EXPLANATORY MEMORANDUM TO

THE INVESTMENT BANK SPECIAL ADMINISTRATION REGULATIONS 2011

2011 No. 245

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 These Regulations provide for a new special administration regime (SAR) for investment banks (as defined in section 232 of the Banking Act 2009).

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

3.1 Normally, the introduction of a new administration regime for a certain type of firm would be made under primary legislation. However, here the Regulations are being made under the enabling powers in section 233 and 234 of the Banking Act 2009[1] ("the Banking Act").

4. Legislative context

4.1 The Treasury lays the following Regulations in exercise of the powers conferred by sections 233, 234 and 259(1) of the Banking Act (the power in section 233 and 234 having not yet lapsed under section 235(4)). These Regulations need to be approved by both Houses of Parliament and are linked to a separate Order "The Investment Bank (Amendment of Definition) Order 2011" which amends the scope of this regime as set out in section 232 of the Banking Act. 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.

4.2 Following the insolvency of Lehman Brothers, it became apparent that there were unanticipated complexities in resolving an investment bank. Essentially, the issues stemmed from the complex ways in which client money and assets are held by broker dealers. This caused delays in allowing the administrator to identify and return assets to clients. This has major implications for the attractiveness of the UK as a place to conduct prime brokerage business, with potential knock-on consequences for UK competitiveness in general.

4.3 In response to these concerns, the Treasury undertook an in-depth review to assess whether there are shortfalls with existing insolvency law regarding investment firms which hold client assets. Powers were then provided for in the Banking Act (sections 232 to 236) to enable the Treasury to create a new insolvency regime, if the review found it to be necessary.

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[1] 2009 c.1

4.4 The Treasury gave undertakings that it would base its decision to create a new SAR for investment firms both on the outcome of public consultation and on the advice of its Investment Banking Liaison Panel of industry experts.

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 Special Administration Regulations 2011 are compatible with the Convention rights."

7. Policy background

- **What is being done and why**

Problem under consideration

7.1 The failure of Lehman Brothers in the UK and the subsequent administration proceedings have demonstrated areas where the UK's insolvency regime can be improved. For example, the administrators have faced substantial difficulties in returning trust assets and money to clients under their current statutory powers.

Rationale for intervention

7.2 The Government believes that there is a strong case for a SAR for investment firms to ensure that there is minimum disruption to financial markets as a result of their insolvency. It is important that client trust property is returned promptly on the insolvency of an investment firm in order to mitigate the possibility that clients are forced into financial difficulties themselves. The prompt return of client assets will also benefit the insolvent firm's unsecured creditors as their claims can be dealt with quicker and administration expenses will be reduced.

Scope

7.3 Currently a firm is within scope of the SAR if it satisfies the following conditions:

a) has permission under Part 4 of the Financial Services and Markets Act 2000 (FSMA) to carry on at least one of the following regulated activities:
   - safeguarding and administering investments;
   - dealing in investments as principal; or
   - dealing in investments as agent;
b) holds client assets; and
c) is incorporated in, or formed under, the law of any part of the UK (includes companies, limited liability partnerships, and partnerships).

7.4 The Government intends to use the order-making power in section 232 of the Banking Act to provide that the term "client assets" in Condition 2 (section 232(3)) also includes client money. This is to ensure that a firm which holds client money or client assets is within scope of the SAR if it satisfies the other conditions. The exception to this are firms which hold client money related to insurance mediation activities that are not part of investment activities. These firms will be excluded as the SAR is meant to apply to investment firms. This amendment to the Banking Act is set out in a separate order which is to be laid at the same time as these Regulations.

Special administration objectives

7.5 The SAR will create three special administration objectives which administrators will have a duty to follow:

- Objective 1 is for the administrator to ensure the return of client money or assets as soon as is reasonably practicable;
- Objective 2 is for the administrator to ensure timely engagement with market infrastructure bodies and the Authorities; and
- Objective 3 is for the administrator to either rescue the investment bank as a going concern, or wind it up in the best interest of the creditors.

7.6 The administrator has the flexibility to prioritise these objectives as appropriate so they are suitable for any size of investment firm which holds client money or assets and is within scope.

