EXPLANATORY MEMORANDUM TO

THE INVESTMENT BANK (AMENDMENT OF DEFINITION) AND SPECIAL ADMINISTRATION (AMENDMENT) REGULATIONS 2017

2017 No. [XXXX]

1. Introduction

1.1 This explanatory memorandum has been prepared by Her Majesty's Treasury and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 The main purpose of this instrument is to amend the Investment Bank Special Administration Regulations 2011 ("the Regulations") to implement changes in response to recommendations by Peter Bloxham, who carried out the first statutory review of the Regulations. This instrument also amends section 232 of the Banking Act 2009 ("the Act"), which defines "investment bank" for the purposes of sections 233 and 234 of the Act, under which the Regulations were made.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

Other matters of interest to the House of Commons

3.2 Disregarding minor or consequential changes, the territorial application of this instrument includes Scotland and Northern Ireland.

4. Legislative Context

4.1 The Regulations were made under sections 232 to 236 of the Act, which empower the Treasury to modify insolvency law in its application to investment banks, and to establish a new procedure where investment banks are unable, or are likely to become unable, to pay their debts or winding up would be fair. The Regulations establish a special administration regime (SAR) for ensuring the return of client assets, for timely engagement with market infrastructure bodies and rescuing the bank or winding it up. Section 236 of the Act required a review of the Regulations to be completed within 2 years of the date on which they came into force.

4.2 Regulations 2 and 3 of this instrument are made under section 232(6) of the Act. Section 232 defines "investment bank". Regulation 3 amends section 232 in consequence of the provision made in regulation 2. An order under section 232(6) is subject to the draft affirmative resolution procedure, so that it can be exercised, relying on section 105 of the Deregulation Act 2015, to make provision in combination with regulations under sections 233 and 234.

4.3 Part 3 of this instrument amends the Regulations under sections 233 and 234 of the Act. Part 4 makes transitional provision under section 259(1) of the Act, so that none of the amendments has effect in relation to an investment bank put into special administration before the date on which the Regulations come into force.

5. Extent and Territorial Application

5.1 This instrument extends to England and Wales, Scotland and Northern Ireland

5.2 The territorial application of this instrument is England and Wales, Scotland and Northern Ireland

6. European Convention on Human Rights

6.1 The Economic Secretary to the Treasury has made the following statement regarding Human Rights:

"In my view the provisions of the Investment Bank (Amendment of Definition) and Special Administration (Amendment) Regulations 2016 are compatible with the Convention rights"

7. Policy background

What is being done and why

7.1 The Act empowers the Treasury by regulations to modify the law of insolvency in its application to investment banks and to establish a new procedure for investment banks where they are unable, or are likely to become unable, to pay their debts or winding up would be fair. The Regulations together with special insolvency rules and the Financial Conduct Authority's Client Asset Sourcebook rules comprise the Special Administration Regime (SAR).

7.2 The Act required the Regulations to be reviewed within 2 years of coming into force. Accordingly, the Treasury appointed Peter Bloxham to evaluate the SAR. His review ("the Review") was published in January 2014 and laid before Parliament. The Review recommended that the SAR should be retained and proposed reforms to strengthen it.

7.3 This instrument implements key recommendations of the review in order to speed up and simplify the process of SAR administrations. It does so by amending the Regulations.

7.4 In particular, this instrument extends and strengthens the bar date mechanism in the SAR. A bar date is a date by which clients are required to submit claims. Administrators may currently set a bar date in respect of custody assets. Amendments extend this mechanism to client money, and provide for a 'hard' bar date for custody assets and client money, which enable an administrator to set a final deadline for the submission of client claims. The hard bar date will enable an administrator more efficiently to transfer unclaimed assets (or the proceeds of their disposal) to the failed firm's general estate and close the client estate. Any rights that are not satisfied before residual assets are transferred may be pursued as unsecured claims against the general estate.

7.5 Amendments also remove restrictions to the transfer of clients' assets and contracts associated with a business transfer, and have the effect of treating contracts (to the extent transferred) as if they had been made by the transferee. They set out restrictions on what may be transferred by an arrangement which transfers just part of the investment bank's business.

