

Bank Resolution - the UK Perspective

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Overview

- The UK experience
- The international context for reform
- The UK response so far
- Banking Act 2009:
 - resolution tools
 - objectives
 - triggers
 - guidance & safeguards
- Limits of existing resolution powers
- Future developments
- Potential implications for corporate and M&A practitioners

The UK experience

- Significant and concentrated banking sector
- No bank resolution powers until 2008
- Run on Northern Rock
- Failure of Bradford & Bingley
- Icelandic bank crisis
- Failure of Lehman Brothers International (Europe)
- £68 billion recapitalisations of RBS and Lloyds/HBOS
- £280 billion Asset Protection Scheme for RBS
- £250 billion Credit Guarantee Scheme
- £200 billion Special Liquidity Scheme

The international context for reform

Reform of regulatory architecture

- Increased focus on macroprudential regulation (European Systemic Risk Board, U.S. Financial Stability Oversight Council)

Capital and liquidity standards

- Basel III
- Financial Stability Board Report on reducing the moral hazard posed by SIFIs, October 2010

Strengthening market infrastructure

- Central clearing & trade reporting of derivatives (European Market Infrastructure Regulation)
- Enhanced regulation of central counterparties

Addressing resolution of failing banks

- Report and Recommendations of Cross-Border Bank Resolution Group, March 2010
- Financial Stability Board interim report to G20 leaders, June 2010

Addressing the cross-border resolution problem

- EU Commission Communication on Crisis Management in the Financial Sector of October 2010 and DG Markt Working Document of January 2011

The UK response so far

- **Reform of UK regulatory architecture**, with prudential regulation of systemically important institutions to be brought under the Bank of England and emphasis on macroprudential regulation through the Bank's new Financial Policy Committee
- **Recovery plans and resolution plans** ("living wills"), pursuant to the Financial Services Act 2010
- **Bank resolution powers**, now in the Banking Act 2009
- **Resolution of investment firms:**
 - Introduction of special administration regime for investment firms
 - Continuing work on a possible special resolution regime for investment firms
- **Review of the structure of the UK banking sector** by an Independent Commission on Banking, due to provide an interim report in April and a final report in September

Banking Act 2009 - resolution tools

- Banking Act 2009 introduces a special resolution regime for ***deposit-taking banks*** consisting of:
 - three "stabilisation options"
 - bank insolvency procedure
 - bank administration procedure
- The three **stabilisation options** are:
 - transfer of property or securities to a ***private sector purchaser***
 - transfer of property to a ***bridge bank***
 - transfer of securities to ***temporary public ownership***

Banking Act 2009 - objectives

- Protect and enhance the stability of UK financial systems, including continuity of banking services
- Protect and enhance public confidence in the stability of UK banking systems
- Protect depositors
- Protect public funds
- Avoid interference with property rights in contravention of the European Convention on Human Rights

Banking Act 2009 - triggers

- Different triggers apply to the stabilisation options, the bank insolvency procedure and the bank administration procedure
- Stabilisation powers may only be exercised if the FSA is satisfied that the bank is failing, or is likely to fail, its threshold conditions and it is not reasonably likely that action will be taken by or in respect of the bank that will enable it to satisfy those conditions
- Additional conditions reflecting the special resolution regime objectives apply to the use of each stabilisation power by the Bank of England or the Treasury
- Special rules apply once public financial assistance has been given

Banking Act 2009 - guidance & safeguards

- Banking Act 2009 requires the Government to issue a Code of Practice providing guidance as to how the special resolution tools will be used
- Secondary legislation sets out safeguards in respect of partial property transfers for:
 - set-off and netting arrangements
 - secured liabilities
 - structured finance arrangements
 - rights of central market counterparties (e.g. default rules of clearing house)
- Impact of the European Convention of Human Rights, in particular the right to property (Article 1, First Protocol)

Limits of the existing resolution powers

- Resolution powers are limited to UK deposit-taking institutions and their UK holding companies
- Structures of UK banking groups are not designed with resolution in mind:
 - multiple legal entities, often tax-driven, in many different jurisdictions
 - systemically important activities (such as deposit-taking) may not be readily separable from non-systemic activities
 - information to facilitate resolution is often difficult to obtain
- Cross-border resolution issues:
 - Winding-up of Credit Institutions Directive (the Iceland problem)
 - absence of cross-border recognition outside the EU
- ... and are some banks just too big?

Future developments

- Internationally:
 - recovery and resolution plans
 - capital surcharges for SIFIs, in particular global SIFIs
 - EU Working Document proposals
 - bail-in
 - cross-border resolution
- In the UK:
 - what will the Independent Commission on Banking recommend?
 - will the Government comply with the recommendations?
 - what will the Bank of England do?

Potential implications for corporate and M&A practitioners

- Capital issuance
- Disposals driven by:
 - Basel III capital constraints
 - state aid requirements
 - restrictions on specific activities (e.g. the Volcker rule)
- Obtaining regulatory consent for acquisitions may be an onerous process
- Potentially, banks separating deposit-taking and investment banking activities either completely or through internal restructuring
- Potentially, banks emigrating
- More action in the "shadow banking" sector

Profile



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Charles has a broadly-based corporate practice. He also covers public sector work. His recent major transactions include advising HM Treasury on a range of assignments arising from the credit crunch, including Northern Rock; Bradford & Bingley; the Icelandic banks; the recapitalisation of the banking sector, including the investment of up to £45 billion in shares of RBS and £23 billion in shares of the merged Lloyds/HBOS; and the £280 billion Asset Protection Scheme.

Charles is included in the highest ranking for Corporate/M&A in *Chambers Global, 2011*.

He speaks French and German.