

The UK Bank Resolution Regime

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Structure

- ***Banking Act 2009***
- ***Secondary legislation***
 - ***“No creditor worse off” Regulations: The Banking Act 2009 (Third Party Compensation Arrangements for Partial Property Transfers) Regulations 2009***
 - ***“Safeguards order”: The Banking Act 2009 (Restriction of Partial Property Transfers) Order 2009***
- ***Code of Practice***

Special Resolution Regime: who is affected?

- ***UK banks (s2), i.e. UK incorporated entities with FSMA deposit taking permission***
 - *N.b. insurance companies*
- ***UK incorporated holding companies of UK banks (s82) (for temporary public ownership stabilisation power only)***
 - *(e.g. Sainsbury's; Tesco)*
- ***Building Societies (s84-88)***
- ***Credit Unions (s89)***
- ***Group undertakings (s63-68 for “continuity” provisions)***

SRR: Role of the Authorities

- **FSA**
 - *Triggers SRR (if bank has failed (or is likely to fail) threshold conditions)*
- **Bank of England**
 - *Operation of SRR*
 - *Selects and operates private sector purchaser and bridge bank stabilisation options*
 - *Provides liquidity support*
- **HM Treasury**
 - *Selects and operates temporary public ownership stabilisation option*
 - *Decisions involving public funds*
 - *Compliance with international obligations*
- **FSCS**
 - *Compensation to eligible depositors*
 - *Transfer of accounts*
 - *Funds SRR*

SRR: Entry into regime (s7)

- ***FSA “pulls the trigger”***
- ***FSA must be satisfied that both:***
 - ***Condition 1: bank is failing or likely to fail threshold conditions s41 FSMA***
 - ***Condition 2: having regard to timing and other relevant circumstances it is not reasonably likely that (ignoring stabilisation powers) action will be taken by or in respect of the bank that will enable the bank to satisfy threshold conditions***
- ***Any financial assistance provided by HM Treasury or the Bank of England (excl. ordinary market assistance on usual terms) to be disregarded***

SRR: What are the options?

Stabilisation Option	Facilitating Order
1. Sale of all or part of the business of the bank to a commercial purchaser.	(a) One or more share transfer instruments. (b) One or more property transfer instruments.
2. Transfer all or part of the bank to a company which is wholly owned by the Bank of England (a “bridge bank”).	One or more property transfer instruments.
3. Take the bank into temporary public ownership.	One or more share transfer orders in which the transferee is a nominee of the Treasury or a company wholly owned by the Treasury.

SRR: what are the options? (2)

- ***Private sector purchaser (s11)***
 - *Share transfer (all/part)*
 - *Property transfer (all/part)*
- ***Bridge bank (s12)***
 - *Property transfer (all/part) to company 100% owned by Bank of England*
- ***Temporary public ownership (s13)***
 - *Share transfer(s) to nominee/company 100% owned by HM Treasury*
- ***N.b. also bank insolvency procedure (s96)***

SRR: what are the options? (3)

■ *Private Sector Purchaser*

- *Bradford & Bingley – out of TPO (September 2008)*
- *Dunfermline Building Society (March 2009)*

■ *Bridge Bank*

- *Kaupthing Singer & Friedlander - deposits to bridge bank then ING*
- *Dunfermline Building Society (March 2009)*

■ *Temporary Public Ownership*

- *Northern Rock (February 2008)*
- *Bradford & Bingley (September 2008)*

SRR: what are the options? (4)

- ***Bridge Bank/Private Sector Purchaser – good bank/bad bank***
- ***Partial property transfer***
 - ***Particular concern in consultation***
 - ***Led to “Safeguards Order” and “No Creditor Worse Off” Regulations***

SRR: specific conditions for specific stabilisation powers

- ***Private sector purchaser/bridge bank (s8)***
 - ***A – exercise of power necessary having regard to the public interest in:***
 - ***Stability of financial systems in UK***
 - ***Maintenance of public confidence in stability of banking systems of UK***
 - ***Protection of depositors***
 - ***B – exercise of power necessary to protect public interest where HM Treasury has provided financial assistance to bank in question***

