

# Summary of responses to consultation on amendments to Part 7 of Companies Act 1989

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December 2008



HM TREASURY





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# 1

## Consultation to reform Part 7 of Companies Act 1989

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### Introduction

**1.1** This document summarises the responses to HM Treasury's consultation on proposals to reform Part 7 of the Companies Act 1989. The consultation was launched on 22 July and closed on 14 October 2008. The relevant text from the final version of the Statutory Instrument is provided at Annex B.

**1.2** The consultation document outlined proposals to amend Part 7 of the Companies Act 1989 so as to reflect developments in market practice and address issues arising from legal changes that had been made since the Part 7 regime was introduced.

**1.3** The proposals were discussed in detail with the Financial Services Authority (FSA). Direct notification of the consultation document was sent to key stakeholders, including central counterparties and trade associations, and a copy was published on the Treasury's website.

**1.4** The consultation document invited general comments on the proposals, as well as views on a number of specific issues. These included:

#### Box 1.A: Consultation Questions

- 1 Do you agree that the scope of the proposed amendments, reflected in paragraph 2.5 of the consultation is appropriate?
- 2 Do you agree that default fund contributions should be given explicit recognition under Part 7?
- 3 Do you agree that the current legislation should be amended, in line with insolvency protections available to clearing houses in several other jurisdictions, to allow central counterparties to apply the net house account surplus of a defaulting clearing member to cover any net deficit on that member's client account held at the central counterparty, before balances are returned to the defaulter?
- 4 Do you agree that cross-margining agreements between recognised clearing houses or recognised investment exchanges and with another person, where that person is within or outside the UK, should be protected under Part 7, including the 1991 Regulations and 2001 Recognition Requirements Regulations? Is the amended wording added to section 155 suitable to cover cross-margining agreements?
- 5 Do you agree that under a cross-margining agreement, a member common to the central counterparties should be a single legal entity or should the definition of common member in this context be extended to include other participating members of either central counterparty which are in the same group? If the latter, how would that extension work?

- 6 Do you agree with our proposed approach to the amendments to the definition of market contracts? Is it helpful that the Regulations do not prescribe eligible non-investment products?
- 7 Do you agree that contracts between recognised clearing houses for the purposes of parallel clearing should be captured within the definition of 'market contract'? If yes, do you agree that the definition should also be extended to recognised investment exchanges, and to central counterparties providing clearing services that are not recognised under FSMA?
- 8 Do you have views on possible extensions to provisions on client money?
- 9 We propose amending sections 159, 161 and 163 to take into account changes in the law relating to administration so that they take account of administration on an equivalent basis to bankruptcy and winding up. This is consistent with the purposes of section 154 of Part 7, namely to safeguard the operation of a recognised investment exchange's, or recognised clearing house's, default rules. Do you agree with these changes, in particular the disapplication of the wholes of paragraphs 40 and 41 of schedule B1 to the Insolvency Act 1986 and sections 10 and 11 of the 1986 Act and the amendments to sections 159, 161 and 163 of Part 7?

**1.5** Respondents were supportive of the proposals, although several indicated that they would welcome a broader review of Part 7 in light of market events over the past few months. However, respondents also stressed that such a review should not delay implementation of the amendments that had already been proposed.

**1.6** In due course, the Treasury proposes to undertake a full review jointly with the FSA of the Part 7 regime, taking account of developments in the EU context and in the operation of central counterparties more broadly. However, the Treasury shares the respondents' view that this should not delay implementation of the proposed Financial Markets and Insolvency Regulations (the Regulations).

**1.7** An amended Statutory Instrument (SI) is included in this document at Annex B. The revisions take account of the issues raised by respondents during the consultation. The Treasury intends to lay the SI before Parliament as soon as possible after publication of this document, but proposes to allow until the end of January 2009 for comments on the proposed revisions to the Regulations.

**1.8** Questions or comments about this document and / or the revised SI should be addressed to:

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London SW1A 2HQ  
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# 2

## Summary of responses to the consultation

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### Responses from consultees

**2.1** We received ten consultation responses, including from clearing houses and exchanges, trade associations and other representative bodies. A full list of consultation respondents is provided at Annex A.

**2.2** The consultation proposals received broad support from respondents, and a number of technical drafting points were made. Other significant issues raised, along with the Treasury's response, are summarised below. A more technical explanation of the revisions that have been made to the draft Regulations is set out in Chapter Three.

