



HM Treasury

# Secondary legislation for Non-Bank resolution regimes:

summary of responses

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June 2014





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# 1

## Introduction

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**1.1** The Special Resolution Regime (SRR) established by the Banking Act 2009 currently extends to most deposit taking institutions (banks and building societies). The Financial Services Act 2012 widens the SRR to include investment firms and recognised central counterparties (CCPs) and other undertakings in the same group as a failing entity (a 'banking group company' (BGC)).

**1.2** On 26 September the government published the consultation document *Secondary Legislation for Non-Bank resolution regimes*.<sup>1</sup> This sought comment on 5 statutory instruments required to underpin the widened SRR. The five instruments will:

- exclude smaller investment firms from the scope of SRR
- specify conditions for inclusion of group undertakings within SRR
- introduce additional partial property transfer safeguards for the wider scope of the SRR (in relation to BGCs and CCPs)
- amend 'no creditor worse off' safeguards to cover investment firms
- make amendments to the existing Bank Administration Procedure (BAP)

**1.3** The consultation closed on the 21 November 2013. The government received 10 written responses from industry and individuals. During this time, the government also met to consult with a wide range of industry stakeholders. The purpose of this document is to summarise these responses and outline the next intended steps for the government.

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<sup>1</sup> This consultation document can be found at: <https://www.gov.uk/Government/consultations/secondary-legislation-for-non-bank-resolution-regimes/secondary-legislation-for-non-bank-resolution-regimes>



# 2

## Summary of responses

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**2.1** The government received 10 responses to the consultation. This paper sets out the questions asked, a summary of the responses received and the position taken by the Treasury with respect to each question having considered the responses received.

### **Question 1: Do you have any specific recommendations for required updates in the Code of Practice?**

**2.2** Broadly speaking, respondents sought clarification regarding the application of stabilisation powers with respect of CCPs and opined that this should be reflected in the Code of Practice. It was highlighted that there is need for a separate section within the Code of Practice relating to CCPs. Respondents, in particular, suggested that the Code of Practice should discuss the use of partial property transfers (PPTs) by Authorities to resolve a CCP.

**2.3** The government notes these concerns and will include a separate section within the Code of Practice which will set out guidance as to how the special resolution regime will be applied to CCPs.

**2.4** Respondents also opined that the Code of Practice could acknowledge that with regards to CCPs there are alternatives to a PPT and that these alternatives might sometimes be equally effective and less disruptive and complex than a PPT.

**2.5** The government acknowledges that a CCP could design its default management processes in such a way that if a segregated clearing service is no longer viable there is limited recourse to the CCP's other solvent clearing services. Whilst this presents an alternative mechanism in some circumstances to a PPT it does not mitigate the need for the PPT power. If the CCP is the sole provider of clearing service, the process outlined above results in the failing product line being closed down and subject to mandatory tear up. This could potentially result in the cessation of clearing services which would be detrimental to financial stability.

### **Question 2: Do you have any further comments concerning updating the Code of Practice?**

**2.6** No responses were received.

**2.7** A draft of annex to the Code of Practice outlining how the SRR will apply to CCPs has been included as Annex B within this response document. The Code of Practice will be updated to reflect the amendments to the Banking Act 2009 by the Financial Services Act 2012. The government aims to publish the Code of Practice in autumn 2014.

### **Question 3: Do you agree with the exclusion of non- €730k investment firms from the scope?**

**2.8** Respondents agreed with the need to exclude non-€730k investment firms, recognising that these would not pose a threat to UK financial stability. The Banking Act 2009 (Exclusion of Investment Firms of a Specified Description) Order 2014 excludes a type of firm from the definition of "investment firm" in s258A of the Banking Act 2009. The firms excluded are firms referred to in Article 29 of Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (the Capital Requirements Directive), which are not required to have initial capital of EUR 730 000.

**2.9** The activities of an investment firm which is subject to the €730,000 capital threshold differ from the activities of a non-€730,000 investment firm, and having regard to those differences

the government does not think it is appropriate to extend the SRR to non-€730,000 firms. The government does not consider that there is any competitive advantage in being caught within the scope of the SRR.

**Question 4: Do you feel this is the correct threshold, bearing in mind that the regime will be applied in a proportionate manner to those firms in scope?**

**2.10** Some respondents noted that some Multilateral Trading Facilities (MTF) have €730K status but pose little threat to UK financial stability.

**2.11** Whilst the government understands this concern, the proposal for the SRR to be applicable to €730k firms is consistent with the proposed Directive on Bank Recovery and Resolution (the BRR Directive), which is to be adopted shortly. Its transposition date is 31 December 2014 and its implementation date is 1 January 2015.

**Questions 5 and 6: Do you agree with the proposed specification of firms to be considered BGCs? If you disagree, how would you prefer the specification to be approached?**

**2.12** Respondents disagreed with the specification of BGCs, suggesting that the definition was too complex and gave rise to legal uncertainty. For example, with regard to CCPs, some respondents felt that it would unintentionally include other financial market infrastructures (FMIs).

**2.13** The government acknowledges these concerns and has revised the draft BGC order to remove legal uncertainty. The draft order published in the consultation proposed that stabilisation powers could be used over a sister company of a bank only to the extent that it was a subsidiary of the “resolution group holding company”. The concept of resolution group holding company has been removed, so that the Bank can use its powers over any parent company of the bank in resolution or any subsidiary of any parent in the group. Whilst this approach does broaden the definition of BGC, it has the advantage of simplifying the order, reducing complexity and removing legal uncertainty. This does not mean that SRR powers may be exercised without constraint with respect to any parent company of the bank or group subsidiary. The exercise of the Bank’s powers will be subject to the Code of Practice and additional safeguards (as follows).

**2.14** The effect of the changes is that a BGC may be a parent or subsidiary undertaking of the failing bank, CCP or investment firm, or another company in the same group. For these purposes the subsidiary may be outside the financial sector, so that, for example, stabilisation powers may be exercisable in respect of a company providing electronic payment services or IT support to the failing bank or other entity being resolved. The exercise of the power must be necessary having regard to the public interest tests in section 81B of the Banking Act 2009 and the additional necessity test being implemented with respect to partial property transfers (PPTs) by article 4 of the BGC Order (the amendment of the Banking Act 2009 (Restriction of Partial Property Transfers) Order 2009) and article 9 of the draft Banking Act 2009 (Restriction of Partial Property Transfers) (Recognised Central Counterparties) Order 2014 (equivalent provision for CCP group companies).

**2.15** Furthermore, the government will use the Code of Practice to reiterate the policy intent that in exercising resolution powers over BGCs, the Bank of England (the Bank), will only do so as necessary to achieve the objectives of the SRR. Therefore the Bank will not apply resolution tools to holding companies beyond the resolved entity’s most immediate parent, or subsidiaries of that parent, unless the Bank believes doing so is *necessary* to meet the objectives of the SRR. The Bank must act reasonably and proportionately, and must consult the PRA, the FCA and the Treasury.

