

EXPLANATORY MEMORANDUM TO
THE BANKING ACT 2009 (BANKING GROUP COMPANIES) ORDER 2014

2014 No. 1831

- 1.** This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 This instrument is laid in draft together with:

- the Banking Act 2009 (Restriction of Partial Property Transfers) (Recognised Central Counterparties) Order 2014
- the Banking Act 2009 (Exclusion of Investment Firms of a Specified Description) Order 2014
- the Banking Act 2009 (Third Party Compensation Arrangements for Partial Property Transfers) (Amendment) Regulations 2014

2.2 These instruments underpin the extension of the special resolution regime (SRR) to central counterparties (CCPs), investment firms and banking group companies (BGCs). The Banking Act 2009 ('the Act') established a SRR for banks and building societies. The SRR gave the UK authorities a permanent framework and tools for dealing with failing UK banks and building societies. The Financial Services Act 2012 amended the Act to extend the scope of the SRR to CCPs, BGCs and investment firms.

2.3 This Order specifies conditions which must be met by an undertaking in the same group as a bank if it is to be a "banking group company" for the purposes of the SRR. Section 81B of the Act empowers the Bank of England to exercise a stabilisation power to transfer the whole or part of a BGC to a commercial purchaser or a bridge bank.

2.4 This Order also amends the Banking Act 2009 (Restriction of Partial Property Transfers) Order 2009 (S.I. 2009/322) to restrict partial transfers of property rights and liabilities of BGCs as a safeguard for transferors and third parties.

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

3.1 None

4. Legislative Context

- 4.1 The SRR provides the Authorities with tools to deal with banks that get into financial difficulty. Part 1 of the Act describes special resolution objectives and how the SRR is triggered. It sets out three stabilisation options (transfer to a private sector purchaser, transfer to a bridge bank and transfer to temporary public sector ownership). The options are exercised through stabilisation powers, which are powers to effect the transfer of securities or property, rights and liabilities by operation of law.
- 4.2 Section 100 of the Financial Services Act 2012 inserts provision in the Act, principally sections 81B to 81D, to extend Part 1 (SRR) and Part 3 (bank administration procedure) to BGCs. Section 81B empowers the Bank to exercise a stabilisation power in respect of a BGC to achieve a transfer to a commercial purchaser or a bridge bank. Section 81B is applied to CCP group companies with the modification that there is also the option of transfer to temporary public sector ownership.
- 4.3 Section 81D provides that a BGC is an undertaking which is (or, but for the exercise of a stabilisation power, would be) in the same group as a bank, and in respect of which any conditions specified in an order made by the Treasury are met. This Order specifies the conditions.
- 4.4 Part 1 of the Act, including section 81B, applies to building societies (section 84), investment firms (section 89A) and recognised central counterparties (“CCPs”) (section 89B) with modifications “as it applies to banks”. Consequently, a ‘bank’ which meets the conditions for the exercise of a stabilisation power may be any one of these types of institution and a BGC may be a group company of any type.
- 4.5 The proposed Directive establishing a framework for the recovery and resolution of credit institutions and investment firms will require the SRR to be applied to specified types of entity and will lay down some exceptions. While this Order does not implement the Directive, it is intended to be compatible with relevant requirements.

The Directive is to be adopted shortly. Its transposition date is 31 December 2014 and its implementation date is 1 January 2015.

4.6 Finally, section 47 of the Act allows the Treasury to restrict partial property transfers (a property transfer instrument which provides for the transfer of some, but not all, of the property, rights and liabilities of a bank). The Banking Act 2009 (Restriction of Partial Property Transfers) Order 2009 safeguards specified interests affected by such a transfer. This Order lays down an additional safeguard applicable where the transferor under such a transfer is a BGC.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

6.1 The RT Hon Andrea Leadsom MP has made the following statement regarding Human Rights:

In my view the provisions of the Banking Act 2009 (Banking Group Companies) Order 2014 are compatible with the Convention rights.

7. Policy background

What is being done and why

7.1 Since the financial crisis of 2007 to 2009, a wide programme of financial sector reform has been implemented at a domestic, European and G20 level. The reform has not only focused on banks, but also on investment firms and financial market infrastructure, which also have the potential to cause major wide-spread disruption to the financial system. The Financial Stability Board's (FSB) Key Attributes of Effective Resolution Regimes – endorsed by the G20 – has recommended that resolution regimes should be put in place for all systemically important financial institutions including investment firms and central counterparties.

7.2 The Bank Recovery and Resolution Directive (BRRD) has now been finalised and is expected to be adopted in May 2014. This establishes a framework for recovery and resolution for investment firms and holding companies, as well as banks and credit institutions across the EU. In addition the European Commission has

recently consulted on “a possible recovery and resolution framework for financial institutions other than banks”, which included certain types of market infrastructure. However, given the uncertainty around the timetable for introducing any European legislation in this area, the UK government has actively sought to meet the FSB recommendations, by pressing ahead with domestic legislation.