7.7 The aim is to provide administrators with clarity and direction to resolve the firm, without needing to approach the court on a frequent basis.

FSA's power of direction

7.8 The FSA, after consultation with HM Treasury and the Bank of England, has the power to direct the administrator to prioritise certain objectives over others, if it is necessary to maintain public confidence in the stability of the UK financial markets. This direction from the FSA will give administrators an additional defence to undertake certain actions which otherwise they may be reluctant to undertake due to concerns over their personal liability for their actions.

Bar dates for claims to client assets

7.9 It is hard for an administrator to start returning client assets until they have complete information on all claims to the assets. Not having a cut-off date after which the administrator can start reconciling claims can cause a severe delay in the return of client assets.

7.10 The SAR gives an administrator the option of setting a "bar date" (i.e deadline) if they think it is necessary to expedite the return of client assets.

7.11 The bar date should allow:

- sufficient time for the fact of administration to be publicised;
- sufficient time for affected clients to calculate and submit their claims; and

- sufficient time for practical difficulties in establishing claims, particularly where arrangements are complex, to be sorted out.

7.12 A late claimant is not allowed to challenge the distribution of the administrator as long as it is conducted in good faith. This is to give certainty to clients who receive back their assets that they will not be challenged at a later date by a third party for the return of those assets.

7.13 To reduce the possibility of there being a late claimant there are safeguards. For example, the administrator must set a reasonable timeframe for submission of claims, and proactively approach any client who is on the books and records of the firm as having a potential claim. Further safeguards are to be set out in the Investment Bank Special Administration Rules- see paragraphs 7.22 – 7.24 below.

7.14 In addition, no distribution can be made by the administrator following the bar date until the creditor committee has approved the administrator's distribution plan and court approval has been obtained.

Allocation of shortfalls in an omnibus account

7.15 There is currently a lack of clarity in insolvency law over how shortfalls in client securities held in an omnibus account should be allocated to clients. This uncertainty can delay the return of client assets, and increase the costs of administration.

7.16 The SAR provides the administrator with the power to allocate shortfalls in client securities pro rata in an omnibus account. The inclusion of this power aims to get client assets returned quicker thereby resulting in a less costly administration for creditors.

Continuity of service arrangements

7.17 The Government is seeking to ensure that suppliers of services which are key to the effective administration of the firm and to the meeting of the special administration objectives cannot withdraw their services until the administrator has had time to make suitable alternative arrangements. The SAR adapts the provisions of section 233 of the Insolvency Act 1986 to require continuity of supply of IT and other key services. When an investment firm goes into administration, the supplier cannot make it a condition of the supply, or do anything that would have the effect of imposing that condition, that any outstanding charges owed by the firm to the supplier and incurred before the date of administration are paid. Suppliers of the following are covered:

- computer hardware or software or other hardware used by the investment bank in connection with the trading of securities or derivatives;
- financial data;
- infrastructure permitting electronic communication services;
- data processing;
- secure data networks provided by an accredited network provider; or
- access to a relevant system by a sponsoring system participant.

7.18 The supplier can stop providing a supply if: any charges in respect of the supply, (i.e. charges incurred post the commencement of Special Administration) remain unpaid for more than 28 days; the administrator consents to the termination; or the supplier has the permission of the court. The latter may be given if the supplier can show that the continued provision of the supply shall cause the supplier to suffer hardship.

Interaction of the SAR with the Banking Act for deposit-taking firms

7.19 The interaction between the SAR and the provisions under Parts 2 and 3 of the Banking Act is as follows. Where the investment bank is a deposit-taking bank with eligible depositors then, in addition to the insolvency procedures established under Parts 2 and 3 of the Banking Act, the Bank of England may apply to put the bank into:

- Special Administration (Bank Insolvency); or
- where a property transfer power under Part 1 of the Banking Act 2009 has been exercised, Special Administration (Bank Administration).

7.20 The FSA may also make an application for Special Administration (Bank Insolvency) with the consent of the Bank of England.

7.21 However, where the investment bank is a deposit-taking bank but has no eligible depositors, the investment bank may be put into either:

- Special Administration (Bank Administration); or
- Special Administration.