### Client money

**2.3** Several respondents suggested that the protection of client money rules should be extended, for example to cover foreign client money. In principle, the Treasury considers that there would be benefits to extending protection to client money under foreign laws, by providing greater legal certainty around the treatment of such funds in the event of a default. However, broad changes to client money arrangements would require detailed analysis of a number of issues, in particular the operational implications e.g. around segregation of funds.

**2.4** Therefore the Treasury proposes in the revised regulations merely to update the references to the relevant client money rules made under the Financial Services and Markets Act 2000 as noted in the copy of the regulations appended to the July consultation document but with one further provision to reflect the existing rules in regulation 16 of the Financial Markets and Insolvency Regulations 1991 (S.I. 1991/880) where money is received which may be regarded as immediately due and payable to the member or designated non-member for its own account.

### Non-recognised bodies

**2.5** Some respondents were in favour of extending Part 7 protections to non-recognised investment exchanges and non-recognised clearing houses, although in most cases this was under the caveat that such clearing houses and investment exchanges should be "appropriately authorised" – that is to say the clearing house or exchange must operate to at least the same standard as is required under FSA recognition requirements.

**2.6** These proposals would necessitate significant further analysis and would probably give rise to some wide-ranging amendments to the existing Part 7 regime. The Treasury considers that there may be benefit in extending protections to non-recognised bodies, but this issue requires further consideration and consultation with relevant stakeholders. The intention is to revisit these proposals as part of the wider review of the Part 7 regime.

## Default rules and default fund

**2.7** Respondents raised a number of points in relation to default rules and default fund contributions. There was consensus that the content required to be in recognised investment exchanges' (RIE) and recognised clearing houses' (RCH) default rules needed to be updated, and that default fund contributions should be given explicit recognition under Part 7.

**2.8** One respondent recommended that the amending Regulations should be extended to cover interoperability arrangements that a central counterparty may have put in place with another central counterparty. The Treasury had considered that the draft amending Regulations were sufficiently flexible to accommodate this point; however, on reflection new wording has been inserted into section 188 (1) to make absolutely clear that interoperability arrangements fall within the scope of default rules.

**2.9** One respondent noted that the present requirements as to the content of default rules of RIEs and RCHs only refer to members of those exchanges and clearing houses. Given the provision made for interoperability arrangements and margin set-off agreements the Treasury has added to the requirements where such arrangements are in place a requirement for RIEs and RCHs to have default rules covering defaults by other RIEs or RCHs.

**2.10** Respondents also suggested that the Regulations be amended to allow parent companies or other group companies to provide a default fund contribution on behalf of a central counterparty member. However, the Treasury considers adding such a provision may give rise to more complexity than is necessary and that groups ought to be able to organise their activities so that no legislative provision is needed.

**2.11** One respondent also proposed that the default rules of the central counterparty should set out how a default fund contribution should be allocated between house and client accounts. On balance, the Treasury does not consider that such a requirement would be helpful. The current approach for most central counterparties is for clearing members to make a single default fund contribution which can be used to meet default losses without reference to whether such losses were incurred by a client or house account. The respondent's proposal would have the effect that clearing members would probably be required to provide additional funds as the amount of contributions would be calculated separately for the house and client accounts. This would increase the size of contributions required with a corresponding impact on members' resourcing and liquidity.

## Cross-margining

**2.12** The consultation document sought views as to whether the amended legislation should restrict the provision dealing with margin set-off agreements to dealing with a single legal entity which is a member of more than one recognised investment exchange or recognised clearing house, or whether the benefit of the margin set-off agreement provision should be extended to include members of the same group.

**2.13** Two respondents were in favour of enabling margin set-off provisions to apply to members of the same group, but three respondents recommended that cross-margining should be restricted to a single legal entity. This was on the basis that cross-margining agreements involving members of the same group would carry risks around netting and set off in the event of insolvency, would not bring sufficient legal certainty or is undesirable in principle. The Treasury is therefore, pending further review, of the view that the provision on margin set-off agreements should be restricted to a single legal entity.

**2.14** One respondent also suggested that the definition of market contract was not sufficiently wide to cover margin set-off agreements involving Recognised Investment Exchanges (RIE).

At present, this does not appear to have any practical implications because (so far as the Treasury is aware) no margin set-off arrangements are in place between RIEs. However, this position could change quickly and without a revision to the Regulations this could potentially impact the development of initiatives in the market. The drafting of section 155 has therefore been revised to provide for interoperability and margin set-off agreements by referring to transactions between RIEs, or between an RIE and a Recognised Clearing House (RCH) and vice versa (as regards section 155(3)). The definition of central counterparty clearing services has also been extended to include interoperability arrangements like margin set-off agreements between RIEs and other RIEs or RCHs.