**2.16** Since the publication of this consultation the final text of the BRR Directive has been agreed. While the BGC Order does not implement the Directive, it is intended to be compatible with relevant requirements of the Directive. In particular, the Directive will extend resolution powers to mixed activity financial holding companies (MAHCs), but will exclude a MAHC from

the exercise of resolution powers if the bank is a subsidiary of an intermediate financial holding company. In the case of an “excluded MAHC” resolution powers would have to be exercised with respect to the intermediate financial holding company.

**2.17** Under the BGC Order that company or, if there is none, the MAHC will be caught as parent undertakings. The subsidiaries of an excluded MAHC (apart from a parent of the bank, including the intermediate financial holding company, if there is one, bank subsidiaries and the bank itself) are only within the scope of the SRR if they are financial institutions or subsidiaries of a financial institution. The effect is that SRR powers may not be exercised in respect of a subsidiary of an excluded MAHC which is none of the following: a parent or subsidiary of the bank; a financial institution; a subsidiary of a financial institution.

**Question 7: The definition of ‘financial holding company’ is set in relation to its subsidiaries being exclusively or mainly of a particular type e.g. entities engaged in financial services and entities exclusively or mainly providing services or facilities to those entities. Do you think the use of ‘exclusively or mainly’ provides adequate clarity in the definition of a financial holding company, and therefore the scope of the SRR in relation to BGCs?**

**2.18** Respondents felt that the definition of ‘financial holding company’ did not provide adequate clarity and legal certainty. Respondents suggested using a definition of financial holding company which is more consistent with existing legislation.

**2.19** The government acknowledges these concerns and has amended the definition such that a financial holding company is: (a) a financial institution as defined in Regulation (EU) No. 575/2013 on prudential requirements for credit institutions and investment firms (the Capital Requirements Regulation); and (b) a parent whose subsidiaries are exclusively or mainly credit institutions; financial institutions; investment exchanges; investment firms or central counterparties. Except investment exchanges, these types of institution are all defined in the BGC Order or in the Banking Act 2009.

**2.20** Some respondents felt that it was unclear that Section 81B of the Banking Act 2009 was applicable to CCPs. The government acknowledges that there is no express provision for this in the BGC Order. But as a point of law it is clear that a CCP is a bank for the purposes of Part 1 of the Banking Act 2009, and therefore for the purposes of the BGC Order, and that ‘banking group company’ includes a company in the same group as a CCP. This is because Part 1, including s81B, applies to CCPs (with modifications) “as it applies to banks” (s89B).

**2.21** In response to this question as well some respondents expressed concerns about the scope for using SRR powers with respect to group subsidiaries (whether they should be subsidiaries of the ‘resolution group holding company’). This issue has been resolved by the changes described above (under questions 5 & 6).

**Question 8: Do you think the capital markets arrangements exemption is required in this order?**

**2.22** Respondents agreed with the inclusion of the capital markets arrangements exemption within this order.

**2.23** The BGC Order will protect capital market arrangements, such as covered bond vehicles, alongside existing safeguards, by providing an exemption from the exercise of stabilisation powers. The Code of Practice will be updated to reflect this. But an undertaking which is a covered bond vehicle or a securitisation company is within the scope of SRR if it is an investment firm or financial institution. Many covered bond vehicles and securitisation companies are investment firms or financial institutions, and as the latter are within the scope of the BRR Directive, such vehicles and companies cannot be excluded from the conditions laid down for defining a BGC if the Order is to be compatible with that Directive.

**2.24** A covered bond vehicle or a securitisation company which is not an investment firm or financial institution is excluded from the scope of SRR.

**Question 9: If this exemption is necessary, are the current provisions framed in a sufficiently powerful but flexible way as to provide legal certainty?**

**2.25** Respondents felt that greater legal certainty could be achieved by referring to existing legislation which defines ‘covered bond vehicles’ for taxation purposes. Also, it was argued that ‘securitisation companies’ as well as ‘covered bond vehicles’ should not be within the scope of the SRR. The government recognises that the protection of covered bond vehicles and securitisation companies where SRR powers are exercised with respect to a bank or other entity in the same group, and has amended the exemption in the draft BGC Order to provide greater legal certainty (while reducing the scope of the exemption for reasons given under question 8).

**2.26** A covered bond is a bond issued by a credit institution under which, for the protection of bondholders, sums deriving from the issue of the bond are invested in assets which are capable of covering claims attaching to the bond and, in the event of the issuer’s insolvency, would be used as a priority to reimburse the principal and pay accrued interest. This is achieved by pooling the assets within a bankruptcy-remote special purpose vehicle, which guarantees payments due under the covered bonds pursuant to a guarantee secured over the assets.

**2.27** The vehicle used for this purpose is a limited liability partnership. It is defined in terms of being a party to a capital market arrangement within the meaning given in s72B of IA 1986 (see paragraph 1 of Schedule 2A to that Act) whose business is to provide guarantees or acquire, own and manage assets forming the whole or part of the security for the arrangement.

**2.28** A securitisation company is a bankruptcy-remote special purpose vehicle to which assets are sold in return for immediate cash payment. The company raises the cash through the issue of debt securities in the form of tradable notes or commercial paper. A “securitisation company” is a company which meets conditions set out in s 83(2) of the Finance Act 2005 or regulation 4 of the Taxation of Securitisation Companies Regulations 2006.

**2.29** So far as the BRRD Directive allows, which depends on the SPV’s structure, a covered bond vehicle or securitisation company is not a BGC. If the bond issuer were to fail, the arrangements described ensure that the asset pool would be segregated and payments to bondholders would be protected. It is not necessary for SRR objectives to enable stabilisation powers to be exercised in respect of the SPV; and so far as EU law allows it is important to exclude it on grounds that are legally certain.

**2.30** The BGC Order does not exempt a “warehouse company”, which is a company established to acquire and hold financial assets with a view to transferring them to a company which will make the securitisation. A warehouse company is not a securitisation company for these purposes, so that it may be the subject of stabilisation powers, because the assets it holds have not been securitised at that stage.

**Question 10: Are there other entities you would wish to see excluded? If so, what are they and why should they be excluded?**

**2.31** Respondents felt that subsidiaries which act wholly or mainly as a nominee or trustee and issuers of capital market investments should be excluded from the scope of SRR powers.

**2.32** With regards to these entities respondents felt should also be excluded from the scope of SRR, the government’s position is that SRR powers would not in practice be exercised over these entities (under principles governing their use and purpose), so that it would not be appropriate to make an exemption for them. The Code of Practice will set out how resolution powers are to be used with respect to BGCs.

## Question 11: Do you have any views on how the specifications are framed in the draft order?

**2.33** Respondents were concerned about the lack of any reference to investment firms and CCPs in the s81D definition of 'banking group company' (which is given fuller meaning by the BGC Order). As explained above in relation to the status of a CCP as a 'bank' in Part 1 of the Banking Act 2009 and the BGC Order, it is clear as a matter of law that 'banking group company' includes a company in the same group as a CCP and an investment firm. This is because Part 1, including s81B, applies to CCPs and investment firms (with modifications) "as it applies to banks" (ss89A & 89B).