Investment Bank Special Administration Rules

7.22 There will be insolvency rules for the SAR for England and Wales, for Scotland, and for Northern Ireland. The English and Welsh rules and the Scottish rules are to be made under section 411 of the Insolvency Act 1986 (as applied by the Regulations). The Northern Ireland rules are to be made under Article 359 of the Insolvency (Northern Ireland) Order 1989 (as applied by the Regulations). The English and Welsh rules will be put before the Insolvency Rules Committee, as required by the Insolvency Act 1986.

7.23 These rules will be introduced separately under the negative procedure to come into force as soon as possible after the Regulations come into force.

7.24 These rules will set out the procedural rules which the administrator has to follow in order to comply with the Regulations. The main new provisions include:

- clients being present at the meeting of creditors;
- clients being represented on the creditor committee;
- costs of returning client assets will be paid out of the client assets; and
- the bar date procedure (incorporating various safeguards) and how late claimants are to be to treated.

- **Consolidation.** Not applicable.

8. Consultation outcome

8.1 The Treasury has consulted in accordance with section 235(3) of the Banking Act. There have been three consultations[1] on the SAR. The responses from the three consultation papers have been considered and have informed the policy development of the SAR. Responses to the consultation papers are available on the Treasury's website[2].

8.2 Responses to the most recent consultation paper on the SAR, *Special administration regime for investment firms*[3], which consulted on the actual draft Regulations, were broadly supportive of the introduction of this new regime. The Treasury has considered all amendments raised by the respondents and all subsequent changes to the Regulations are set out on HM Treasury's website[4].

8.3 The Treasury has also taken account of the views of an Investment Banking Liaison Panel of industry practitioners who have helped to develop the SAR.

9. Guidance

9.1 Not applicable.

10. Impact

10.1 The SAR may only be instituted in connection with the insolvency of an investment bank (as defined in section 232 of the Banking Act). There are no significant ongoing or one-off direct costs associated with the SAR. The Treasury has consulted on the costs of the SAR being negligible and there was no serious contention of this assumption apart from the highlighting by some respondents of the potential costs resulting from planning for or risk assessing the new administration regime. This might occur where market participants have to obtain new legal opinions. However, responses have not given any indication of the scale of these costs. An Impact Assessment has been prepared for this instrument.

11. Regulating small business

11.1 These Regulations apply to 'investment banks' (as defined in section 232 of the Banking Act 2009) 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 special administration regime insolvency 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

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1 *Developing Effective Resolution Arrangements for Investment Banks*, HM Treasury, May 2009; *Establishing Resolution Arrangements for Investments Banks*, HM Treasury, December 2009; and *Special Administration Regime for Investment Firms*, HM Treasury, September 2010

2 www.hm-treasury.gov.uk/consult_investment_banks2.htm.

3 www.hm-treasury.gov.uk/d/consult_sar_160910.pdf

4 www.hm-treasury.gov.uk/consult_investment_banks2.htm.

have effect. HM 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

Title: **Special administration regime for investment firms** **Lead department or agency:** HM Treasury **Other departments or agencies:**	**Impact Assessment (IA)** **IA No:** **Date:** 03/12/2010 **Stage:** Final proposal **Source of intervention:** Domestic **Type of measure:** Secondary legislation **Contact for enquiries:** Daniel.Okubo@hmtreasury.gsi.gov.uk

Summary: Intervention and Options

What is the problem under consideration? Why is government intervention necessary?

The failure of Lehman Brothers undermined confidence in the banking system as a whole, requiring governments around the world to provide exceptional levels of financial assistance to the global financial system. Specifically, the failure of Lehman Brothers International Europe (LBIE) raised concerns that the UK's insolvency regime could not handle an investment bank default, which clearly has impacts on financial stability. The Government is committed to improving the UK's legal framework where the LBIE experience has highlighted the need for reform in order to enhance financial stability.

What are the policy objectives and the intended effects?

The policy objective is to improve financial stability by increasing the confidence of market participants in the effectiveness of the UK's insolvency regime. This is to be achieved by the introduction of a new special administration regime (SAR) for investment firms, with special administration objectives for administrators. These special administration objectives should help ensure that client assets and money held on trust by an investment firm can be returned as quickly as possible and that trades that the failed firm has entered into can be resolved effectively to ensure clarity for affected counterparties. It is also important that creditors remain sufficiently protected.

