EXPLANATORY MEMORANDUM TO

THE INVESTMENT BANK (AMENDMENT OF DEFINITION) ORDER 2011

2011 No. [XXXX]

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 and for the Merits Committee.

2. Purpose of the instrument

2.1 The Investment Bank Special Administration Regulations 2011 ("the Regulations"), to be made under section 233 of the Banking Act 2009 ("the Banking Act"), establish a new special administration regime ("SAR") for investment banks. An institution is an "investment bank" if it fulfils the three conditions set out in section 232 of the Banking Act. This Order amends section 232 to clarify what is meant by the term "client assets" and therefore the types of institution that can be brought into the scope of the Regulations.

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

3.1 None

4. Legislative context

4.1 The Treasury lays the Order under the draft affirmative procedure under the power in section 235(5) of the Banking Act. The Order must be made at the same time as the Regulations to which the definition of investment bank will apply. The Regulations must be made by the 11 February 2011 or, in accordance with section 235(4) of the Banking Act, the powers to make them will lapse (under section 235(4) of the Act)). The Order (and the Regulations) must be approved by both Houses of Parliament.

5. Territorial extent and application

5.1 This instrument applies to the United Kingdom.

6. European Convention on Human Rights

6.1 The Commercial Secretary to the Treasury, Lord Sassoon, has made the following statement regarding Human Rights:

"In my view, the provisions of The Investment Bank (Amendment of Definition) Order 2011 are compatible with the Convention rights."

7. Policy background

7.1 Following the insolvency of Lehman Brothers, the Treasury began an in-depth review to assess whether there are shortfalls with existing insolvency law regarding investment firms which hold client assets. Powers were provided for in the Banking Act (sections 232 to 236) to enable the Treasury to create a new investment bank insolvency regime, if the review found it to be necessary.

7.2 Powers were also provided to enable the Treasury to amend the definition of what constitutes an "investment bank" in section 232 of the Banking Act. This power was included to enable the Treasury to amend the scope of the SAR after its review had been completed. The Treasury gave undertakings that it would base its decision to amend the definition of investment bank on both the outcomes of public consultation and the advice of its Investment Banking Liaison Panel of industry experts.

- **What is being done and why**

7.3 Under the current definition of "investment bank", as set out in section 232 of the Banking Act, an institution is an investment bank if it fulfils the following conditions:

- Condition 1 is that the institution has permission under Part 4 of the Financial Services and Markets Act 2000 to carry on the regulated activity of-
  (a) safeguarding and administering investments;
  (b) dealing in investments as principal; or
  (c) dealing in investments as agent.
- Condition 2 is that the institution holds client assets.
- Condition 3 is that the institution is incorporated in, or formed under, the law of any part of the United Kingdom

7.4 Section 232 also provides that in sections 232 to 236 of the Banking Act, "client assets" means assets which an institution has undertaken to hold for a client (whether or not on trust and whether or not the undertaking has been complied with).

7.5 The Order amends how the term "assets" is defined in the definition of "client assets" and therefore amends the meaning of "client assets" for the purposes of sections 232 to 236 of the Banking Act and therefore the scope of the type of institution to which the SAR may apply.

7.6 It is necessary that the new regime applies to all investment firms which hold client assets or client money. Otherwise there would be a two tier insolvency regime for the return of client property, as firms which hold client assets would enter the SAR on insolvency, while firms which hold client money would enter normal insolvency procedures.

7.7 The Government therefore believes it is necessary to clarify that the term "client assets" for the purposes of Condition 2 includes client money. New subsection (5A)(a) is to be inserted into section 232 to provide for this. However, the Government considers that institutions who would fulfil the conditions in section 232, but who hold client assets only for the purposes of carrying on an insurance mediation

activity, should be excluded from the scope of the SAR as it has not been designed for those sorts of businesses. New subsection (5A)(b) is to be inserted into section 232 (together with the definitions in subsection (5B)) to provide for this.

- **Consolidation.** Not applicable.

8. Consultation outcome

8.1 The Treasury has consulted in accordance with section 235(3) of the Banking Act. Responses to the consultation papers are available on the Treasury's website[1]. Responses to the last consultation paper on the SAR, *Special administration regime for investment firms*[2], which consulted on the proposed amendments to the definition of "investment bank", were broadly supportive of the proposed amendments to section 232 of the Banking Act.

8.2 The Treasury has also taken into account the views of an Investment Banking Liaison Panel of industry practitioners.

9. Guidance

9.1 Not applicable.

10. Impact

10.1 No cost to firms as a result of this Order as its purpose is to clarify the scope of the SAR which also has no costs to firms. An Impact Assessment has been prepared for this instrument.

11. Regulating small business

11.1 This Order amends the definition of 'investment banks' (as defined in section 232 of the Banking Act 2009) to include investment firms which hold client money, some of which may be small businesses.

12. Monitoring & review

12.1 Section 236 of the Banking Act provides for HM Treasury to review the Regulations within two years of them coming into force. The review must consider how far the Regulations are achieving the objectives specified in section 233(3) and whether the Regulations should continue to have effect. The Treasury will ensure that arrangements for review are consistent with better regulation policy going forward.

13. Contact

Daniel Okubo at HM Treasury can answer any queries regarding the instrument. Tel: 020 7270 6376 or email: daniel.okubo@hmtreasury.gsi.gov.uk

[1] www.hm-treasury.gov.uk/consult_investment_banks2.htm.
[2] www.hm-treasury.gov.uk/d/consult_sar_160910.pdf