**2.15** The intention concerning margin set-off agreements is that they should be protected as market contracts. As such, the Treasury does not consider that the scope of the provision to be inserted in paragraphs 12 and 25 of the Financial Services and Markets Act 2000 (Recognition Requirements for Investment Exchanges and Clearing Houses) Regulations 2001 (S.I. 2001/995) about such agreements should be wider than the amendments to section 155, which will only cover, as regards interoperability and margin set-off agreements, arrangements between RIEs and RCHs.

## **Impact assessment**

**2.16** A draft Impact Assessment was included in the consultation document. As respondents made no comment on the draft, the Impact Assessment is unchanged.



# 3

## Summary of revisions to the draft Regulations

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**3.1** This chapter provides a more technical explanation of the revisions that have been made to the draft Regulations following consultation. The Treasury proposes to allow until the end of January 2009 for any final comments on these revisions, in particular any practical issues arising from the need to amend the default rules of RIEs and RCHs.

### Transitional Provision

**3.2** A new provision has been made in regulation 1 to make clear that provisions that could apply to insolvency proceedings on foot at the time the regulations come into force will only apply to insolvency proceedings which begin on or after the coming into force of the Regulations. The other provisions by their nature can only apply on a prospective basis.

### Market Contracts

**3.3** The amendment to section 155(3) made in the consultation draft in relation to including as market contracts, contracts between recognised clearing houses and other recognised clearing houses is now extended to cover transactions between recognised investment exchanges and other RIEs. This also means covering transactions between RIEs and RCHs and vice versa in sections 155(2) and (3).

**3.4** Consequential amendments are made following on from this to sections 155(3A), 158(2), [subject to approval of OPC section 188(1)], 188(3A), regulations 10, 11 and 16 of the Financial Market and Insolvency Regulations 1991 (S.I. 1991/880) ("the 1991 Regulations").

### Interoperability and default rules

**3.5** Since provision is now to be made allowing for interoperability between RIEs and RCHs (including margin set-off agreements) it is important that where an RIE or RCH has such arrangements it has default rules to deal with a default by the other RIE or RCH. Provision has been added to paragraphs 10 and 24 of the Schedule to the Financial Services and Market Act 2000 (Recognition Requirements for Investment Exchanges and Clearing Houses) Regulations 2001 (S.I. 2001/995) ("the 2001 Regulations") to that effect.

**3.6** Provision has also been added to paragraphs 14 and 27 of the same Schedule to ensure that the default rules extend the existing provisions concerning sharing information with specified persons in case of insolvency of members of the RIE or RCH, to deal with the default of another RIE or RCH with which an RIE or RCH deals.

### Client Money

**3.7** The amendment to regulation 16(1)(a) of the 1991 Regulations is slightly re-formed with no substantive change, but an existing provision is added back into the amendment that money which would be clients' money if it were not regarded as immediately due and payable to the member or designated non-member for its own account remains a relevant transaction for the purposes of section 187 of Part 7.

**3.8** Provisions are added to regulation 16 as sub-paragraphs (1A) to (1C) and (2) to ensure the provision works in relation to transactions between RIEs and RCHs.

## **Margin set-off agreements**

**3.9** The consultation draft referred to a margin set-off agreement being between an RIE or RCH and *another person*. That did not reflect the scope of the amendment to market contracts in section 155. Therefore an amendment is made so that the margin set-off agreement dealt with under the default rules is one between an RIE or RCH and another RIE or RCH. This is achieved by amending the definition of the tag “AP” in paragraphs 12(2B) and 25(1B) of the Schedule to the 2001 Regulations.

# A

## Summary of respondents

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LCH.Clearnet

City of London Law Society (CLLS) Financial Law Committee

CLLS Regulatory Committee

Investment Management Association

NYSE Euronext (LIFFE)

Euroclear UK and Ireland Ltd

London Stock Exchange

Futures and Options Association

British Bankers' Association

Association of Business Recovery Professionals





# Revised draft regulations

STATUTORY INSTRUMENTS

2009 No.

## FINANCIAL SERVICES AND MARKETS

### Financial Markets and Insolvency Regulations 2009

<i>Made</i>	- - - -	2009
<i>Laid before Parliament</i>		2009
<i>Coming into force</i>	- -	2009

The Secretary of State and the Treasury, in exercise of the powers vested in them jointly conferred by sections 158(4) and (5), 185 and 186(1) of the Companies Act 1989<sup>(1)</sup>;

The Treasury, in exercise of the powers vested in them by sections 155(4) and (5) and 187(3) of the Companies Act 1989;

And the Treasury, in exercise of the powers conferred on them by section 286 and 428(3) of the Financial Services and Markets Act 2000<sup>(2)</sup>, with the approval of the Secretary of State;

make the following Regulations:

#### Citation, commencement and transitional provision

1.—(1) These Regulations may be cited as the Financial Markets and Insolvency Regulations 2009 and shall come into force on [dd mm] 2009.

