EXPLANATORY MEMORANDUM TO

THE BANKING ACT 2009 (EXCLUSION OF INVESTMENT FIRMS OF A SPECIFIED DESCRIPTION) ORDER 2014

2014 No.

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 (Third Party Compensation Arrangements for Partial Property Transfers) (Amendment) Regulations 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 the 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 include CCPs, BGCs and investment firms.

2.3 This Order narrows the scope of the definition of "investment firm" to investment firms of a type that is required under the Capital Requirements Directive to hold initial capital of €730,000, so that investment firms of a type required to hold operating capital of €125,000 are not subject to the SRR.

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 powers to effect the transfer of securities or property, rights and liabilities by operation of law.

4.2 Section 101 of the Financial Services Act 2012 inserts provision in the Act, principally sections 89A and 258A, to extend Part 1 (SRR) and Part 3 (bank administration procedure) to investment firms (s89A), and to define "investment firm", subject to exclusions, by reference to Directive 2006/49/EC on the capital adequacy of investment firms and credit institutions (s258A).

4.3 Section 258A(2) provides that "investment firm" does not include: (a) a bank (within the meaning of Part 1), a building society or a credit union; or (b) an institution which is of a class or description specified in an order made by the Treasury.

4.4 Section 258A has been amended to reflect the repeal of Directive 2006/49/EC. A reference to Regulation (EU) No. 575/2013 has been substituted by regulation 45(2) of the Capital Requirements Regulations 2013 (S.I. 2013/3115). For the purposes of Regulation (EU) No. 575/2013 "investment firm" is defined by reference to point (1) of Article 4(1) of Directive 2004/39/EC. Subject to further provision about undertakings which are not legal persons and providers who are natural persons, the meaning given is "any legal person whose regular occupation or business is the provision of one or more investment services to third parties and/or the performance of one or more investment activities on a professional basis". Investment services and activities are listed in Section A of Annex I in relation to any of the instruments listed in Section C of that Annex.

4.5 This is the first use of the power in Section 258A of the Banking Act 2009, which empowers the Treasury by order to exclude from the definition of "investment firm" an institution of a specified class or description.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

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

In my view the provisions of the Banking Act 2009 (Exclusion of Investment Firms of a Specified Description) Order 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, central counterparties and companies in the same group as an institution which meets the conditions for the exercise of stabilisation powers.

7.4 This Order amends the definition of "investment firm" to exclude firms of a description required by the Capital Requirements Directive to hold the lower minimum level of operating capital of €125,000. The effect is to exclude them (and their BGCs) from the scope of the SRR. The Capital Requirements Directive is Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms. The failure of an investment firm of this description is unlikely to prove of systemic significance or to threaten UK financial stability. The effect of the Order is to limit the SRR to investment firms which are required to have initial capital of EUR 730 000.

- Consolidation

7.5 No consolidation is necessary here.

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 for the preparation of 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 website[1].

8.3 Respondents agreed with the proposal to narrow the scope of the definition of 'investment firm' to exclude from the scope of the SRR firms subject to the lower required level of initial operating capital.

9. Guidance

9.1 It is not considered necessary to issue specific guidance in connection with these Orders. 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 these Orders and in particular how partial property transfers will be carried out.

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

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.

10.3 An Impact Assessment is attached to this memorandum and will be published alongside the Explanatory Memorandum on www.legislation.gov.uk.

11. Regulating small business

11.1 The legislation does not apply to small business.

12. Monitoring & review

12.1 The Banking Act 2009 requires the Treasury to make arrangements for a panel to advise the Treasury about the effect of the SRR on banks, persons with which 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 this Order under review and, were appropriate, provide advice to the Treasury about this Order. The Treasury will also keep this Order under review.

13. Contact

Elizabeth Cowell at the HM Treasury Tel: 02072701007 email: Elizabeth.Cowell@HMTreasury.gsi.gov.uk can answer any queries regarding these instruments.