**2.34** The position is different under the Banking Act 2009 (Restriction of Partial Property Transfers) Order 2009, which the BGC Order amends to introduce an additional necessity test for PPTs. The 2009 Order applies to a 'banking institution', which includes a bank, as defined in s2 of the Banking Act 2009, a building society and a BGC. A BGC whose property etc. is to be transferred is a banking institution because it is 'a bank' for these purposes (s81C provides that when the Bank exercises a stabilisation power in respect of a BGC, provisions relating to the powers and "any other enactment" apply with any necessary modifications "as if the BGC were a bank"; the 2009 Order 2009 is another enactment for these purposes). As regards investment firms, the BGC Order amends the 2009 Order so that an investment firm, like a building society, is a banking institution for the purposes of that Order.

**2.35** A CCP is not a banking institution. The Treasury is to make a separate order to enact equivalent safeguards with respect to CCPs and CCP group companies.

**2.36** Respondents welcomed provision restricting the application of PPTs with respect to BGCs to property or rights of the BGC which are needed for carrying on the business of the failing bank, but suggested that during the resolution of a parent undertaking, Authorities may sensibly want to make a PPT with respect to some of the business of a subsidiary of that parent where the PPT is indirectly necessary for the carrying on the business of the failing bank.

**2.37** The government acknowledges this point. The additional necessity test has been widened so that a PPT with respect to a BGC is restricted to property or rights of the BGC which are necessary for carrying on any business of a banking institution (including the failing bank, in respect of which the Bank proposes to exercise, or has exercised, a stabilisation option) or of any CCP or other BGC which is (or, but for the exercise of a stabilisation power, would be) in the same group as the BGC whose property etc. is to be transferred.

**2.38** At the same time the government recognises that the additional necessity test should not apply if the BGC whose property etc. is to be transferred is a financial institution (as defined in the BGC Order). This is in addition to the existing proposal to exclude the necessity test in the case of a BGC which is a parent undertaking of the failing bank. (Also, it is recognised that liabilities as well as property and rights may need to be transferred).

**2.39** The BGC Order amends the 2009 Order to introduce the further test for the protection of anyone who may be affected by a PPT in respect of the property, rights or liabilities of a BGC which is not a parent undertaking of the failing bank or a financial institution. The BGC may, for example, be a company that provides essential electronic payment services for the group's banking business. The test would be satisfied if the transferred property, rights or liabilities were needed for any part of any business in the group, even if it were not the business of the failing bank. So, for example, a partial property transfer may be justified on the ground that it is necessary for carrying on the business, or any part of the business, of another BGC (and no other group business). It does not matter if any of that business has already been transferred in the exercise of stabilisation powers.

**2.40** The additional test is narrower than the public interest tests in s81B of the Act, and does not affect the application of those broader tests.

**2.41** As a result of these changes SRR powers may be exercisable to transfer the property etc. of a BGC whether or not the transfer is necessary to carry on the business of the failing entity itself. For example, if a subsidiary of the parent company of the failing entity provides services to that entity and for that purpose is dependent on the provision of essential services by another subsidiary, it might be feasible to transfer property, rights or liabilities of both subsidiaries.

**Question 12: Do you think extending the PPT order, as it stands, to investment firms is sufficient?**

**2.42** Nil response.

**2.43** The UK government does not believe that it is necessary to amend the Banking Act 2009 (Restriction of Partial Property Transfers) Order 2009 in any other way for the purpose of extending it to investment firms. The safeguards in place with respect to partial property transfers will be equally applicable where an investment firm is the transferor, and in such cases will protect contractual and market arrangements in the same way as for any other 'banking institution' whilst maintaining the flexibility of the special resolution regime.

**Question 13: Are there further safeguards you would like to see in place, and why?**

**2.44** Nil response.

**Question 14: Do you feel sufficient protection is provided for clients in line with the new client protection objective of the resolution regime?**

**2.45** Respondents raised concern over the protection of clients' assets where Authorities were to take resolution action with respect to a CCP prior to the completion of a CCP's default management procedures.

**2.46** The government acknowledges these concerns. However the government would stress that the triggers for exercising stabilisation powers with respect to CCPs mean that the Bank will only be able to exercise stabilisation powers where the likelihood is that the CCP will be unable to maintain critical services whilst continuing to satisfy the recognition requirements, and in any event, client assets will benefit from the various protections provided for by EMIR and the FCA's CASS.

**Question 15: In the 2009 Order the definition of title transfer collateral arrangements requires that both the collateral-provider and collateral-taker are non-natural persons. Should this definition be amended to include title transfer collateral arrangements entered into by real persons?**

**2.47** A respondent welcomed the widening of the definition of title transfer collateral arrangements so that both the collateral-provider and the collateral-taker can be real persons, or non-natural persons. As there was not significant support for this change the government does not intend to amend the definition of title transfer collateral arrangements to include arrangements entered into by real persons.

**Question 16: Are there any practical considerations that the government will need to address to ensure these safeguards work as planned?**

**2.48** Nil response.

**2.49** The government intends to proceed with the implementation of safeguards to ensure the protection of contractual and market arrangements with the intention of mitigating negative market consequences to creditors and counterparties.

**Questions 17 and 18: Do you agree there should be a broad safeguard to limit PPT powers over the assets of a BGC that are not involved in the business of the failing entity? Are there any other type of assets that you feel should be excluded?**

**2.50** Broadly speaking respondents agreed with the need to limit PPT powers so that they would not be exercisable with respect to the assets of a BGC unless the transfer proposed was necessary for carrying on the business of the failing bank. But as discussed above (paragraphs 2.35 to 2.41) respondents suggested that during resolution Authorities may sensibly seek to make a partial property transfer with respect to a company in the failing bank's group even if the transfer were necessary for other group business rather than for the business of the bank itself.

**2.51** Accordingly, the BGC Order amends the Banking Act 2009 (Restriction of Partial Property Transfers) Order 2009 so that the additional necessity test may be satisfied where the transfer is needed for carrying on the business of any banking institution, CCP or other company in the same group as the BGC. But this further safeguard does not apply where the transferor under the proposed PPT is a financial institution or a parent undertaking of the failing bank.

**2.52** Some respondents suggested that CCP group companies that provide FMI should be excluded from the scope of PPTs. Furthermore, some respondents expressed a preference for expressly excluding all CCP group companies from the SRR regime.

**2.53** The government notes the concerns expressed regarding the application of the SRR to CCP group companies, but responses to the consultation do not make it entirely clear what the concerns are or provide evidence to support the proposal to exclude them from the scope of the regime.

**2.54** The objective of these powers is, in particular, to ensure that any intra-group service provision to the failing CCP remains in place while a CCP is in resolution. Before making any transfer in respect of a CCP group company, the Bank would look to rely on the continuity obligations provided for in the Act and only where these were found to be ineffective would the use of transfer powers be considered. For example, where a group company providing services to the CCP is insolvent itself, the imposition of continuity obligations on the group company may not be effective. The Bank must have regard to the need to minimise the effect of the exercise of powers on other undertakings in the same group.

**2.55** As mentioned above, the government also proposes to restrict the PPT of a CCP group company such that a partial transfer of the business of the group company would not be possible unless the transfer is necessary for the carrying on of the relevant business (i.e. the business of the CCP itself).