(2) Regulations 2(4), (5), (6), (7), (8), (9), (10) and (12) apply to insolvency proceedings which relate to the insolvency events set out in paragraph (3) which take place on or after the coming into force of these regulations.

(3) The insolvency events are—

- (a) an application for an administration order;
- (b) the filing of a notice of intention to appoint an administrator for an appointment under paragraph 14 or 22 of Schedule B1 to the Insolvency Act 1986;<sup>(3)</sup>

<sup>(1)</sup> 1989 c.40. The powers originally vested in the Secretary of State under section 155 and 187(3) are now vested in the Treasury and the powers under sections 158(4) and (5), 185 and 186(1) of the Companies Act 1989 are now exercisable by the Secretary of State jointly with the Treasury – see the Transfer of Functions (Financial Services) Order 1992 (S.I. 1992/1315).

<sup>(2)</sup> 2000 c. 8.

<sup>(3)</sup> Schedule B1 to the Insolvency Act 1986 was inserted by s248(2) of the Enterprise Act 2002, Schedule 16.

- (c) where no notice of intention to appoint is filed, the appointment of an administrator under paragraph 14 or 22 of Schedule B1 to the Insolvency Act 1986;
- (d) the presentation of a bankruptcy petition;
- (e) the presentation of a petition for sequestration of a person's estate;
- (f) the presentation of a winding up petition;
- (g) the passing of a resolution for voluntary winding up;
- (h) the appointment of an administrative receiver;
- (i) the making of an order appointing an interim receiver.

## **Amendment of the Companies Act 1989**

2.—(1) The Companies Act 1989 is amended as follows.

(2) In paragraph (c) of section 154 (introduction), after “such transactions” insert “or as default fund contribution,”.

(3) In section 155 (market contracts)—

(a) in subsection (2)<sup>(4)</sup>, at the end of paragraph (a) omit “and” and for paragraph (b) substitute—

“(b) contracts entered into by the exchange, in its capacity as such, with a member of the exchange or with a recognised clearing house or with another recognised investment exchange for the purpose of enabling the rights and liabilities of that member or clearing house or other investment exchange under a transaction to be settled; and

(c) contracts entered into by the exchange with a member of the exchange or with a recognised clearing house or with another recognised investment exchange for the purpose of providing central counterparty clearing services to that member or clearing house or other investment exchange.”;

(b) for subsection (2A)<sup>(5)</sup>, substitute—

“(2A) Where the exchange in question is a recognised overseas investment exchange, this Part does not apply to a contract that falls within paragraph (a) of subsection (2) (unless it also falls within subsection (3)).”;

(c) for subsection (3)<sup>(6)</sup>, substitute—

“(3) In relation to a recognised clearing house this Part applies to—

(a) contracts entered into by the clearing house, in its capacity as such, with a member of the clearing house or with a recognised investment exchange or with another recognised clearing house for the purpose of enabling the rights and liabilities of that member or investment exchange or other clearing house under a transaction to be settled; and

(b) contracts entered into by the clearing house with a member of the clearing house or with a recognised investment exchange or with another recognised clearing house for the purpose of providing central counterparty clearing services to that member or investment exchange or other clearing house.”; and

(d) after subsection (3) insert—

“(3A) In this section “central counterparty clearing services” means—

(a) the services provided by a recognised investment exchange or a recognised clearing house to the parties to a transaction in connection with contracts between each of the parties and the investment exchange or clearing house (in place of, or as an alternative to, a contract directly between the parties),

(b) the services provided by a recognised clearing house to a recognised investment exchange or to another recognised clearing house in connection with contracts between them, or

(c) the services provided by a recognised investment exchange to a recognised clearing house or to another recognised investment exchange in connection with contracts between them.”.

<sup>(4)</sup> Section 155(2) and (2A) were substituted for subsection (2) by S.I. 1991/880, regulation 3, subsections (2)(b) and (3) were amended by S.I. 1998/1748, regulations 3(b) and 4 respectively

<sup>(5)</sup> Section 155(2) and (2A) were substituted for subsection (2) by S.I. 1991/880, regulation 3.

