

EXPLANATORY MEMORANDUM TO

THE BANKING ACT 2009 (THIRD PARTY COMPENSATION ARRANGEMENTS FOR PARTIAL PROPERTY TRANSFERS) REGULATIONS 2009

2009 No. 319

1. This explanatory memorandum has been prepared by Her Majesty's 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 Parts 1 to 3 of the Banking Act 2009 ("the Act") establish a Special Resolution Regime (SRR). The SRR provides the Treasury, the Bank of England and the Financial Services Authority (collectively referred to as the "Authorities") with various options for dealing with a failing bank and certain other financial institutions.

2.2 Part 1 of the Act confers powers on the Bank of England and, in certain circumstances, the Treasury to transfer the securities in, and property of, a bank or certain other financial institutions where certain conditions (see sections 7-9) are satisfied. In certain circumstances, the Treasury or the Bank of England may make a transfer of some, but not all, of the property of a failing bank or financial institution ("a partial property transfer").

2.3 The Act (sections 49-62) requires the Treasury to make provision for compensation in connection with the exercise of the powers conferred by Part 1 by means of a compensation scheme order, resolution fund order or third party compensation order.

2.4 These Regulations require the Treasury, as part of the provision for compensation, to make provision for the assessment and payment of compensation to those who were creditors of a bank or financial institution before the exercise of a power conferred by Part 1 ("pre-transfer creditors") where a partial property transfer has been made. Such provision is to be included in a third party compensation order made in accordance with section 59 of the Act.

2.5 These Regulations provide that a third party compensation order made in relation to certain partial property transfers must include the following provision –

- Provision for the appointment of an independent valuer to assess whether compensation should be payable to pre-transfer creditors and if so, what amount is to be paid;
- A requirement for the independent valuer to be required to determine the difference in treatment between the treatment pre-transfer creditors actually received in consequence of the partial property transfer and the treatment they would have received had the bank or financial institution entered an insolvency process immediately before the exercise of the Part 1 power. If the actual treatment is less favourable than the insolvency treatment, the independent valuer must determine that compensation is payable;
- Provision as to which insolvency process should be taken into account by the independent valuer;
- Provision as to the principles to be applied by the independent valuer;
- Provision as to payments on account;
- Provision requiring the independent valuer to have regard to certain information provided by pre-transfer creditors.

2.6 In addition, the Regulations provide that a third party compensation order made in relation to a partial property transfer may make provision as to the assumptions the independent valuer should make as to how certain property would have been treated had the bank or financial institution entered an insolvency process.

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

3.1 Pursuant to section 259(4) to (6) of the Act, these Regulations are being made under the 28-day affirmative procedure.

3.2 This is the first time the power conferred by section 60 of the Act is being exercised. The Treasury are satisfied that it is necessary to exercise this power without laying a draft of the Regulations for approval.

3.3 It is necessary to commence the powers conferred by the Act to make a partial property transfer order or instrument on 21st February 2009. This is because the powers to make provision for the transfer of the shares or property of a failing bank or banking institution provided for in the Banking (Special Provisions) Act 2008 largely cease to be exercisable on 20th February 2009. Given the current financial instability, it is essential that the Authorities have adequate powers to make provision in relation to failing banks and financial institutions.

3.4 These Regulations provide for provision to be made for an assessment of whether compensation should be paid to pre-transfer creditors in the event of a partial property transfer. It is essential that these Regulations come into force at the same time as the powers in the Act to make a partial property transfer order or instrument come into force. This will ensure that the power to make a partial property transfer cannot be exercised without the appropriate provision being made for compensation being in place.

4. Legislative Context

4.1 These Regulations are part of a package of secondary legislation made in connection with the coming into force of the SRR on 21st February 2009.

4.2 These Regulations are made under section 60 of the Act.

5. Territorial Extent and Application

5.1 This instrument extends to the United Kingdom.

6. European Convention on Human Rights

6.1 The Economic Secretary to the Treasury, Ian Pearson MP, has made the following statement regarding Human Rights: In my view the provisions of the Banking Act 2009 (Third Party Compensation Arrangements for Partial Property Transfers) Regulations 2009 are compatible with the Convention rights.

7. Policy background

- *What is being done and why*

7.1 The Regulations provide additional protection for creditors of UK banks, in relation to the fact that UK banks may be subject to partial property transfers under the SRR.