**Question 19: Do you agree with the proposed action to be taken following breach of the new safeguards?**

**2.56** Respondents agreed that the action to be taken where the Authorities are notified that a PPT is in breach of the new safeguard (the additional necessity test for a PPT made with respect to a BGC) should be governed by article 12 of the 2009 Order, which applies to the contravention of any provision of the 2009 Order other than a provision relating to continuity powers, set-off and netting or compliance with EU law.

**Question 20: Do you have any views on how the new safeguard is framed in the draft order?**

**2.57** There was some concern that the new safeguard as well as existing safeguards for netting and set-off arrangements might prevent the Authorities from exercising transfer powers effectively. Specifically, there may be circumstances in which property needed for the provision of services to the bank, investment firm or CCP has to be excluded from a PPT because it is subject to set-off arrangements.

**2.58** As outlined above, a PPT may not transfer property, rights or liabilities of a BGC unless the property rights or liabilities are necessary for carrying on relevant business. Where it is necessary to transfer rights and liabilities which are part of a netting, set-off or collateral arrangement, the PPT can transfer them, as long as it transfers all of them. The existing safeguards do not exclude the

transfer of protected rights and liabilities, but require them to be kept together. The new safeguard does not exclude the transfer of protected rights and liabilities, as long as the transfer is necessary.

**Question 21: Do you agree with the proposed carve out for BGCs which are a parent undertaking of the bank?**

**2.59** Respondents were concerned with the carve-out for parent undertakings from PPT safeguards, noting that assets which may not be critical for the failing entity may be critical for other group entities.

**2.60** The effect of the carve-out for parent undertakings is that the new necessity test for making PPTs with respect to BGCs does not apply to a PPT made with respect to a BGC which is a parent of the failing bank. As in the case of a BGC which is a financial institution, the PPT may be made whether or not the new test is satisfied. Of course, the general public interest test in s81B of the banking Act 2009 will always be applicable, and the Bank must have regard to the need to minimise the effect of the exercise of powers on the rest of the group. Furthermore, it would be inconsistent with the BRR Directive to make PPTs with respect to parent undertakings and financial institutions subject to a tighter necessity test.

**Question 22: Do you agree with the approach of issuing a new order specifically concerning the resolution of CCPs?**

**2.61** Respondents broadly agreed with the issuing of a new order to deal with the resolution of CCPs. However some respondents commented that making a PPT in respect of a CCP may be practically difficult, in particular because of the impact that the partial transfer may have on netting arrangements.

**2.62** The government understands these concerns, however the government would highlight that the Order includes provision that has the effect of safeguarding netting arrangements that apply within segregated business lines, provision which is consistent with the BRR Directive.

**Question 23: Is the protection of netting at the level of a CCP's segregated business lines (and the default waterfall associated with each segregated business line) appropriate?**

**2.63** Broadly speaking, respondents agreed with the need for protection of netting agreements at the level of the CCP's segregated business lines, however some had concerns surrounding the practicality exercising a PPT and sought further clarification of when a segregated business line can be transferred. Also, respondents highlighted that a default fund would not necessarily apply to a single financial instrument class which will prevent a PPT from being affected.

**2.64** The government notes these concerns and intends to address these concerns by providing guidance on the use of resolution tools with respect of CCPs in the Code of Practice.

**Question 24: Do you agree with the proposal to modify article 7?**

**2.65** Respondent's disagreed and were concerned with the proposal to remove protections put in place by Article 7 with respect to CCPs. Respondents opined that this would cause uncertainty and have a destabilising effect on markets. The central concern was that Authorities would take resolution action before default management procedures have been completed.

**2.66** Before exercising stabilisation powers in respect of a CCP, the Bank must have regard to any action that the failing CCP is proposing to take in order to ensure that it continues to be able to function effectively without breaching its recognition requirements. This would include any action that the CCP will have to take pursuant to the requirements of EMIR. Resolution action prior to the exhaustion of default management processes would be only taken when it is necessary in order to reach resolution objectives.

**Question 25: Do you agree with the removal of the safeguard around capital markets arrangements?**

**2.67** Nil response.

**2.68** The government feel the extension of the safeguards around capital markets arrangements for CCPs is unnecessary on the ground of relevance to the business, and operations of a CCP.

**Question 26: Do you agree with the removal of the safeguard concerning reverse transfers?**

**2.69** Respondents were concerned with the removal of reverse transfers safeguards, suggesting that if safeguards are to be removed on the basis that they are unlikely to be made then the reverse transfer provisions in the Act should not have been applied in the case of CCP resolution.

**2.70** The government accepts this concern and will leave the safeguard in place.

**Question 27. Are there any additional safeguards you would expect to be included that have not yet been considered, and what are they?**

**2.71** . Respondents felt that the CCP Safeguards Order should expressly protect set-off arrangements, netting arrangements and title transfer financial collateral arrangements.

**2.72** The CCP Safeguards Order provides protection for all positions which are netted within a segregated business line. A "segregated business line" in this context means a product set cleared by a CCP that has its own dedicated default protections. Where a CCP only has a single set of default protections (single default fund) but multiple product sets, all positions are protected and a PPT would not be possible. This will ensure netting arrangements are protected as the partial transfer of a CCPs clearing business can only be effected where a complete segregated business line is transferred wholly intact.

**2.73** Respondents commented that an equivalent of section 159(1) (d) of the Companies Act 1989 should be included in the CCP safeguards order. Section 159 does not need to be reiterated as it will apply in any event.

**2.74** Finally respondents argued that a PPT should not interfere with any client protection actions of porting or return of client assets which are required under EMIR.

**2.75** Client protection action of porting or return of client assets form part of the default management processes a CCP deploys and as such the Bank must have regard to such actions when considering if resolution action is necessary.

**Question 28: Do you feel any of the proposed safeguards are superfluous and why?**

**2.76** Respondents did not feel that any of the proposed safeguards were superfluous.

**Question 29: Do you agree that no changes are required to the NCWO Order?**

**2.77** Nil Response.

**Question 30: Do you have any concerns over the likely effectiveness of the safeguard Regulations as they are presently framed?**

**2.78** Nil response.

**Question 31: Do you agree that there is no need for a NCWO order to specify the terms to be applied when a clearing house compensation order is made under 89F in the case of PPT?**

**2.79** Respondents disagreed, stating that a NCWO order should be made for CCPs in order to provide clarify on what basis creditor will be deemed worse off as a result of resolution rather than liquidation.

**2.80** The government notes these concerns, however would highlight that it is very difficult, due to the nature of a CCP and the complexity of PPTs, to prescribe now the terms under which it would be appropriate to compensate third parties. It is anticipated that compensation orders would only be made in exceptional circumstances. As such, anticipating these circumstances ex ante would be very difficult.