<sup>(6)</sup> Section 155(3) was amended by S.I. 1998/1748, regulation 4.

- (4) In subsection (2) of section 158 (modifications of the law of insolvency),
- (a) at the end of paragraph (a) omit “and”;
  - (b) for paragraph (a) substitute—
    - “(a) proceedings in respect of a recognised investment exchange or a member or designated non-member of a recognised investment exchange,
    - (aa) proceedings in respect of a recognised clearing house or a member of a recognised clearing house, and”.
- (5) In section 159 (proceedings of exchange or clearing house take precedence over insolvency procedures)—
- (a) in subsection (1), after “sequestration, or”, insert “in the administration of a company or other body or”;
  - (b) in subsection (4), after “or bankruptcy”, insert “or in the administration of a company or other body” and after “or sequestration”, insert “or in the administration of a company or other body”; and
  - (c) in subsection (4A)(b)<sup>(7)</sup>, after “England and Wales,” insert “or in the administration of a company or other body”.
- (6) In section 161 (supplementary provisions as to default proceedings)—
- (a) in subsection (2), after “liquidator”, insert “, administrator”;
  - (b) in subsection (4)<sup>(8)</sup>—
    - (i) after “or paragraph”, insert “40, 41,”; and
    - (ii) for “including paragraph 43(6) as applied by paragraph 44”, substitute “including those paragraphs as applied by paragraph 44”; and
  - (c) in subsection (4) as it has effect, by virtue of section 249(1) of the Enterprise Act 2002, without the amendments made by paragraph 45 of Schedule 17 to that Act, for “10(1)(c), 11(3)” substitute “10, 11”.
- (7) In section 163 (net sum payable on completion of default proceedings)—
- (a) in subsection (2)—
    - (i) for “or winding-up order has been made”, substitute “, winding-up or administration order has been made”;
    - (ii) in paragraph (a), for “or winding up”, substitute “, winding up or administration”;
    - (iii) in paragraph (b), after “winding up”, add “or administration”;
    - (iv) after “(within the meaning of section 247 of the Insolvency Act 1986)”, insert “, or enters administration”; and
    - (v) after “the date of the winding-up order” insert “or the date on which the partnership enters administration”.
  - (b) in subsection (3)—
    - (i) after “sequestration or a winding-up”, insert “or administration”;
    - (ii) in each of paragraphs (a) and (b), for “or winding up”, substitute “, winding up or administration”; and
    - (iii) after “(within the meaning of section 129 of the Insolvency Act 1986)”, insert “or the date on which the body corporate enters administration”;
  - (c) after subsection (3)<sup>(9)</sup>, insert—
    - “(3A) In subsections (2) and (3), a reference to the making of an administration order shall be taken to include a reference to the appointment of an administrator under—
    - (a) paragraph 14 of Schedule B1 to the Insolvency Act 1986 (appointment by holder of qualifying floating charge); or

<sup>(7)</sup> Subsection (4A) was inserted by S.I. 1991/880, regulation 4.

<sup>(8)</sup> Subsection (4) was amended by the Enterprise Act 2002, section 248(3), Schedule 17 paragraphs 43, 45.

<sup>(9)</sup> Schedule B1 to the Insolvency Act 1986 was inserted by s248(2) of the Enterprise Act 2002, Schedule 16.