What policy options have been considered? Please justify preferred option (further details in Evidence Base)

The Government is proposing a special administration regime. The SAR has been extensively consulted on - with the responses to three consultation papers taken into account. The Government has also worked closely with an Investment Banking Advisory Panel of industry experts to develop the legislation. The option to do nothing has been considered; however, the failure of Lehman Brothers clearly demonstrated areas where the UK's insolvency regime could be strengthened in respect of investment firms.

When will the policy be reviewed to establish its impact and the extent to which the policy objectives have been achieved?	It will be reviewed 02/2013
Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review?	Yes

Ministerial Sign-off For consultation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister: ..... Date: 6/12/10

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Summary: Analysis and Evidence

Policy Option 1

Description:

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low:	High:	Best Estimate:

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	0		0	**0**
High	0		0	**0**
Best Estimate				

Description and scale of key monetised costs by 'main affected groups'

No costs to market participants as a result of this proposal. These are legislative changes that will aim to provide greater legal clarity to help overcome specific obstacles to the effective resolution of investment firms as discussed in the evidence base. There are no anticipated costs to the Authorities as a result of these measures, as there are existing processes in place.

Other key non-monetised costs by 'main affected groups'

No other key non-monetised costs.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	n/a		n/a	**n/a**
High	n/a		n/a	**n/a**
Best Estimate	n/a		n/a	**n/a**

Description and scale of key monetised benefits by 'main affected groups'

It is not possible to quantify the monetised benefits, but improved resolution arrangements for investment firms will benefit clients, counterparties and creditors of the failed firm by lessening the length of the administration. Clients should receive their trust property back sooner. Cooperation between the administrators and market infrastructure bodies to resolve failed trades or open positions should be improved, which will benefit counterparties and unsecured creditors.

Other key non-monetised benefits by 'main affected groups'

The aim is to provide administrators with clarity and direction to resolve the firm, without needing to approach the court on a frequent basis. These adjustments to current insolvency law will aim to make the process less expensive and less disruptive for an investment firm, its clients, creditors and the market. In addition to the above benefits there are unquantifiable benefits associated with a financial sector with a better resolution process, such as improved investor confidence.

Key assumptions/sensitivities/risks **Discount rate (%)** N/A

The most significant risk of the SAR is that it might not be in the best interests of all creditors of the investment firm. This is because the SAR has additional objectives for the administrator, including returning client assets. However, the Government expects that no creditor will be materially affected by the SAR, as provisions such as the setting of bar dates should allow for a shorter administration period . These savings in administration expenses will ultimately benefit all the creditors. Similarly, in the event of a large and complex investment firm insolvency, the Government expects several administrators to be appointed to focus on each of the special administration objectives. This should mean that there will be no deterioration of focus on the needs of creditors.

Impact on admin burden (AB) (£m):			Impact on policy cost savings (£m):	In scope
New AB: n/a	**AB savings:** n/a	**Net:** n/a	**Policy cost savings:**	Yes/No

Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?			United Kingdom		
From what date will the policy be implemented?			11/02/2011		
Which organisation(s) will enforce the policy?			Not applicable		
What is the annual change in enforcement cost (£m)?			0		
Does enforcement comply with Hampton principles?			Yes		
Does implementation go beyond minimum EU requirements?			No		
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** n/a	**Non-traded:** n/a	
Does the proposal have an impact on competition?			No		
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?			**Costs:** n/a	**Benefits:** n/a	
Annual cost (£m) per organisation (excl. Transition) (Constant Price)	**Micro** n/a	**< 20** n/a	**Small** n/a	**Medium** n/a	**Large** n/a
Are any of these organisations exempt?	No	No	No	No	No

Specific Impact Tests: Checklist

Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.

Please note this checklist is not intended to list each and every statutory consideration that departments should take into account when deciding which policy option to follow. It is the responsibility of departments to make sure that their duties are complied with.