**Question 32. Do you have any specific recommendations for terms that needed to be updated for the extension of these rules to investment firms? Or to BGCs?**

**2.81** Nil response.

**Question 33. Do you have any further comments?**

**2.82** Nil response.

**Question 34. Do CREST clearing members believe there is an increased perceived risk as a result of the extension of secured liabilities safeguard with respect to floating charges? If yes, and if possible, please provide evidence of these effects being observed in relation to deposit takers already in the scope of the existing regime.**

**2.83** Respondents felt there was an increased perceived risk as a result of the extension which would adversely impact confidence in the CREST system. No evidence of the effects in relation to deposit takers was provided.

**2.84** The government is confident that the degree of uncertainty should be perceived as small. First, the Bank will always act to adhere to the PPT safeguards in making a transfer; and second, the Authorities have confidence in the compensation mechanism that protects parties affected if the PPT safeguards are broken.

# 3

## Next steps

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**3.1** The information published in this document provides a brief summary of the responses to the consultative document, *Secondary Legislation for Non-Bank resolution regimes*, published on 26 September 2013, and the government's position with respect to points raised.

**3.2** The government is grateful for the responses received, and has continued to work with and engage with both industry and stakeholders in developing this legislation. The government will now implement the secondary legislation to amend the Banking Act 2009.





# List of respondents

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Allen and Overly LLP

Baillie Gifford and Co

Barclays

City of London Law Society

Clifford Chance LLP

Euroclear SA/NV

HSBC

ICE Clear Europe Limited

International Swaps and Derivatives Association, Inc. (ISDA)

London Stock Exchange Group (LSEG)



# B

# Draft CCP annex to Code of Practice

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## Introduction

**B.1** This annex sets out how the Banking Act 2009 (“the Act”) applies to UK central counterparties (CCPs). This annex to the Code of Practice supports the legal framework of the special resolution regime (“SRR”) under Part 1 of the Act, and provides guidance as to how and in what circumstances the Bank of England, as the resolution authority, will use stabilisations powers with respect to CCPs.

**B.2** Under the Act (as amended by the Financial Services Act 2012) the Bank of England has the following stabilisation powers with respect to recognised central counterparties (“CCP”):

- (a) The power to transfer some or all the business of a CCP or its group undertaking to a commercial purchaser.
- (b) The power to transfer some or all the business of a CCP or its group undertaking to a bridge CCP (a company wholly owned and controlled by the Bank of England);
- (c) The power to transfer the ownership of the CCP to any person.

**B.3** Under options (a) and (b), the Bank of England can transfer membership agreements, which preserve the position of each member together with the rules of operation of the failed CCP.

**B.4** There are outstanding changes that need to be made to the Code in order to reflect changes to the regulatory architecture, and other changes to the resolution regime introduced in the Financial Services Act 2012 and the Financial Services (Banking Reform) Act 2013. This annex broadly reflects these changes (for example, referring to the Prudential Regulation Authority (the “PRA”) and the Financial Conduct Authority (the “FCA”), rather than the FSA) but does not attempt to make all of the changes necessary. These changes will be made in due course, and this annex will be replaced by, and incorporated within, a fully updated version of the Code which will reflect all of these recent changes.

## Contents

**B.5** In accordance with section 5 of the Act, this annex sets out guidance as to how the special resolution regime will be applied to CCPs. In particular, it sets out:

- how the special resolution objectives are to be understood and achieved
- the information that is to be provided in the course of a consultation under this Part (i.e. information to be provided as part of any consultation between the authorities and the giving of advice between one authority and another)
- guidance as to the giving of advice by one relevant authority to another about whether, when and how the stabilisation powers are to be used
- how to determine whether Condition 2 in section 7 is met (this condition stipulates that before a stabilisation power can be exercised in respect of a CCP, the Bank must have determined that it is not reasonably likely that, excluding the use of stabilisation powers, action will be taken by or in respect of the CCP that will enable

it to maintain continuity of any critical clearing services it provides while also satisfying recognition requirements)

- how to determine whether the public interest test for the use of stabilisation powers in section 8 is satisfied
- how the requirements of sections 63 and 66 (general continuity obligations) are to be complied with
- the basis upon which compensation may be payable as a result of the use of a stabilisation power

**B.6** Section 12 also requires the inclusion in the Code of certain matters relating to the governance of bridge CCPs.

### **The authorities regard to the Code**

**B.7** The authorities are legally obliged to have regard to the Code under section 5(4) of the Act.

**B.8** The Treasury considers that one of the primary purposes of this annex to the Code is to provide a clear guide for market participants and the public to how the authorities will seek to achieve the special resolution objectives and how the SRR powers may be used in practice. Therefore, in addition to describing the legal powers, the annex also sets out the authorities' policy approach to using these powers. The authorities must 'have regard' to these statements of policy intention (under section 5(4) of the Act) when exercising the SRR powers. The statements of policy intention in the Code should therefore provide a greater insight into how the authorities would expect to act in order to achieve the special resolution objectives.

**B.9** Consistent with the rest of the Code, this annex should be viewed as a guide to the most likely use of the powers with regard to CCPs. The powers may be exercised in a range of ways, provided that these are consistent with the special resolution objectives set out in section 4 of the Act. So while the authorities must have regard to the Code (including this annex), they are not necessarily bound to adopt an approach recommended in the Code where circumstances arise which mean that another approach better meets these objectives.

### **Banking Liaison Panel**

**B.10** Consistent with its commitment in the current Code, the Treasury will consult the Banking Liaison Panel when making material changes to the Code, including changes to this annex.

### **Special resolution objectives**

**B.11** Section 4 of the Act provides for the special resolution objectives, modified with regards to CCPs as follows:

- objective 1 is to protect and enhance the stability of the financial systems of the UK
- objective 2 is to protect and enhance public confidence in the stability of the financial system
- objective 3 is to maintain the continuity of CCP clearing services
- objective 4 is to protect public funds
- objective 5 is to avoid interfering with property rights in contravention of a Convention Right (within the meaning of the Human Rights Act 1998)

**B.12** The Bank of England shall have regard to the special resolution objectives in using or considering the use of the stabilisation powers.

## Matters to be considered in having regard to the objectives

**B.13** Specific terms used within the objectives are not generally defined by the Act. Therefore, this annex provides further explanation as to how the objectives may be achieved by outlining the factors that the authorities may consider to be relevant in applying them.

### Stability of the financial systems of the UK

**B.14** The term “stability of the financial systems of the UK” refers to the stable functioning of the systems and institutions (including trading, payment, clearing and settlement infrastructure) supporting the efficient operation of financial services and markets for purposes including capital-raising, risk-transfer, and the facilitation of domestic and international commerce in addition to day-to-day banking operations.

**B.15** By virtue of section 4(6) of the Act, the reference to the stability of the financial systems of the UK includes in particular a reference to the continuity of central counterparty clearing services. Continuity of central counterparty clearing services is relevant not only for the protection of public confidence in the stability of the financial system under objective 2, but has wider relevance to the stability of the financial systems of the UK.

**B.16** The intention of the first objective is to (a) recognise the wider systemic risks posed by the potential or actual failure of a central counterparty or group of companies containing a central counterparty; and (b) require the authorities to have regard to the likely systemic impact of their actions (including a decision not to act) when considering whether to use a SRR tool.