7.6 In pursuit of Objective 1 of the SAR (the rapid return of client assets) an administrator may arrange a transfer of the whole or part of the investment bank's business to

another financial institution. For the purpose of a transfer of the whole business, amendments provide, among other things, that the administrator does not need to give clients notice of transfer of their assets and their contracts with the bank or obtain clients' consent. In the case of a transfer of part of an investment bank's business, the effect of the amendments is that the need for notice and client consent is unchanged. To guard against partial property transfers without consent, the administrator must negotiate with the transferee such provisions as they think appropriate to facilitate a reverse transfer of assets and contracts where that is what a client wants.

7.7 Other amendments provide: (a) for allocating to the investment bank's estate certain costs incurred because the bank has failed to comply with requirements relating to holding client assets (so that clients are not responsible for such costs); (b) for power to move client money between accounts on a final reconciliation of the amount of client money which the bank is required to hold in accordance with rules with the amount of client money it holds in client money accounts; (c) for a duty on the administrator to co-operate with the scheme manager of the Financial Services Compensation Scheme; (d) for the continuation of contracts for services relating to the safe custody of client assets; (e) for taking away a client's entitlement to interest on an unsecured claim for the return of client money (where the client does not claim against the client money pool) for the period after the bank enters special administration).

7.8 All these measures are designed to help the administrator more effectively and quickly to achieve the objectives of special administration, particularly the return (including transfer) of client assets. For example, the measure about interest on an unsecured claim for the return of client money claim will discourage attempts to gain by arbitrage between client and creditor estates, which has delayed special administrations.

Consolidation

7.9 This is the third amending instrument. There are currently no plans to consolidate the legislation.

8. Consultation outcome

8.1 A consultation on the changes in the instrument was published on 9th March 2016 and closed on 20th April 2016. The consultation responses were broadly supportive of the government's proposals. In addition, the Banking Liaison Panel[1] (BLP) has been consulted on the government's proposed reforms and a subgroup of the BLP was established to consider closely the proposals to enable arrangements for the transfer of a failed investment bank's business to be concluded more quickly and efficiently.

8.2 Respondents were supportive of the government's proposals in the two most significant areas of change, namely provisions about business transfers and bar dates of the distribution of client assets.

8.3 Respondents were supportive of the government's proposals to assist the transfer of a failed investment firm's business. The BLP subgroup, in its advice to the Treasury, highlighted factors which the government should have regard when finalising the

[1] The Treasury established the Banking Liaison Panel in accordance with section 10 of the Banking Act 2009. The Panel's function is to provide advice to the Treasury about the effect of the special resolution regime (SRR) on banks, persons who do business with banks, and on financial markets. The Panel's function includes giving advice to the Treasury on secondary legislation made under the Act and the SRR Code of Practice.

proposals. In particular, in response to this advice, protections have been introduced to protect common law and equitable set-off and netting rights in the case of a partial property transfer.

8.4 Respondents supported the extension of the bar date mechanism to provide a bar date for the distribution of client money and new powers for an administrator to set a hard bar date for the distribution of client money and custody assets.

8.5 In order to speed up the return of client assets, respondents supported the government's proposal to introduce a duty on banks, custodians and counterparties to cooperate in providing information or supplying documents to the administrator. However, in the absence of clear and effective mechanisms (apart from the contractual rights of the investment bank) for the enforcement of these duties, it has been decided that it would not be appropriate to implement this recommendation.

9. Guidance

9.1 HM Treasury do not plan to issue guidance.

10. Impact

10.1 The instrument will simplify and speed up the SAR process to reduce costs for both clients and creditors; provide legal certainty about the status of claims; and reduce the market impact of firm failures. The government's assessment is that these measures do not impost a cost on business on an ongoing basis.

10.2 There is no impact on business, charities or voluntary bodies.

10.3 The impact on the public sector is estimated to be zero.

10.4 An Impact Assessment is submitted with this memorandum and will be published alongside the Explanatory Memorandum on the legislation.gov.uk website.

11. Regulating small business

11.1 The legislation applies to activities that are undertaken by small businesses. The impact on small businesses (employing up to 50 people) is expected to be minimal; small businesses tend to be infrequent clients of investment banks and, where the investment bank is itself a small business, these regulations will not apply whilst it is a going concern.

12. Monitoring & review

12.1 This legislation will be reviewed within 2 years of coming into force, under s.236 of the Act.

13. Contact

13.1 Katie Kochmann at HM Treasury Telephone: 020 7270 6039 or email: Katie.kochmann@hmtreasury.gsi.gov.uk can answer any queries regarding the instrument.