Does your policy option/proposal have an impact on...?	**Impact**	**Page ref within IA**
Statutory equality duties[1] Statutory Equality Duties Impact Test guidance	No	
Economic impacts		
Competition Competition Assessment Impact Test guidance	No	
Small firms Small Firms Impact Test guidance	No	
Environmental impacts		
Greenhouse gas assessment Greenhouse Gas Assessment Impact Test guidance	No	
Wider environmental issues Wider Environmental Issues Impact Test guidance	No	
Social impacts		
Health and well-being Health and Well-being Impact Test guidance	No	
Human rights Human Rights Impact Test guidance	No	
Justice system Justice Impact Test guidance	No	
Rural proofing Rural Proofing Impact Test guidance	No	
Sustainable development Sustainable Development Impact Test guidance	No	

[1] Race, disability and gender Impact assessments are statutory requirements for relevant policies. Equality statutory requirements will be expanded 2011, once the Equality Bill comes into force. Statutory equality duties part of the Equality Bill apply to GB only. The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

Evidence Base (for summary sheets) – Notes

Use this space to set out the relevant references, evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Please fill in **References** section.

References

Include the links to relevant legislation and publications, such as public impact assessment of earlier stages (e.g. Consultation, Final, Enactment).

No.	Legislation or publication
1	Developing Effective Resolution Arrangements for Investment Banks, HM Treasury, May 2009
2	Establishing Resolution Arrangements for Investments Banks, HM Treasury, December 2009
3	Resolution of Investment Banks: Summary of Consultation Responses, HM Treasury, July 2010
4	Special Administration Regime for Investment Firms, HM Treasury, September 2010

+ Add another row

Evidence Base

Ensure that the information in this section provides clear evidence of the information provided in the summary pages of this form (recommended maximum of 30 pages). Complete the **Annual profile of monetised costs and benefits** (transition and recurring) below over the life of the preferred policy (use the spreadsheet attached if the period is longer than 10 years).

The spreadsheet also contains an emission changes table that you will need to fill in if your measure has an impact on greenhouse gas emissions.

Annual profile of monetised costs and benefits* - (£m) constant prices

	Y_0	Y_1	Y_2	Y_3	Y_4	Y_5	Y_6	Y_7	Y_8	Y_9
Transition costs	0	0	0	0	0	0	0	0	0	0
Annual recurring cost	0	0	0	0	0	0	0	0	0	0
Total annual costs	0	0	0	0	0	0	0	0	0	0
Transition benefits	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Annual recurring benefits	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Total annual benefits	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a

* For non-monetised benefits please see summary pages and main evidence base section

Microsoft Office
Excel Worksheet

Evidence Base (for summary sheets)

Special administration regime for investment firms

Introduction

This section sets out the assumptions supporting this impact assessment.

Problem under consideration

The failure of Lehman Brothers undermined confidence in the banking system as a whole, requiring governments around the world to provide exceptional levels of financial assistance to the global financial system. While this action has led to stabilisation in the short term, governments must now enact substantive reforms to ensure that, in future, a similar failure does not have the same impact on financial stability.

Rationale for intervention

Investment firms are a core part of financial markets, and among other things, play a critical role in providing market liquidity. A freezing of credit markets and a substantial strain on financial stability have followed the recent failures of investment firms, along with the failure of retail banks.

The Government believes that there is a strong case for a SAR for investment firms to ensure that there is minimum disruption to financial markets as a result of their insolvency. The Government believes that current insolvency legislation under the Insolvency Act 1986, while generally robust and flexible, presents specific legal constraints for the effective resolution of large and complex investment firms. To leave the insolvency regime for investment firms unchanged would mean that an administration of an investment firm would be conducted under the Insolvency Act 1986 and would leave unresolved the issues which have been demonstrated in the Lehman Brothers insolvency.

Policy objective

The policy objective is to create a SAR in the form of an administration procedure. The aim is to provide administrators with clarity and direction to resolve the firm, without needing to approach the court on a frequent basis. These adjustments to current insolvency law will aim to make the process less expensive and less disruptive for an investment firm, its clients, creditors and the market.