**B.17** The authorities will have regard to ensuring that the transfer powers are not exercised in a manner that is likely to harm financial stability. As part of this, in transferring rights and obligations that confer a particular status the authorities will seek to ensure that this status is not transferred to an unsuitable entity.

**B.18** In carrying out a resolution, the authorities will seek, where possible, to minimise operational disruptions to critical market infrastructure. Where appropriate, this may involve liaising with the relevant parties in order to understand the different risks and stresses associated with the timing of resolution actions and market openings; and taking steps to minimise disruptions which may arise where the failed institution has links to other financial market infrastructures and trading venues. Consideration will also be given to the impact of resolution on the functioning of the financial markets where this may have implications for the stability of the financial systems of the UK.

### Public confidence in the stability of the financial system

**B.19** The term “public confidence in the stability of the financial system” refers to the crucial role that public confidence has in maintaining the stable and efficient operation of financial services and markets.

**B.20** Public confidence has a number of dimensions with regards to CCPs. For example, it refers to the expectation that (a) problems (or perceived problems) in one CCP will not extend to other institutions (contagion); and (b) if an institution does fail, systems exist to mitigate the impact on markets and asset classes cleared by the CCP.

**B.21** The intention of the second objective is to provide that the authorities have regard to the need to act so that a failing CCP will be resolved in a manner that protects and enhances public confidence in the financial system as a whole.

## Maintain the continuity of central counterparty clearing services

**B.22** The term “maintain the continuity of central counterparty clearing services” refers to the central role that CCPs play in the efficient functioning of the financial system. A particular CCP may be the sole provider of clearing services in respect of a particular asset class or a given trading platform and thus can be seen as an essential part of the financial system. CCPs can be strongly interconnected with clearing members and other financial market infrastructure in the trading and post trading chain thus creating a high risk of contagion. Continuity of a CCP’s systemically important clearing services is vital to maintain public confidence and the stability of the financial system as a whole.

## Protection of public funds

**B.23** The term “protection of public funds” refers primarily to the protection of taxpayers’ interest in the effective expenditure of public money. The intention of the fourth objective is to recognise the strong duty of the authorities, and particularly the Treasury, to protect public funds in taking decisions with implications for public funds.

## Avoiding interference with property rights

**B.24** The term “avoiding interfering with property rights in contravention of a Convention right” refers in particular to holders of property rights in a failing CCP. This can include the CCP itself, its shareholders, creditors, members or other third parties. Such persons may hold property in the failing CCP, or have a right of control over such property, or both. The primary Convention right at issue is Article 1 of Protocol 1 to the Convention (right to property). The inclusion of this objective acknowledges the importance ensuring that any interference with the Convention rights is in the public interest and proportionate.

## Balancing the objectives

**B.25** Neither the Act, nor this annex to the Code, ranks the SRR objectives. Under section 4(10) of the Act, the objectives are to be balanced as appropriate in each case. This provision recognises that the relative weighting and balancing of objectives will vary according to the particular circumstances of each failure, including both (a) circumstances specific to the failing institution; and (b) general circumstances relating to the wider financial system.

## Authorities’ regard to objectives

**B.26** The special resolution objectives in the Act serve two purposes:

- they reflect the purpose of the SRR measures in the Act
- they set out the objectives to which the authorities must have regard when using or considering using their powers under the SRR

**B.27** This means that the authorities must consider the effect of their likely actions (including inaction) and assess them in light of the objectives. This applies to the exercise of all powers under Part 1 of the Act.

**B.28** In exercising the powers under Part 1, the Bank of England will also, as is the case with any public body in the exercise of its functions, necessarily have regard to restrictions and conventions of public law, in particular the requirement for the authorities to act rationally and reasonably.

**B.29** Following actions taken under the SRR, the Bank of England shall make a public statement explaining (a) the extent to which its actions have been informed by the special resolution objectives; and (b) how it has balanced the objectives against each other. The form that such an explanation will take will depend on the circumstances.

**B.30** However, it should be noted that it may not be possible to divulge certain information; for example, information the release of which would threaten financial stability or confidence in the financial system will not be made available by the Bank of England in any public statement.

## Roles of Authorities

**B.31** For CCPs the Bank of England is responsible for making the determination that the CCP is failing (or likely to fail) its recognition requirements. The Bank may treat the recognition requirements (meaning the requirements resulting from section 286 of the Financial Services and Markets Act 2000) as failed if there was a withdrawal or possible withdrawal of critical clearing services by a UK CCP.

**B.32** The Bank of England will be responsible for the operation of the SRR, including the decision on which of the SRR tools to use, and its implementation.

**B.33** The Treasury will be responsible for decisions with implications for public funds, for ensuring the UK's ongoing compliance with its international obligations, and for matters relating to the wider public interest. The Treasury will also exercise a number of the ancillary powers under the SRR (particularly those where Parliamentary scrutiny is required), including the power to modify the law and powers in relation to compensation.

## General and specific condition for choosing the SRR tools

### Determining the regulatory pre-condition are satisfied

**B.34** A stabilisation power may be exercised with respect to a CCP only if the Bank of England is satisfied that the conditions prescribed in section 7 of the Act have been met. The first condition is that the CCP is failing, or is likely to fail, to satisfy the recognition requirements.

**B.35** The second condition is having regard to timing and other relevant circumstances it is not reasonably likely that (ignoring the stabilisation powers) action will be taken by or in respect of the CCP that will enable the CCP to maintain continuity of any critical clearing services it provides while also satisfying the recognition requirements. CCP services are deemed 'critical' if the removal of such services, in the Bank of England's opinion, would threaten the stability of the financial systems of the UK.

**B.36** The Bank of England may treat condition 1 as met if satisfied that it would be met but for the withdrawal or possible withdrawal of critical clearing services by the CCP. Before determining whether or not condition 2 is met the Bank of England must consult the Treasury and FCA. The BoE must also consult the PRA if the CCP is a PRA authorised person.

**B.37** When considering whether condition 2 is met the Bank of England must have regard to any action that the failing CCP is proposing to take to ensure that it continues to be able to function effectively without breaching its recognition requirements. This would include any action that the CCP will have to take pursuant to the requirements of EMIR. For example, in the event of member default, deployment of default management processes and where losses arise for other reasons 'non default losses'<sup>1</sup>, use of CCPs capital specifically held to cover non default losses. Resolution action prior to the exhaustion of default management processes would be only taken when it is necessary in order to reach resolution objectives.

**B.38** Client protection action of porting of assets and positions held for the accounts of clients, or liquidation of those positions and return of those assets, form part of the default

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<sup>1</sup> Where loss does not arise as a result of a member default but, for example, from an operational failure, fraud or treasury loss.

management processes a CCP deploys and as such the Bank of England must have regard to such actions when considering if condition 2 is met.

**B.39** The recognition requirements mean the requirements resulting from section 286 of the Financial Services and Markets Act 2000. The recognition requirements represent the minimum conditions that a CCP is required to satisfy, and continue to satisfy, in order to act as a CCP.

**B.40** Once they are authorised under Regulation (EU) 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (OJ No L 201, 27.7.2012, p 1) (“EMIR”), the recognition requirements CCPs will have to satisfy will include a requirement to comply with EMIR (which includes provision on counterparty and liquidity risk, capital, governance and conduct requirements).