- (b) paragraph 22 of that Schedule (appointment by company or directors).”; and
  - (d) in subsection (4), at the end of paragraph (a) omit “or” , at the end of paragraph (b) insert “or”, and, after paragraph (b), insert—
    - “(c) that an application for an administration order was pending or that any person had given notice of intention to appoint an administrator.”.
- (8) In section 164 (disclaimer of property, rescission of contracts, &c)—
- (a) in subsection (1), at the end of paragraph (b) insert “or as default fund contribution”;
  - (b) in subsection (3)—
    - (i) after paragraph (b) insert—
      - “(ba) the provision of default fund contribution to the exchange or clearing house,”;
    - (ii) in paragraph (c), after “in relation to a market contract” insert “or as default fund contribution”; and
    - (iii) at the end of paragraph (d) insert “or as default fund contribution”;
  - (c) in subsection (4)—
    - (i) after “margin in relation to a market contract” insert “or default fund contribution”;
    - (ii) after “the margin” in each of the two places where the expression occurs insert “or default fund contribution”; and
  - (d) in subsection (5) at the end insert “or of default fund contribution”.
- (9) In section 165 (adjustment of prior transactions)—
- (a) in paragraph (c) of subsection (4), after “clearing house”, insert “in question”; and
  - (b) after subsection (4) insert—
    - “(5) This section also applies to—
      - (a) the provision of default fund contribution to a recognised investment exchange or recognised clearing house,
      - (b) any contract effected by a recognised investment exchange or recognised clearing house for the purpose of realising the property provided as default fund contribution, and
      - (c) any disposition of property in accordance with the rules of the recognised investment exchange or recognised clearing house as to the application of property provided as default fund contribution.”.
- (10) In section 167 (application to determine whether default proceedings to be taken)—
- (a) for subsections (1) and (1A) substitute—
    - “(1) This section applies where a relevant insolvency event has occurred in the case of—
      - (a) a recognised investment exchange or a member or designated non-member of a recognised investment exchange, or
      - (b) a recognised clearing house or a member of a recognised clearing house.
 The investment exchange, member, designated non-member or clearing house in whose case a relevant insolvency event has occurred is referred to below as “the person in default”.
      - (1A) For the purposes of this section a “relevant insolvency event” occurs where—
        - (a) a bankruptcy order is made,
        - (b) an award of sequestration is made;
        - (c) an order appointing an interim receiver is made,
        - (d) an administration or winding up order is made,
        - (e) an administrator is appointed under paragraph 14 of Schedule B1 to the Insolvency Act 1986 (appointment by holder of qualifying floating charge) or under paragraph 22 of that Schedule (appointment by company or directors),
        - (f) a resolution for voluntary winding up is passed, or
        - (g) an order appointing a provisional liquidator is made.
      - (1B) Where in relation to a person in default a recognised investment exchange or a recognised clearing house (“the responsible exchange or clearing house”)—

- (a) has power under its default rules to take action in consequence of the relevant insolvency event or the matters giving rise to it, but
  - (b) but has not done so,
- a relevant office-holder appointed in connection with or in consequence of the relevant insolvency event may apply to the Authority.”;
- (b) in subsection (2), for “the exchange or clearing house concerned” substitute “the responsible exchange or clearing house”;
  - (c) in subsection (3)—
    - (i) for “the exchange or clearing house”, in each of the three places where the expression occurs, substitute “the responsible exchange or clearing house”;
    - (ii) for “the member or designated non-member in question” substitute “the person in default”; and
  - (d) in each of subsections (4) and (5), for “the exchange or clearing house” substitute “the responsible exchange or clearing house”.
- (11) In section 170 (certain overseas exchanges and clearing houses) for subsection (1) substitute—
- “(1) The Secretary of State and the Treasury may by regulations provide that this Part applies in relation to contracts connected with an overseas investment exchange or overseas clearing house which—
- (a) is not a recognised investment exchange or recognised clearing house, but
  - (b) is approved by the Treasury in accordance with such requirements as may be so specified,
- as it applies in relation to contracts connected with a recognised investment exchange or recognised clearing house.”.
- (12) In section 175<sup>(10)</sup> (administration orders, &c) as it has effect, by virtue of section 249(1) of the Enterprise Act 2002, without the amendments made by paragraph 47 of Schedule 17 to that Act, for subsection (1) substitute—
- “(1) The following provisions of the Insolvency Act 1986 (which relate to administration orders and administrators) do not apply in relation to a market charge—
- (a) sections 10 and 11 (effect of application for administration order and of an administration order), and
  - (b) section 15(1), (2) and (3) (power of administrator to deal with charged property).”.
- (13) In section 177 (application of margin not affected by certain other interests)—
- (a) in the heading, after “margin” insert “or default fund contribution”;
  - (b) in each of subsection (1) and (2), at the end insert “or as default fund contribution”; and
  - (c) in subsection (3), after “as margin” insert “or as default fund contribution”.
- (14) In subsection (1) of section 180<sup>(11)</sup> (proceedings against market property by unsecured creditors)—
- (a) after “as margin in relation to market contracts”, insert “or as default fund contribution,”; and
  - (b) in paragraph (a), after “for margin”, insert “or as default fund contribution”.
- (15) In section 188 (meaning of “default rules” and related expressions),
- (a) in subsection (1) after “person” insert “(including another recognised investment exchange or recognised clearing house )”;
  - (b) after subsection (3), insert—
- “(3A) In this Part “default fund contribution” means—
- (a) contribution by a member of a recognised investment exchange to a fund which—
    - (i) is maintained by that exchange for the purpose of covering losses arising in connection with defaults by any of the members of the exchange, and

<sup>(10)</sup> Subsections (1), (1A) and (2A) were inserted, and section (2) amended, by Section 248(3) of the Enterprise Act 2002 (c.40), Schedule 17, paragraph 47. The amendment made by s248(2) did not apply to special administration regimes set out in section 249 of that Act nor to specified regimes set out in S.I. 2003/2093, regulation 3.