Scope

Currently a firm is within scope of the SAR if it satisfies the following conditions:

(a) has permission under Part 4 of the Financial Services and Markets Act 2000 (FSMA) to carry on at least one of the following regulated activities:

- safeguarding and administering investments;
- dealing in investments as principal; or
- dealing in investments as agent;

(b) holds client assets; and

(c) is incorporated in, or formed under, the law of any part of the UK.

The Government intends to use the order-making power in section 232 of the Banking Act 2009 to clarify that the term "client assets" in condition (b) also includes client money. This clarification is to ensure that a firm which holds client money or client assets is within scope of the SAR if it satisfies the other conditions. The exception to this are firms which hold client money related to insurance activities. These firms will be excluded as the SAR is meant to apply to investment firms. There are no costs associated with this Order.

Costs/benefits

There are no significant ongoing or one-off direct costs associated with the SAR. The December 2009 consultation paper, *"Establishing resolution arrangements for investment banks"*, set out the assumption that the costs of introducing a SAR were negligible. There has been no serious contention of this assumption apart from the highlighting by some respondents of the potential costs resulting from planning for or risk assessing the new administration regime. This might occur where market participants have to obtain new legal opinions. However, responses to the December consultation paper did not give any indication of the scale of these costs.

This impact assessment will now assess the respective costs and benefits of each of the main aspects of the SAR including:

- special administration objectives;
- bar date for claims to client assets;
- allocating shortfalls pro rata;
- the FSA's power of direction; and
- continuity of service arrangements.

Special administration objectives

The SAR will create three special administration objectives which administrators will have a duty to follow:

- Objective 1 is for the administrator to ensure the return of client money or assets as soon as is reasonably practicable;
- Objective 2 is for the administrator to ensure timely engagement with market infrastructure bodies and the Authorities; and
- Objective 3 is for the administrator to either rescue the investment bank as a going concern, or wind it up in the best interest of the creditors.

Costs

None of these statutory objectives entail any direct costs. It is possible that unsecured creditors may be indirectly affected by the new special administration objectives 1 and 2. However, the Government believes that this is unlikely because the SAR will:

- speed up the agreement of unsecured claims, because unsecured claims of clients will be clarified through the imposition of a bar date;
- expedite the distribution process for unsecured creditors on the basis that the unsecured claims can be determined more quickly; and
- reduce the level of unsecured claims as certain claims of clients for consequential and indirect losses are netted off through the bar date and distribution of client assets process.

Benefits

The benefits of the special administration objectives include:

- greater certainty and clarity for administrators over the objectives against which they are liable;
- increased focus on the return of client assets, which is not currently a statutory requirement on administrators;
- increased focus on communicating with the Authorities and market infrastructure providers; and
- a cut-off date for client, affiliate and third party claims to client assets through the imposition of a bar date. Objective 1 also allows the administrator to allocate any shortfalls which are revealed by the bar date pro rata on a stock line basis among the affected clients.

These benefits are not quantifiable, as it would depend on the specific circumstances of the administration. For example, if a firm that held significant amounts of client assets entered administration, then it is likely that the benefits of the SAR in reducing the length of the administration and ensuring that clients receive their assets back quicker are more substantial then if a firm held fewer client assets.

Where respondents have commented on the benefits of such a regime it has generally been felt that in the case of LBIE the existence of such a regime for administrators would have reduced the time spent on identifying and returning client assets, thereby benefiting the estate in terms of cost savings (albeit unquantifiable).

Establish bar dates for claims to client assets

It is hard for an administrator to start returning client assets until they have complete information on all claims to the assets. Not having a cut-off bar date after which the administrator can start reconciling claims causes there potentially to be a severe delay in the return of client assets.

The Government is proposing to give an administrator within the SAR the option of setting a bar date if the records of the insolvent firm do not give a clear indication of what clients and third parties are owed.

The bar date should allow for:

- sufficient time for the fact of administration to be publicised;
- sufficient time for affected clients to calculate and submit their claims; and
- practical difficulties in establishing claims, particularly where arrangements are complex.

Costs

The cost of the bar date would be on the client or third party to submit a claim for the assets. However, this is a process that is usually undertaken in complex insolvencies anyway, so the Government considers the costs to be negligible. The Government consulted in the December paper on the costs of the bar date proposal being negligible and no alternative costs were proposed.