### **Determining that the specific conditions are met**

**B.41** Under Section 8 of the Act, the Bank of England may only exercise a stabilisation power if satisfied that the exercise of the power is necessary having regard to the public interest in:

- the stability of the financial systems of the United Kingdom
- the maintenance of public confidence in the stability of those systems of the United Kingdom

**B.42** The Bank of England must consult the Treasury, the FCA, and the PRA (in the event that the CCP is a PRA authorised person) before making this determination and deciding how to proceed.

**B.43** The test of “necessity” is a high one, and the Bank of England and the Treasury will necessarily have regard to public law restrictions, the authorities regard to the special resolution objectives and the duty to act compatibly with the Convention rights.

**B.44** If, having had regard to the public interest test, the Bank of England determines that it is necessary to exercise one of the SRR tools, the Bank of England will need to consider as a practical matter which of the tools it will be possible to use; and further, whether use of the tool would be compatible with the Bank of England’s legal obligations and the special resolution objectives.

### **The choice between tools**

**B.45** In choosing between tools, the Bank of England will consider the relative merits of the stabilisation powers.

**B.46** CCPs differ in nature from banks and therefore the approach the Bank of England will take with respect of CCP resolution will differ from bank resolution. Banks use their own capital to take credit risk and are remunerated on the amount of exposure they assume through credit extension. They also trade and take market risk. A CCP uses the collateral collected from each party, its mutualised default fund and any segment of CCP capital specifically allocated to be exposed to default losses to fill any losses it might incur in closing out the collateral-giving party’s obligations if it defaulted. In a default scenario a CCP is required to apply its own dedicated financial resources before contributions of non-defaulting members as part of the default management procedures under EMIR.

**B.47** The resolution strategy by the Bank of England may differ depending on whether the losses faced by the failing CCP were as a result of member default or non default losses.

**B.48** In the event of losses arising for a reason other than the default of a clearing member, as mentioned above, the CCP would generally use its own capital to cover these losses. EMIR stipulates that a CCP must hold capital to cover “credit, counterparty, market, operational, legal and business risks which are not already covered”. UK CCPs also have in place loss allocation arrangements for investment losses.

**B.49** Resolution by way of a transfer of some or all of the CCP to a private sector purchaser is generally likely to be a resolution option that could best meet the special resolution objectives, if it can be effected in a cost effective way. This option would allow continuity of clearing services. However, it may not be possible to transfer some clearing services easily and quickly due to the specificities of the sector. Finding a private sector purchaser may be more difficult in comparison to a bank due to the fewer number of firms in the industry and the different nature of CCPs' assets and liabilities. Even if a substitute provider is available, operational constraints such as system compatibility (eg IT infrastructure and account identification) may be an obstacle to effecting such a transfer.

**B.50** Resolution by way of a bridge entity may be appropriate where an immediate private sector sale is not possible and where a stable platform is needed to prepare for and effect an onward sale of all or part of the CCP to a private sector purchaser.

**B.51** Resolution by way of a partial property transfer (PPT) of some of the failing CCP to a bridge entity or private sector purchaser may be appropriate when the CCP incurs losses in a particular segregated product line that the default resources and loss allocation mechanisms cannot cover, so that losses reduce the CCP's financial resources to a level which is no longer sufficient to meet its recognition requirements.

**B.52** A PPT would be likely to involve the transfer of the positions and collateral associated with a segregated product line (or lines) cleared together with the systems, processes and legal arrangements (such as payment and settlement arrangements) facilitating operation of the relevant clearing service to the bridge entity.

**B.53** It is important to ensure that the relevant domestic and EU requirements which apply to the conduct of a CCPs business are complied with when making a PPT. Therefore, the occasions when the Bank of England would seek to use PPT powers are limited. To ensure collateral and netting arrangements are protected a partial transfer of a CCP's clearing business is only possible when a complete segregated business line could be transferred. A "segregated business line" in this context means a product set cleared by a CCP that has its own dedicated default protections. Where a CCP only has a single set of default protections (single default fund) but multiple product sets, all positions are protected and a PPT would not be possible.

**B.54** Further issues which the authorities will need to take into account in determining the feasibility of different tools include:

- the existence of, or likelihood of finding, a private sector purchaser;
- the likely saleability of assets and liabilities of the failing CCP, including whether a whole institution sale is viable;
- the feasibility of effecting a partial transfer in compliance with the safeguards set out in primary and secondary legislation;
- the operational risks of managing a bridge CCP, and the amount of public funding that may be required to keep it operational, including consideration of state aid issues; and
- the time available to implement a private sector sale, including for due diligence by potential purchasers.

**B.55** Before determining which of the stabilisation options to use, the Bank of England must consult the PRA if the CCP is a PRA authorised person, the FCA and the Treasury.

## Announcement of tools

**B.56** When publicly announcing any action to exercise the stabilisation options the Bank of England will explain the grounds on which it considers that the conditions for the exercise of the tool set out in section 8 are met. It should be noted that it may not be possible to divulge certain information where, for example, its release would threaten financial stability or confidence in the financial system.

## Ensuring that resolutions are effective

**B.57** There are a number of supplementary and ancillary powers that may be needed to ensure that resolutions are effective. This part of the annex provides further information on powers are covered by sections 63-70 (continuity obligations), 26, 28-31 (supplemental, reverse and onward share transfers), 42-46 (supplemental, reverse and onward property transfers) and 75 (power to change law).

### Supplemental, reverse and onwards transfers

**B.58** Under sections 26, 28-31, 42 - 46, the Act provides the Bank of England with the power to make supplemental onward and reverse transfer of securities and property. The Bank of England may make one or more onward or reserve transfer instruments. Supplemental transfers allow further transfers of property or securities from the original owner to a bridge CCP or private sector purchaser. Reverse transfers provide for property to be moved back from a bridge CCP or private sector purchaser to the previous owner, subject to certain restrictions. Onward transfers allow for the bridge CCP's property or shares in the bridge CCP to be transferred to a private sector purchaser or a Bank of England owned company. These powers increase the chances of a private-sector solution, reducing the barriers to an onward sale.

**B.59** The general and specific conditions in section 7 and 8 do not apply to onward or reverse transfers but sections 26, 28-31, 42 - 46 set requirements that the Bank of England must not make a onward or reverse transfers of securities of property unless the original transferee was a company wholly owned by the Bank of England, a nominee of the Treasury or a company owned by the Bank of England or the Treasury.

**B.60** As with all other forms of transfer, the Bank of England must consult with the PRA if the CCP is PRA regulated, the FCA and the Treasury before making the order.

**B.61** In the case of a CCP, the Bank of England has a power of direction over an insolvency practitioner appointed in relation to the CCP (under paragraph 35 of Schedule 17A to FSMA), which could be used by the resolution authority to ensure the continuity of support services to a resolved firm.

### Continuity obligations

**B.62** Where it is necessary to use a stabilisation option in respect of an individual CCP that forms part of a group of companies, the general continuity obligations will apply (see sections 63 to 70 of the Act).