<sup>(11)</sup> Subsection (1) was amended by the Tribunals, Courts and Enforcement Act 2007, section 62(3), Schedule 13, paragraph 91.



party under the rules referred to in paragraph 25 of the Schedule to the Recognition Requirements Regulations”.

(6) In regulation 16 (circumstances in which member or designated non-member dealing as principal to be treated as acting in different capacities)—

(a) for paragraph (1)(a), substitute—

“(a) a market contract, effected as principal by a member or designated non-member of a recognised investment exchange or a member of a recognised clearing house, in relation to which money received by the member or designated non-member is clients’ money for the purposes of rules relating to clients’ money or would be clients’ money for the purposes of those rules were it not money which, in accordance with those rules, may be regarded as immediately due and payable to the member or designated non-member for its own account.”;

(b) after paragraph (1) insert—

“(1A) In addition “relevant transaction” means a market contract entered into by a recognised clearing house effected as principal in relation to which money is received by the recognised clearing house from a recognised investment exchange or from another recognised clearing house.

(1B) In addition “relevant transaction” means a market contract entered into by a recognised investment exchange effected as principal in relation to which money is received by the recognised investment exchange from a recognised clearing house or from another recognised investment exchange.

(1C) Where paragraph (1A) or (1B) apply paragraph (1) applies to the recognised clearing house or recognised investment exchange as it does to a member of the clearing house or investment exchange, and as if the clearing house or investment exchange were subject to the rules referred to in paragraph (1)(a)(i).

(1D) In paragraph (1), “rules relating to clients’ money” are rules made by the Financial Services Authority, in particular, under section 138 or 139 of the Financial Services and Markets Act 2000.”;

(c) for paragraph (2) substitute—

“(2) For the purposes of section 187(1) (construction of references to parties to market contracts)—

(a) a recognised investment exchange or a member or designated non-member of a recognised investment exchange, or

(b) a recognised clearing house or a member of a recognised clearing house,

shall be treated as effecting relevant transactions in a different capacity from other market contracts it has effected as principal.”; and

(d) omit paragraphs (3) and (4).

#### **Amendment of the Financial Services and Markets Act 2000 (Recognition Requirements for Investment Exchanges and Clearing Houses) Regulations 2001**

4.—(1) The Financial Services and Markets Act 2000 (Recognition Requirements for Investment Exchanges and Clearing Houses) Regulations 2001 are amended as follows.

(2) In paragraph (1) of regulation 3 (interpretation), after the definition of “the Companies Act”, insert—

““default fund” means the sum of the default fund contributions by the members of a recognised investment exchange to that exchange or by the members of a recognised clearing house to that clearing house or by one recognised clearing house to another to the extent those contributions have not been returned or otherwise applied;

“default fund contribution” has the same meaning as in section 188(3A) of the Companies Act;”.

(3) In the Schedule—

(a) in paragraph 10 after sub-paragraph (3) insert—

“(4) Sub-paragraph (5) applies where the exchange has arrangements for transacting business with, or in relation to common members of, a recognised clearing house or another recognised investment exchange.

(5) A recognised investment exchange must have default rules which in the event of the clearing house or the investment exchange being or appearing to be unable to meet its obligations in respect

of one or more market contracts, enable action to be taken in respect of unsettled market contracts to which that person is a party.”.

(b) in paragraph 12—

(i) in sub-paragraph (1) after “155(2)(b)”, insert “or (c)”;

(ii) in sub-paragraph 2(b) after “different contracts” insert “entered into by the defaulter in one capacity for the purposes of section 187 of the Companies Act”;

(iii) after sub-paragraph (2)(b), insert—

“(bb) if relevant, for that sum to be aggregated with, or set off against, any sum owed by or to the investment exchange by or to AP under an indemnity given or reimbursement or similar obligation in respect of a margin set off agreement in which the defaulter chose to participate so as to produce a net sum.”;

(iv) for sub-paragraph (2)(c), substitute—

“(c) for the net sum referred to in paragraph (b) or, if relevant, the net sum referred to in paragraph (bb)—

(i) if payable by the defaulter to the exchange, to be set off against—

(aa) any property provided by or on behalf of the defaulter as cover for margin (or the proceeds of realisation of such property);

(bb) to the extent (if any) that any sum remains after set off under paragraph (aa), any default fund contribution provided by the defaulter remaining after any application of such contribution;