There is the possibility that a late claimant may find that they only have an unsecured claim against the estate for the value of their assets. This could arise where there is a shortfall in a particular stock line and the administrator has already distributed all the assets of that particular stock line it possesses following the bar date.

A late claimant is not allowed to challenge the distribution of the administrator as long as it is conducted in good faith. This is to give certainty to clients who receive back their assets that they will not be challenged at a later date by a third party for the return of those assets. The potential cost of a client having a unsecured shortfall claim rather than a proprietary claim is unquantifiable as it depends on the size of the shortfall and whether or not the client's unsecured claim is eventually paid in full.

To reduce the possibility of there being a late claimant there are safeguards. For example, the administrators need to advertise the bar date widely, set a reasonable timeframe for submission of claims, and proactively approach any client who is on the books and records of the firm as having a potential claim.

In addition, no distribution can be made by the administrator following the bar date until the creditor committee has approved the administrator's distribution plan and court approval has been obtained.

Benefits

The benefits of the bar dates proposal would be that the administrator should be able to reconcile and return client assets much faster than the current insolvency regime allows. However, this is unquantifiable as it depends on the circumstances of the administration.

Increase clarity over the allocation of shortfalls in an omnibus account

There is currently a lack of clarity in insolvency law over how shortfalls in client securities held in an omnibus account should be allocated to clients. This uncertainty can delay the return of client assets, and increase the costs of administration.

The Government understands that it would be beneficial if there were certainty for clients and administrators as to how shortfalls should be allocated post-insolvency by an administrator. By providing clarity, it is believed that the length of administration can be reduced and clients can have their securities returned to them quicker, which will result in a less costly administration for creditors.

Costs

The cost of this proposal is that clients may be prevented from putting in tracing claims to their assets, as the SAR would allow the administrator to allocate shortfalls pro rata if they felt it was necessary to meet their first special administration objective of returning client assets as soon as is reasonably practicable.

This could lead to clients bearing shortfalls which actually belong to another client. This cost is mitigated by the fact that the administrator will not necessarily allocate any shortfall pro rata. If it were a fairly simple administration, with clear records which allow the shortfall to be traced to a particular client, then the administrator would be expected to do so. The cost of this proposal is not quantifiable, as it depends on the circumstances of the administration. For example, if there are shortfalls in many stock lines, then the cost is potentially greater than if the shortfall is only in one stock line. It also depends on how large the shortfall is, and the amount of assets held.

Benefits

The benefit of this option is that it potentially speeds up the return of client assets and reduces the cost of the administration. Again this is unquantifiable.

It is expected that the wider impact of allowing administrators to allocate shortfalls pro rata would be greater confidence in the UK insolvency regime for managing the return of client assets. The faster return of client assets will also help the clients of a failed investment firm remain solvent.

The FSA's power of direction

One aspect of the SAR is that the FSA (after consultation with HM Treasury and the Bank of England) has the power to direct the administrator to prioritise certain objectives over others. This direction from the FSA would give administrators an additional defence to undertake certain actions which otherwise they may be reluctant to do, due to concerns over their personal liability.

Costs

In the event of an extremely complex insolvency, there is a possibility that the Authorities may be more involved in the administration than usual, and this could add some additional burden. However, this is unquantifiable. It would be expected that any additional costs to the Authorities would be mitigated against by the improvement in market conditions and a more managed wind-up of the firm following their intervention.

Benefits

The FSA's power of direction could prevent a "log jam" situation whereby the administrators are unable to take the necessary actions to wind-up the firm. This benefit is unquantifiable, as it depends on the circumstances of the administration.

Continuity of service arrangements

The Government is seeking to ensure that suppliers of services which are key to the effective administration of the firm and to the meeting of the special administration objectives cannot withdraw their services until the administrator has had time to make suitable alternative arrangements. The SAR adapts the provisions of section 233 of the Insolvency Act 1986 to require continuity of supply of IT and other key services. When an investment firm goes into administration, the administrator may request the continuation of a service contract, and the supplier cannot make it a condition of the supply, or do anything that would have the effect of imposing that condition, that any outstanding charges owed by the firm to the supplier and incurred before the date of administration are paid.