**B.63** Group companies will be obliged under the continuity obligations to provide such services and facilities as the Bank of England or Treasury consider are necessary in order to enable the acquirer of the transferred business to operate it effectively. This general duty, however, is subject to a right to receive reasonable consideration (see section 63(4) and 66(4)).

**B.64** In addition, it may be appropriate to impose special continuity obligations. These obligations will be restricted to ensuring that necessary services and facilities continue to be provided in order to ensure that the part of the business is transferred can continue to be operated effectively.

**B.65** The special obligations provide powers to create, modify or cancel contracts and confer or impose rights and obligations between a transferee and the group companies of a residual CCP and the residual CCP itself – but only in relation to services and facilities required to operate the CCP business effectively. As far as is reasonably practicable, provision will be made to ensure that providers receive reasonable consideration for any services provided.

**B.66** For example, where there is a pre-existing committed funding arrangement, continuity obligations may provide for that arrangement to be continued to prevent cash flow from being disrupted while new funding arrangements are being put in place. Section 64(3) provides that the Bank of England shall aim to preserve or include provision for reasonable consideration and any other provision which would be expected in arrangements undertaken between two parties dealing at arm's length. In addition, subsection (4) provides that the powers under subsection (2) may be exercised only in so far as the Bank of England thinks it necessary to ensure the provision of such services and facilities as are required to operate the transferred business effectively, and that the Treasury must consent to the exercise of this power. These measures ensure that providers will not be placed under a disproportionate burden as a result of being subject to special continuity obligations.

**B.67** The Bank of England may only exercise these powers with Treasury consent, and Ministers will assess the broad public interest in the particular situation.

### **Transfer powers in relation to group companies**

**B.68** The Bank has the following power over the companies in the group of a CCP in resolution.

A transfer power over the “CCP financial holding company” and any subsidiary of this company or any financial holding company within the group. This power enables the Bank to transfer to a bridge entity or private sector purchaser rights or liabilities that are necessary for the maintenance of the CCP's clearing services.

**B.69** The objectives of these powers are, in particular, to ensure that any intra-group service provision to the CCP remains in place while a CCP is in resolution. In particular, in the situation in which the group company providing services to the CCP is insolvent itself, a power of direction would be unlikely to be effective. The Bank must have regard to the need to minimise the effect of the exercise of powers on the rest of the group.

**B.70** In line with legislation, in exercising resolution powers over group companies, the Bank of England will only do so as necessary to achieve the objectives of the SRR. Therefore the Bank will not apply resolution tools to banking group companies which are subsidiaries of holding companies beyond the subsidiaries of the resolved entity's most immediate holding company, unless the Bank believes that doing so is necessary to meet the objectives of the SRR.

**B.71** The test of “necessity” is a high one, in the first instance during resolution, the Bank of England would look to rely on the continuity obligations provided for in the Act and only when these are ineffective or are likely to be ineffective would the use of transfer powers be considered. For example, where a group company providing services to the CCP is insolvent itself, the imposition of continuity obligations on the group company may not be effective.

**B.72** Additionally, the Bank of England would look to resolve a BGC when resolution of the failing CCP alone or of its intermediate holding company would not achieve the objectives of the SRR.

**B.73** We would not normally consider that it would be appropriate to exercise the transfer power over a BGC solely for the purpose of supporting the residual CCP unless the residual CCP itself was still supporting the BGC.

**B.74** The Bank must consult the Treasury, the FCA and the PRA (in the event that the group company is a PRA authorised person) before making this determination and deciding how to proceed.

**B.75** As outlined in chapter 6 of the Code, the power to change law applies in the context of CCP resolution in the same manner it applies to Bank resolution.

### **Termination rights and events of default**

**B.76** As outlined in chapter 6 of the Code, section 38 and 22 apply to CCP resolution in the same manner it applies to Bank resolution. Section 6.33 of the code currently contains an outdated reference to the Financial Collateral arrangements Directive (FCAD). BRRD (Article 107) amends FCAD with the effect that, in certain circumstances, the Bank of England will be able to disregard certain FCAD restrictions when activating the SRR in respect of a CCP.

### **Partial Property Transfers and Safeguards**

**B.77** The property transfer powers (sections 33-48) provide the flexibility to transfer just some, but not necessarily all, of the property of a failing CCP. The Bank of England will exercise the power to effect a partial transfer when they believe that this approach will best meet the special resolution objectives.

**B.78** The most likely use for this power is to transfer part of an institution's business to a new entity – either a private sector purchaser or a bridge entity – with a 'residual entity' left behind, containing any assets and liabilities that are not transferred.

**B.79** The authorities recognise the significant potential for partial property transfers to interfere with vital market interests including set-off and netting arrangements and security interests. Partial property transfers under the Act are subject to restrictions imposed by secondary legislation that ensure that certain types of contractual arrangement are adequately protected, thereby mitigating any negative market consequences to CCPs and creditors. These legislative safeguards are intended to continue to allow the flexibility to effect a partial transfer of a CCP's property where necessary.

**B.80** The safeguards for partial property transfers are set out in The Banking Act 2009 (Restriction of Partial Property Transfers)(Recognised Central counterparties) Order 2014 (referred to as the 'CCP Safeguards Order').

**B.81** The Safeguards Order is kept under review by the authorities.

### **Safeguard for set-off and netting arrangements**

**B.82** The CCP Safeguards Order provides protection for all positions which are netted within a segregated business lines. A "segregated business line" in this context is defined as a product set cleared by a CCP that is covered by a segregated set of default protections.

**B.83** This will ensure netting arrangements are protected as the partial transfer of a CCPs clearing business can only be effected where a complete segregated business line is transferred wholly intact.

### **Protection for market contracts**

**B.84** This safeguard prohibits a partial property transfer when a transfer would render market contracts unenforceable.

### **Protection for secured liabilities**

**B.85** This safeguard prohibits a partial property transfer or the exercise of a continuity power from separating from any transferred liability any security that attaches to that liability.

## **Protection for trust arrangements**

**B.86** This safeguard protects terms at which property held on behalf of the CCP (typically custodians) to the extent that the terms of under which the property is held will be changed only to the extent necessary to give effect to the PPT.

## **Restrictions on reverse partial transfers**

**B.87** The Act allows for the use of transfer powers to transfer property, rights and liabilities from certain entities (including a bridge CCP) back to the residual CCP. However, the safeguards prevent the Bank of England from transferring back certain types of property, rights and liabilities.

## **'No Creditor worse off' provisions**

**B.88** For CCPs individual compensation orders are made under section 89F. It is very difficult, due to the nature and business of a CCP and the complexity of partial property transfers, to prescribe now the terms under which it would be appropriate to compensate third parties. HMT intends to make compensation orders with respect of CCPs in the event of a PPT in exceptional circumstances only.

## **Governance arrangements for bridge CCPs**

The governance of a bridge CCP is analogous to that of a bridge bank outlined in chapter 8 of the Code (subject to updates to the Code to reflect the Financial Services Act 2012). The bridge CCP would require recognition and authorisation in compliance with existing UK and EU legislation.



## **HM Treasury contacts**

This document can be downloaded from  
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