7.2 Market participants have raised various concerns related to partial transfer powers, including fears that important contractual arrangements, such as set-off and netting and financial collateral arrangements, which are used to reduce risk between UK banks, and between UK banks

and non-UK banks or other non-bank counterparties, could be threatened. Unfettered partial transfer powers would allow the Authorities to ‘cherry pick’ assets from a failing bank, to the potential detriment of remaining creditors. Market participants made it clear that negative consequences, such as increased costs of funding and regulatory capital requirements for UK banks, could occur if safeguards were not provided. The Treasury are therefore providing for a range of safeguards in connection with the power to make partial property transfers. These safeguards will be set out in a separate Order, the ‘Banking Act 2009 (Restriction of Partial Property Transfers) Order 2009’.

7.3 The Regulations provide for an additional layer of protection for creditors of UK banks. The Regulations provide that no creditor should be worse off after a partial transfer of the failing bank they contracted with, relative to the counterfactual in which the failing bank was placed into an insolvency process on a “whole-bank” basis. The Treasury consider that the additional protection provided by these Regulations is appropriate given their acknowledgement that a creditor could be left worse off in aggregate, irrespective of the legal safeguards mentioned above (which protect certain arrangements on a counterparty by counterparty basis). The Treasury’s aim in providing such compensation is to reduce further market participants’ concerns with contracting with UK banks subject to the SRR.

- ***Consolidation***

7.4 These are the first Regulations to be made under section 60 of the Act. No consolidation is necessary.

8. Consultation outcome

8.1 The Government consulted publicly on a draft of the Regulations in November 2008. The draft Regulations have also been the subject of consultation with the Expert Liaison Group (“ELG”), a group of experts established by the Treasury to advise it on the development of certain statutory instruments under the Act.

8.2 The Regulations reflect the outcome of the formal consultation process and the consultation with the ELG. There was strong support from stakeholders for this safeguard.

9. Guidance

9.1 These Regulations relate to the provision that the Treasury must include in certain third party compensation orders made under the Act. It is not considered necessary to issue guidance in connection with these Regulations.

10. Impact

10.1 Businesses, charities or voluntary bodies may all be pre-transfer creditors and so may benefit from the provision made by these Regulations.

10.2 These Regulations may have an impact on the public sector in that, pursuant to these Regulations, compensation may have to be paid (by the Treasury or Financial Services Compensation Scheme) to pre-transfer creditors.

10.3 An Impact Assessment is attached to this memorandum.

11. Regulating small business

11.1 The legislation, and the protection it provides, applies to small businesses.

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' (BLP), will keep these Regulations under review and, where appropriate, provide advice to the Treasury about these Regulations. The Treasury will also keep these Regulations under review itself.

13. Contact

James Ridgwell at HM Treasury can answer queries regarding the instrument. Tel: 02072704883 or email: James.Ridgwell@hm-treasury.gov.uk.

Summary: Intervention & Options

Department /Agency: HM Treasury	Title: Impact Assessment of the Banking Act 09 (Third Party Compensation Arrangements for Partial Property Transfers) Regulations	
Stage: Final	Version: 1	Date: 18 February 2009
Related Publications: “ <i>Financial stability and depositor protection: further consultation</i> ” – July 2008, “ <i>Banking Bill: Impact Assessment</i> ” – October 2008 “ <i>Special resolution regime: safeguards for partial property transfers</i> ” – November 2008		

Available to view or download at:

<http://www.hm-treasury.gov.uk>

Contact for enquiries: James Ridgwell

Telephone: 02072704883

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

The Banking Act 2009 includes a provision whereby the Authorities¹ may transfer some, but not all, of the property of a failing UK bank. The unfettered ability of the Authorities to carry out partial property transfers would cause major problems for important risk reduction arrangements for transactions involving UK banks. A loss in legal certainty in these areas would ultimately result in higher costs of funding, and higher regulatory capital requirements, for UK banks. The Government has committed to providing legislative safeguards to avoid this, which are provided in a separate Order under the Act. However, bank creditors left in a failing bank (i.e. not transferred) could still be left worse-off on aggregate as a result of a partial transfer of a failed bank they had contracted with. The Government believes it is appropriate to provide compensation arrangements for bank creditors affected by partial transfers in this way, to provide further comfort to the financial markets. This compensation will be in addition to the general compensation mechanisms under the Banking Act 2009 following a transfer, and be provided by these Regulations.

What are the policy objectives and the intended effects?

Partial transfer powers are an important tool that may be employed, in the likely event of a bank failure, to support financial stability and protect depositors while reducing risk for public funds. The powers may be used to transfer specific property, such as a failing bank's deposit book, to, for example, a healthy bank. While the legislative safeguards mentioned above will ensure that wholesale counterparties' risk reduction arrangements are respected (on a counterparty-by-counterparty basis), it is still possible that, after the transfer of some of the assets of a failing bank to another company, on aggregate, the creditors of the residual bank could be left worse-off compared to a hypothetical situation in which a failing bank was wound-up whole. While the Authorities ECHR obligations to the creditors' rights would be fulfilled by other compensation mechanisms under the Act (such as a bank resolution fund), the Government believes that it would be desirable to allow the Government to provide a compensation arrangement that has regard to ensuring that creditors of UK banks subject to a partial transfer are left no worse off compared to a whole-bank wind-up.