SRR: specific conditions for specific stabilisation powers (2)

- ***Temporary public ownership (s9)***
- ***Either:***
 - ***A – exercise of power necessary to resolve/reduce serious threat to stability of financial systems of UK; or***
 - ***B - Exercise of power necessary to protect public interest where HM Treasury has provided financial assistance to bank in question***

Implementation of SRR Options

■ *Share transfers*

- *Share transfer instrument (s15) – for transfers by Bank of England under private sector purchaser option*
- *Share transfer order (s16) – for transfers by HM Treasury under temporary public ownership option*

■ *Property transfers*

- *Property transfer instrument (s33) – for transfers by Bank of England under private sector purchaser and bridge bank options*

■ *Implementing instrument will specify what assets are to be transferred: implementation risk*

Implementation of SRR Options (2)

- ***In all circumstances – contractual or other restrictions overridden***
 - *share transfers s17*
 - *property transfers s34*
- ***Others only if “turned on”***
- ***Continuity powers (affecting “group undertakings”)***
 - *Share transfers s18, s67*
 - *Property transfers s36, s64*
- ***Termination rights/default events/CPs s22***
 - *Generally*
 - *Generally save as provided*
 - *Share transfers s22*
 - *Property transfers s38*

Implementation of SRR Options (3)

- ***Share transfers only:***
 - ***Conversion or Delisting s19***
 - ***Directors s20***
- ***N.b. foreign property – statutory further assurance s39***

SRR: Safeguards

- ***Safeguards Order***
- ***Protections only for partial property transfers***
- ***Voidability only for protected set-off, netting and “financial markets” arrangements***
- ***For others, notify authority of contravention and seek to have transfer unwound***

SRR: Compensation

- ***HM Treasury can issue three types of order:***
 - ***Compensation scheme order: payment to transferor(s)***
 - ***Resolution fund order: payment to transferor(s)***
 - ***Contingent***
 - ***Beneficiary given an interest in proceeds of disposal net of public funds/SRR costs***
 - ***Third party compensation order: payment to people other than transferor(s)***
 - ***Each type of order may provide for:***
 - ***(i) independent valuer (who must be appointed by HM Treasury nominee)***
 - ***(ii) valuation principles and/or assumptions (e.g. loss of FSMA permission, insolvency treatment)***
- ***Grant of compensation order doesn't guarantee compensation/quantum***

SRR: Compensation (2)

Stabilisation Option	Compensation Scheme Order	Resolution Fund Order	Third Party Compensation Order
Private sector purchaser (s11, s50)	Required	N/A	Required for partial property transfers Optional for others
Bridge bank (s12, s52)	Optional	Required	Required for partial property transfers Optional for others
Temporary public ownership (s13, s51)	Either/or	Either/or	Optional

SRR: Compensation (3)

- ***“No creditor worse off” Regulations***
- ***Partial property transfers only***
- ***Order must provide for:***
 - ***Independent valuer***
 - ***Assessment of***
 - ***(1) Insolvency treatment; and***
 - ***(2) Actual treatment of pre-transfer creditors***
 - ***Payment of difference if (1) is higher than (2)***
 - ***Fair and equitable value***
 - ***Possibility of payments on account to ensure receipt of compensation in a timely manner***

Share transfer powers – When? What?

- ***Stabilisation options:***
 - ***Option 1: Sale of all or part of business to private sector purchaser***
 - ***Option 3: Temporary public ownership***

- ***Provides for securities issued by a specified bank to be transferred***

- ***Makes other provision for the purposes of, or in connection with, the transfer of securities issued by a specified bank***

Share transfer powers - Scope (1)

■ “Securities”

- **Class 1:** shares and stock
- **Class 2:** debentures, including debenture stock, loan stock, bonds, certificates of deposit and any other instrument creating or acknowledging a debt;
- **Class 3:** warrants or other instruments that entitle the holder to acquire anything in 1 and 2;
- **Class 4:** rights granted by a deposit-taker and which form part of deposit-taker's own funds for purposes of Section 1 of Chapter 2 of Title V of Directive 2006/48/EC (on the taking up and pursuit of the business of credit institutions).