- 7.3 In August 2012, HM Treasury launched a consultation entitled Financial Sector resolution: broadening the regime. The consultation proposed implementing resolution powers over institutions other than banks: investment firms; the parent and subsidiary undertakings of banks and investment firms; central counterparties (CCPs); other financial market infrastructures; and insurers. Following this, in the Financial Services Act 2012, the government legislated to extend the special resolution regime to investment firms, group undertakings ‘banking group companies’ and central counterparties.^{7.4} This Order sets out the conditions that must be met in order for an entity to be considered a BGC. It provides that a BGC must be a parent or subsidiary undertaking of the failing ‘bank’, which may be a CCP a building society or an 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 for the group’s banking business.
- 7.4 This does not mean that a stabilisation power is exercisable in respect of any subsidiary without restrictions. First, the exercise of the power must be necessary having regard to the public interest (the statutory safeguards in section 81B(2) and (3) of the Act), and article 4 of the Order amends the Banking Act 2009 (Restriction of Partial Property Transfers) Order 2009 to lay down an additional safeguard for partial property transfers. Such a transfer must be necessary for carrying on the business, or any part of the business, of the bank or other banking institution, any CCP or any other BGC which is (or but for the exercise of a stabilisation power, would be) in the same group as the company which is the transferor.
- 7.5 Secondly, some undertakings are excluded from the meaning of “banking group company” because the Bank Recovery and Resolution Directive will exclude them from resolution action”—
- a mixed activity holding company where the bank is a subsidiary of an intermediate financial holding company;

— a subsidiary of such a mixed activity holding company, other than a parent or subsidiary of the bank, if it is neither a financial institution nor a subsidiary of a financial institution.

7.6 Thirdly, the Order excludes a covered bond vehicle or securitisation company which is not an investment firm or a financial institution (within the meaning given in Regulation (EU) No. 575/2013 on prudential requirements for credit institutions and investment firms). The exclusion recognises that assets held by such vehicles are protected from the consequences of the insolvency of the bank to whose group they belong.

- Consolidation

7.7 No consolidation is necessary.

8. Consultation outcome

8.1 The consultation on this instrument opened on September 26th September 2013 and closed on the 21st November 2013. The consultation lasted 8 weeks. HM Treasury received 10 written responses from industry including CCPs, banks, law firms and trade associations. The Treasury was satisfied that 8 weeks would be sufficient for effective consultation because, having consulted on these policies previously, when developing the primary legislation, it was satisfied that stakeholders would be familiar with the issues at hand.

8.2 The full details of the responses to the consultation and the government response will be published on the GOV website¹.

8.3 Respondent disagreed with some of the proposals implemented in the draft instrument published with the consultation, under which an entity would be considered to a BGC. Government redrafted the instrument to address these concerns and consulted the Banking Liaison Panel² on the revised draft. The panel were broadly content with the revised draft and any additional comments they made have been considered and have informed decisions about further changes to the draft Order.

9. Guidance

¹ Add link to non bank res consultation page here

²<https://www.gov.uk/government/publications/banking-liaison-panel>

- 9.1 It is not considered necessary to issue specific guidance in connection with this instrument. However, under section 5 of the Act, the Treasury is obliged to issue a code of practice about the use of the stabilisation powers. The Code of Practice will contain further material on these Orders and in particular how partial property transfers will be carried out.

10. Impact

- 10.1 The impact on business, charities or voluntary bodies in terms of direct costs is zero as it doesn't require affected firms to take any action, and will only have an impact on relevant business (banking and associated activity) in the unlikely event that SRR powers need to be exercised. The potential impact on business cannot be quantified, but there is a large potential positive impact on public finances (see below), which is similarly unquantifiable.
- 10.2 The impact on the public sector is that having a robust resolution regime for CCPs, investment firms and banking group companies will allow authorities to manage the orderly failure of systemic firms. This reduces the probability and severity of financial crises that may result in the expenditure of public funds to bail out failing firms. The benefits are potentially very significant, as financial crises have been estimated to cost up to £40bn per year.
- 10.3 The Impact Assessment prepared for the Financial Services Act 2012, which inserted provisions in the Act extending the SRR to investment firms, CCPs and BGCs, still applies and is up to date.

11. Regulating small business

- 11.1 The legislation does not apply to small business.

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 this Order under review and, where appropriate, provide advice to the Treasury about this Order. The Treasury will also keep this Order under review itself.

13. Contact

Elizabeth Cowell at the HM Treasury Tel: 02072701007 email:
Elizabeth.Cowell@HMTreasury.gsi.gov.uk can answer any queries regarding these
instruments.