What policy options have been considered? Please justify any preferred option.

The 'no creditor worse off' compensation mechanism was requested by stakeholders. The possibility of not offering this was considered by the Government. However, the Government appreciated stakeholder's comments on the desirability of providing maximum confidence to the markets in terms of their interactions with UK banks. The Government considered that the benefits of this increased market confidence out-weighed the potential costs to public funds of offering compensation that has regard to the desirability of no creditor being left worse-off after a partial transfer, and has therefore provided for this policy in these Regulations.

¹ The Authorities: HM Treasury, the Financial Services Authority (FSA), and the Bank of England (the Bank).

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

The Banking Act provides for a standing group, known as the 'Banking Liaison Panel' (BLP) to advise the Government as to the effect of the Regulations on the financial market in terms of providing adequate additional comfort.

Ministerial Sign-off For final proposal/implementation 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:

IAN PEARSON MP, ECONOMIC SECRETARY TO THE TREASURY

.....Date: 18 February 2009

Summary: Analysis & Evidence

Policy Option: as set-out in the Order.	Description: see below
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COSTS	ANNUAL COSTS	Description and scale of key monetised costs by 'main affected groups' See below
	One-off (Transition) Yrs	
	£ 	
	Average Annual Cost (excluding one-off)	
£ 	Total Cost (PV)	£
Other key non-monetised costs by 'main affected groups' n/a		

BENEFITS	ANNUAL BENEFITS	Description and scale of key monetised benefits by 'main affected groups' See below
	One-off Yrs	
	£ 	
	Average Annual Benefit (excluding one-off)	
£ 	Total Benefit (PV)	£
Other key non-monetised benefits by 'main affected groups' n/a		

Key Assumptions/Sensitivities/Risks none
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Price Base Year	Time Period Years	Net Benefit Range (NPV) £ 	NET BENEFIT (NPV Best estimate) £
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What is the geographic coverage of the policy/option?	UK				
On what date will the policy be implemented?	21 February 2009				
Which organisation(s) will enforce the policy?	Judiciary, FSA				
What is the total annual cost of enforcement for these organisations?	£ Not known				
Does enforcement comply with Hampton principles?	Yes				
Will implementation go beyond minimum EU requirements?	No				
What is the value of the proposed offsetting measure per year?	£				
What is the value of changes in greenhouse gas emissions?	£ n/a				
Will the proposal have a significant impact on competition?	No				
Annual cost (£-£) per organisation (excluding one-off)	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 25%; text-align: center;">Micro</td> <td style="width: 25%; text-align: center;">Small</td> <td style="width: 25%; text-align: center;">Medium</td> <td style="width: 25%; text-align: center;">Large</td> </tr> </table>	Micro	Small	Medium	Large
Micro	Small	Medium	Large		
Are any of these organisations exempt?	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 25%; text-align: center;">No</td> <td style="width: 25%; text-align: center;">No</td> <td style="width: 25%; text-align: center;">N/A</td> <td style="width: 25%; text-align: center;">N/A</td> </tr> </table>	No	No	N/A	N/A
No	No	N/A	N/A		

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)
Increase of £	Decrease of £	Net Impact £

Key: Annual costs and benefits: Constant Prices (Net) Present Value

The 'No Creditor Worse-off' (NCWO) Regulations

Policy, rationale, development

Introduction

The Authorities are keen that they have the ability to quickly take action, via partial transfers (under the Banking Act 2009), in the interests of financial stability and minimising tax-payer exposure. For example, the Authorities would wish to protect, and provide continuity of banking service (and thereby avoid a loss of liquidity) to, 'retail' bank counterparties.

It is noted above that the separate safeguards Order provides legislative safeguards for creditors and counterparties of UK banks, to counter fears that their risk reduction arrangements could be damaged if the UK Authorities make a partial property transfer of a failing UK bank with which they had contracted.

It is noted that creditors left in the 'residual bank' that is left after a partial transfer could be left worse off on aggregate, irrespective of the existence of legislative safeguards protecting individual institutions' risk reduction arrangements. This could harm market confidence in terms of contracting with UK banks. This is the policy issue addressed by these Regulations.