Share transfer powers - Scope (2)

- ***Briefly....***
- ***Transfer may occur:***
 - *despite restriction arising by virtue of contract or legislation or in any other way*
 - *free from trust, liability or other encumbrance (extinguish?)*
- ***May involve conversion / delisting***
- ***Does not, itself, trigger default provision***

“...disregarded in determining whether a default event provision applies, except insofar as the instrument or order provides otherwise...”

Share transfer powers - Scope (3)

- **“Whether transferred or not”?**
- **Banking (Special Provisions) Act 2008**
 - *B&B plc – dated subordinated debt*
- **Banking Act 2009**
 - *Explanatory Note to 2009 Act - Conversion, Delisting*
 - *s. 21 - Ancillary instruments ?*
 - *Lord Myners (letter, 25 Feb 2009):*
 - “... do not provide for the modification of contracts (including subordinated debt instruments) of a banking institution to the same extent as the Banking (Special Provisions) Act 2008....
 - The application of these powers and procedures to banks will not involve the modification of the terms of their subordinated debt...”*

■ **Compensation**

Powers to alter contractual arrangements

- ***Provisions disapplying contractual restrictions, trusts and other encumbrances, and default provisions***
- ***Continuity obligations to ensure that a transferee of all or part of a UK bank's business can operate the transferred business effectively***

Disapplication of contractual terms

(1)

- ***A share or property transfer takes effect despite any restriction arising by virtue of contract or legislation or in any other way (sections 17 and 34)***
- ***A “restriction” includes any restriction, inability or incapacity affecting what can be assigned or transferred and a requirement for consent (by any name)***

Disapplication of contractual terms

(2)

- ***A share transfer may***
 - ***Provide for a transfer to take effect free from any trust, liability or other encumbrance (and may include provision about their extinguishment) – s.17(5)***
 - ***Extinguish rights to acquire securities falling within Class 1 or 2 of the definition in s. 14 – s.17(6)***
 - ***Provide for securities to be converted from one form or class to another, or for a listing of securities to be discontinued – s. 19***

Disapplication of contractual terms

(3)

- ***A property transfer may***
 - ***Provide for a transfer to be conditional upon a specified event or situation occurring or arising, or not occurring or arising – s.34(5)***
 - ***Where it makes provision in respect of property held on trust, also remove or alter the terms of the trust – s.34(7)***

Disapplication of contractual terms

(4)

- ***A share or property transfer may provide that the transfer instrument or order is to be disregarded in determining whether a default event provision applies, or whether it applies except in so far as the instrument or order provides otherwise (sections 22 and 38)***
- ***Default event provision***
 - ***Type 1 – termination rights, etc.***
 - ***Type 2 – conditions precedent to performance***

Continuity obligations (1)

- ***Property transfers – residual bank and each group company***
- ***Share transfers – transferred bank and each former group company***
- ***Wide definition of group company – CA 2006 definition of “group undertaking” - extends to group undertakings and former group undertakings which may be non-UK entities***

Continuity obligations (2)

- ***General continuity obligation arises by operation of law***
- ***Special continuity obligation powers only to be used in so far as necessary and with the consent of the Treasury***
- ***Right to receive reasonable consideration***

Continuity obligations (3)

■ **Property transfers**

- **General - the residual bank and each group company of the residual bank must provide such services and facilities as are required to enable a transferee to operate the transferred business, or part of it, effectively – s.63**
- **Special – BoE may cancel or modify the terms or a contract or other arrangement between the residual bank and a group company, add or substitute a transferee, and confer and impose rights and obligations on either and a transferee – s.64**

Continuity obligations (4)

■ Share transfers

- **General - each former group company of a transferred bank must provide such services and facilities as are required to enable the transferred bank to operate effectively – s.66**
- **Special – BoE/Treasury may cancel or modify the terms of a contract or other arrangement between the transferred bank and a former group company, and confer and impose rights and obligations on them – s. 67**