The continuity of supply provisions are being expanded to include:

- computer hardware or software or other hardware used by the investment bank in connection with the trading of securities or derivatives;
- financial data;
- infrastructure permitting electronic communication services;
- data processing;
- secure data networks provided by an accredited network provider; or
- access to a relevant system by a sponsoring system participant.

Costs

The Government believes that there will be negligible costs to this proposal because the supplier can stop providing a supply if:

- any charges in respect of the supply, being charges for a supply given after the commencement of special administration remain unpaid for more than 28 days;
- the administrator consents to the termination; or
- the supplier has the permission of the court, which may be given if the supplier can show that the continued provision of the supply shall cause the supplier to suffer hardship.

Benefits

The benefits of this proposal are significant, as it is essential that the core operational services that the administrator requires to resolve the firm are accessible and are not withdrawn at the start of the administration. However, this benefit is unquantifiable as it depends on the circumstances of the administration.

Risks and assumptions

The most significant risk of the SAR is that it might not be in the best interests of all creditors of the investment firm. This is because the SAR has additional objectives for the administrator, including returning client assets. However, the Government expects that no creditor will be materially affected by the SAR, as provisions such as the setting of bar dates should allow for a shorter administration period. These savings in the expenses related to administration will ultimately benefit all the creditors of the firm.

Similarly, in the event of a large and complex investment firm insolvency, the Government expects several administrators to be appointed to focus on each of the special administration objectives. This should mean that there will be no deterioration of focus on the needs of creditors.

Impact on small firms and competition

The Government believes that there will be no impact on small firms and competition, as the main feature of the SAR is new special administration objectives for insolvency practitioners which do not impose any burdens on firms.

Summary and preferred option with description of implementation plan

The preferred option is establishing a special administration regime for investment firms. This would be achieved by making and laying regulations under the powers in section 233 of the Banking Act 2009. This power expires on 11 February 2011. The SAR regulations are subject to affirmative draft procedures. Now the responses to the consultation have been considered, the final draft of regulations, subject to Ministerial approval, will be laid before Parliament. This measure will be for HM Treasury to take forward.

In addition, there will be a separate Order amending the scope of the SAR as set out in section 232 of the Banking Act. This Order will also be subject to the affirmative draft procedure.

The SAR will also have accompanying insolvency rules for the regulations. These will be subject to the negative procedure.

Annexes

Annex 1 should be used to set out the Post Implementation Review Plan as detailed below. Further annexes may be added where the Specific Impact Tests yield information relevant to an overall understanding of policy options.

Annex 1: Post Implementation Review (PIR) Plan

A PIR should be undertaken, usually three to five years after implementation of the policy, but exceptionally a longer period may be more appropriate. A PIR should examine the extent to which the implemented regulations have achieved their objectives, assess their costs and benefits and identify whether they are having any unintended consequences. Please set out the PIR Plan as detailed below. If there is no plan to do a PIR please provide reasons below.

Basis of the review: [The basis of the review could be statutory (forming part of the legislation), it could be to review existing policy or there could be a political commitment to review]; For legislative measures, section 236 of the Banking Act 2009 provides for HM Treasury to review the special administration regime insolvency 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
Review objective: [Is it intended as a proportionate check that regulation is operating as expected to tackle the problem of concern?; or as a wider exploration of the policy approach taken?; or as a link from policy objective to outcome?] See Basis of Review section above
Review approach and rationale: [e.g. describe here the review approach (in-depth evaluation, scope review of monitoring data, scan of stakeholder views, etc.) and the rationale that made choosing such an approach] See Basis of the review section above
Baseline: [The current (baseline) position against which the change introduced by the legislation can be measured] See Basis of the review section above
Success criteria: [Criteria showing achievement of the policy objectives as set out in the final impact assessment; criteria for modifying or replacing the policy if it does not achieve its objectives] See Basis of the review section above
Monitoring information arrangements: [Provide further details of the planned/existing arrangements in place that will allow a systematic collection systematic collection of monitoring information for future policy review] See Basis of the review section above
Reasons for not planning a PIR: [If there is no plan to do a PIR please provide reasons here] n/a