Consultation

The Government consulted on the policy to be implemented by the Regulations, and on the drafting of the Regulations themselves. A consultation paper, '*special resolution regime: safeguards for partial transfers*' was published on 6 November 2008. The Government also sought direct stakeholder engagement via meetings with, and other input from, the Expert Liaison Group' (ELG). The ELG was made up of representatives from the financial services industry (the ELG has now been superseded by the statutory 'Bank Liaison Panel' (BLP), provided for under the Banking Act. Overall, it should be noted that stakeholder comment was largely supportive of the NCWO Regulations, and comment focused on the correct drafting of the Regulations.

The policy

The Regulations aim to provide extra comfort for creditors of UK banks, in relation to the fact that UK banks may be subject to partial property transfers under the SRR.

The Regulations provide for an additional layer of protection for creditors of UK banks, beyond the safeguards Order mentioned above. The Regulations provide that no creditor should be worse off after a partial transfer of the failing bank they contracted with, relative to the counterfactual in which the failing bank was wound-up whole. The Government is including these Regulations in acknowledgement that a creditors could be left worse off in aggregate, irrespective of the legal safeguards mentioned above (which protect certain arrangements on a counterparty by counterparty basis). The Government's aim in providing such compensation is to reduce further market participants' concerns with contracting with UK banks subject to the SRR. However, it should be noted that the compensation provision implemented by these Regulations goes beyond what the Government is required to offer under the EU Human Rights law.

Foreign creditors are covered by the compensation offered by the Regulations. The Government is keen to provide extra comfort to foreign creditors of UK banks, as the

Government recognises that such creditors can be an important source of funding for UK banks. However, where the Authorities attempt to transfer foreign property, as part of a partial or full transfer, and such property is not transferred, for example, due to a foreign court failing to recognise the transfer, the compensation offered by these Regulations will not apply. The Government does not think it is proportionate or appropriate to apply the 'no creditor worse off' process to foreign property that is not transferred solely due to the decisions of a foreign jurisdiction.

Cost Benefit analysis

The affected group in terms of benefits is potentially any creditor of a UK bank. As noted above, the actual beneficiaries would be any creditor of a UK bank whose net economic position may have been damaged after the partial transfer of a failed UK bank, relative to the position the creditor would have found themselves in had the failed bank been wound-up whole.

The affected group in terms of costs is the Government (Her Majesty's Treasury) or potentially the Financial Services Compensation Scheme (the extent to which this scheme will contribute to any costs will be consulted upon separately).

The Government believes that the potential costs that these compensation arrangements are out-weighed by the benefits of adding materially to the confidence that domestic and international financial services market participant have in dealing with UK banks on an on-going basis (it should be noted that these compensation arrangements will not be invoked frequently, and potentially only very rarely). It should also be noted that these benefits have been confirmed by stakeholders, who have welcomed the proposal for these regulations.

Summary: Analysis & Evidence

Policy Option:	Description:
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COSTS	ANNUAL COSTS	Description and scale of key monetised costs by 'main affected groups' See above for cost benefit analysis
	One-off (Transition) Yrs	
	£	
	Average Annual Cost (excluding one-off)	
£	Total Cost (PV)	£
Other key non-monetised costs by 'main affected groups'		

BENEFITS	ANNUAL BENEFITS	Description and scale of key monetised benefits by 'main affected groups' See above for cost-benefit analysis
	One-off Yrs	
	£	
	Average Annual Benefit (excluding one-off)	
£	Total Benefit (PV)	£
Other key non-monetised benefits by 'main affected groups'		

Key Assumptions/Sensitivities/Risks none

Price Base Year	Time Period Years	Net Benefit Range (NPV) £	NET BENEFIT (NPV Best estimate) £
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What is the geographic coverage of the policy/option?	UK
On what date will the policy be implemented?	21 February
Which organisation(s) will enforce the policy?	HMT, Judiciary
What is the total annual cost of enforcement for these organisations?	£ n/a
Does enforcement comply with Hampton principles?	Yes
Will implementation go beyond minimum EU requirements?	Yes
What is the value of the proposed offsetting measure per year?	£ n/a
What is the value of changes in greenhouse gas emissions?	£ n/a
Will the proposal have a significant impact on competition?	No
Annual cost (£-£) per organisation (excluding one-off)	Micro Small Medium Large
Are any of these organisations exempt?	N/a N/a N/A N/A

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)
Increase of £	Decrease of £	Net Impact £ See above

Key: Annual costs and benefits: Constant Prices (Net) Present Value

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	No	No
Small Firms Impact Test	No	No
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	No	No
Disability Equality	No	No
Gender Equality	No	No
Human Rights	Yes	No
Rural Proofing	No	No

Annexes

http://www.hm-treasury.gov.uk/consult_special_resolution_regimes.htm