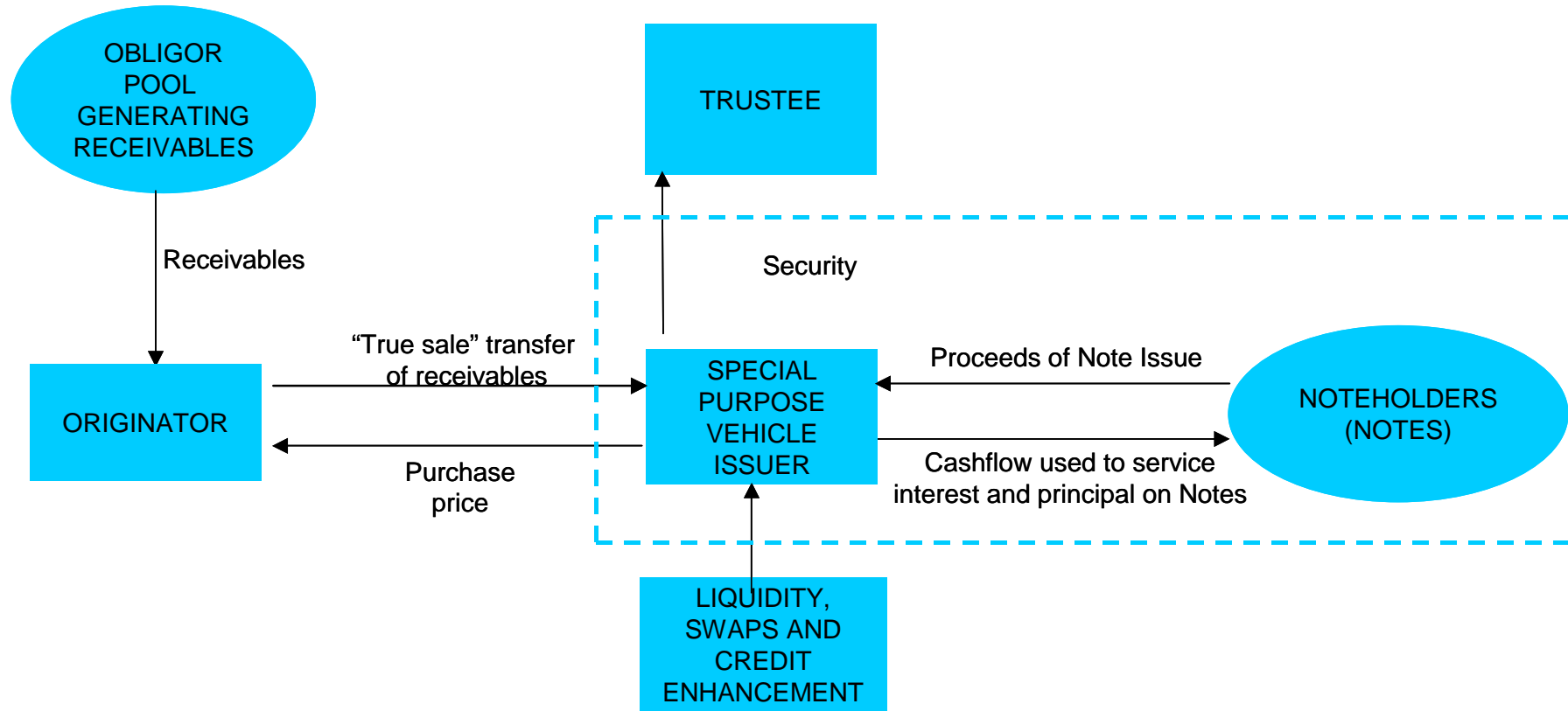
Partial Property Transfers and Safeguards Order

- ***Property Transfer Instruments***
- ***Partial Property Transfers***
- ***Ability to split assets and liabilities***
- ***Banking Act 2009 (Restriction of Partial Property Transfers) Order 2009 (“Safeguard Order”) pursuant to S. 47 & 48***
- ***Protects security interests, title transfer collateral arrangements, set-off and netting arrangements, capital market arrangements and ‘clearing house’ contracts***

