order.

10. Impact

10.1 The impact of the safeguards order on business, charities or voluntary bodies is that potential disruption of their contractual rights and methods of reducing credit risk, for example, set-off and netting and financial collateral arrangements, due to the existence of partial property transfer powers, will be either entirely avoided, or minimised. This Order, will further assist in reducing disruption to business, charities or voluntary bodies.

10.2 The impact of the safeguards order on the public sector is that the Authorities must comply with the safeguards order when considering and executing a partial transfer of a failing bank. This Order, in excluding from protection publicly tradable securities that are not identified or described in a set-off, netting agreement or title transfer financial collateral arrangement, will reduce some of the difficulties in transferring publicly tradeable debt during the execution of a partial transfer, enabling partial transfers to be effected more quickly and effectively.

10.3 An impact assessment is not attached to this memorandum. In addition to the evidence set out in this memorandum, the evidence base for the safeguards regulations was presented to the Joint Committee on Statutory Instruments, as an appendix to the Explanatory Memorandum to The Banking Act 2009 (Restriction of Partial Property Transfers) Order 2009 (No. 322). As set out in that document, the purpose of the safeguards order is to provide legislative safeguards for such creditors

and counterparties of UK banks, to counter fears that their interests could be damaged if the UK Authorities make a partial property transfer of a failing bank with which they had contracted.

11. Regulating small business

11.1 The legislation applies to small business.

12. Monitoring & review

12.1 The 'Banking Liaison Panel' (BLP), will keep this Order under review and, where appropriate, provide further advice to the Treasury about this Order. The Treasury will also keep this Order under review itself.

13. Contact

Lucy French (Tel: 020 7270 4479 or email: lucy.french@hm-treasury.gsi.gov.uk) or Chris Rusbridge at HM Treasury (Tel: 020 7270 4552 or email: christopher.rusbridge@hm-treasury.gsi.gov.uk) can answer any queries regarding the instrument.