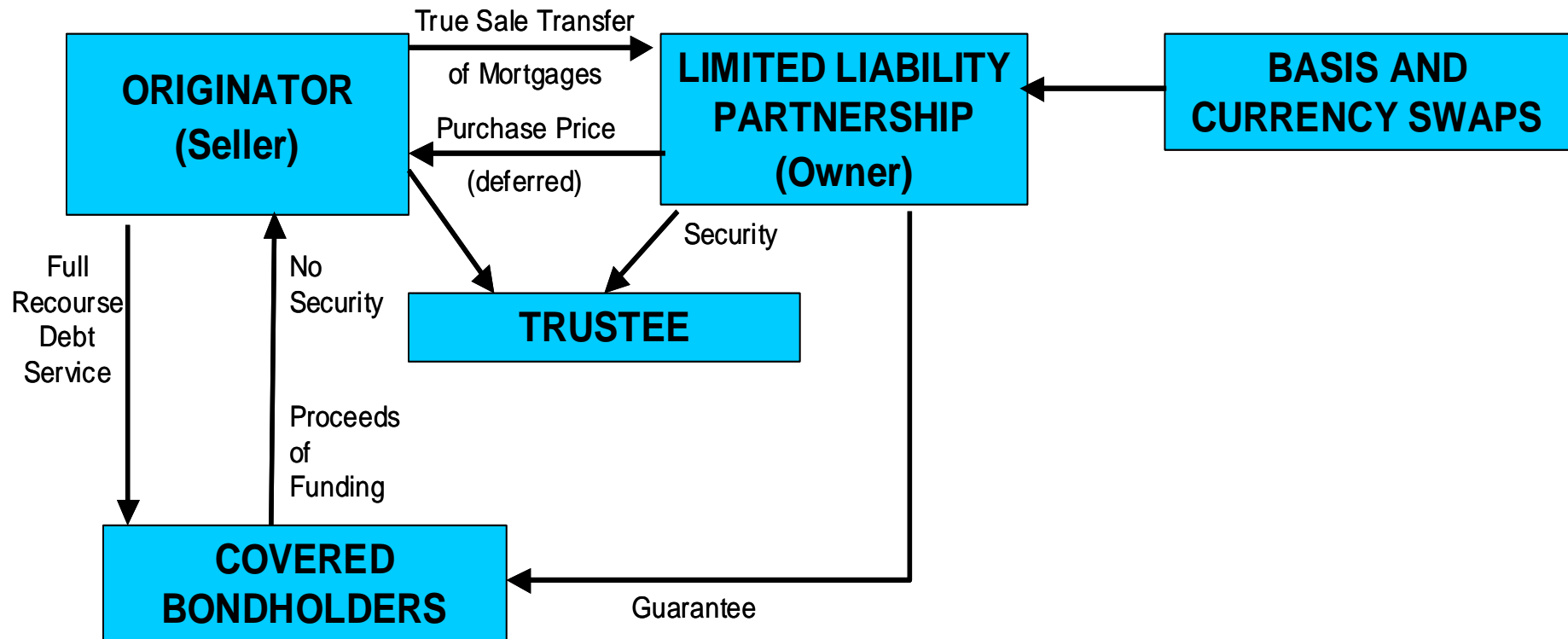
Structured Finance Arrangements

- ***Starting point is intention to protect Structured Finance Arrangements***
- ***Protected rights include capital market arrangement (CMA)***
- ***Prohibits transfer of some but not all of rights and liabilities forming part of capital market arrangement to which bank is party***
- ***Insolvency Act definition of CMA***

Reminder - Paradigm True Sale Structure



Paradigm Covered Bond Structure



Derivative Issues

- *Power to vary contractual provisions*
- *“Securities” transfer orders*
- *Trusts/CMA*
- *Safeguards Order*

Partial Property Transfers (“PPT”) – The Issue

- ***A PPT may split:***
 - ***Security from secured liability***
 - ***Netting arrangement***
 - ***Sums due from sums owed under a set-off arrangement***
- ***Therefore need to be protected***
- ***But***
- ***Will this limit efficacy of a PPT?***

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