(cc) to the extent (if any) that any sum remains after set off under paragraph (bb), such other funds, including the default fund, or resources as the exchange may apply under its default rules;

(ii) if payable by the exchange to the defaulter, to be aggregated with—

(aa) any property provided by or on behalf of the defaulter as cover for margin (or the proceeds of realisation of such property);

(bb) any default fund contribution provided by the defaulter remaining after any application of such contribution;”;

(v) after sub-paragraph (2), insert—

“(2A) In sub-paragraph (2), “margin set off agreement” means an agreement between the exchange and AP permitting any eligible position to which the Participant Member is party with the exchange and any eligible position to which the Participant Member is party with AP to be taken into account in calculating a net sum owed by or to the Participant Member to either the exchange or AP and/or margin to be provided to, either or both, the exchange and AP.

(2B) In sub-paragraph (2)—

“AP” means a recognised clearing house or another recognised investment exchange of whom a Participant Member is a member;

“eligible position” means any position which may be included in the set off calculation;

“Participant Member” means a person who—

(a) is a member of the exchange;

(b) is a member or participant of AP; and

(c) chooses to participate, in accordance with the rules of the exchange, in such agreement.

(2C) The property, contribution, funds or resources referred to in paragraph (2)(c), against which the net sum is to be set off (or with which it is to be aggregated) are subject to any unsatisfied claims arising out of the default of a defaulter before the default in relation to which the calculation is being made.”;

(c) after paragraph 12, insert—

“12A. The rules of the exchange must provide that, in the event of a default, any default fund contribution provided by the defaulter shall only be used in accordance with paragraph 12(2)(c)(i) or (ii).”;

(d) in paragraph 14 at the end insert—

- “or the default of a recognised clearing house or another recognised investment exchange”.
- (e) in paragraph 15(1), at the end insert, “other than a client account of the defaulter.”;
- (f) after paragraph 15(2), insert—
- “(3) For the purposes of this paragraph, “client account” means an account held by the exchange in the name of the defaulter in which relevant transactions effected by the defaulter have been recorded.
- (4) In sub-paragraph (3) “relevant transaction” has the same meaning as in regulation 16(1) of the Financial Markets and Insolvency Regulations 1991.”;
- (g) in paragraph 24 after sub-paragraph (2) insert—
- “(3) Sub-paragraph (4) applies where the exchange has arrangements for transacting business with, or in relation to common members of, a recognised investment exchange or another recognised clearing house.
- (4) A recognised clearing house must have default rules which in the event of the investment exchange or the clearing house being or appearing to be unable to meet its obligations in respect of one or more market contracts, enable action to be taken in respect of unsettled market contracts to which that person is a party.”.
- (h) in paragraph 25—
- (i) in sub-paragraph (1)(b), after “different contracts” insert “entered into by the defaulter in one capacity for the purposes of section 187 of the Companies Act”;
- (ii) after sub-paragraph (1)(b), insert—
- “(bb) if relevant, for that sum to be aggregated with, or set off against, any sum owed by or to the clearing house by or to AP under an indemnity given or reimbursement or similar obligation in respect of a margin set off agreement in which the defaulter chose to participate so as to produce a net sum.”;
- (iii) for sub-paragraph (1)(c), substitute—
- “(c) for the net sum referred to in paragraph (b) or, if relevant, the net sum referred to in paragraph (bb)—
- (i) if payable by the defaulter to the clearing house, to be set off against—
- (aa) any property provided by or on behalf of the defaulter as cover for margin (or the proceeds of realisation of such property);
- (bb) to the extent (if any) that any sum remains after set off under paragraph (aa), any default fund contribution provided by the defaulter remaining after any application of such contribution;
- (cc) to the extent (if any) that any sum remains after set off under paragraph (bb), any such funds, including the default fund, or resources as the clearing house may apply under its default rules;
- (ii) if payable by the clearing house to the defaulter, to be aggregated with—
- (aa) any property provided by or on behalf of the defaulter as cover for margin (or the proceeds of realisation of such property);
- (bb) any default fund contribution provided by the defaulter remaining after any application of such contribution; and”;
- (iv) after sub-paragraph (1), insert—
- “(1A) In sub-paragraph (1), “margin set off agreement” means an agreement between the clearing house and AP permitting any eligible position to which the Participant Member is party with the clearing house and any eligible position to which the Participant Member is party with AP to be taken into account in calculating a net sum owed by or to the Participant Member to either the clearing house or AP and/or margin to be provided to, either or both, the clearing house and AP.
- (1B) In sub-paragraph (1A)—
- “AP” means a recognised investment exchange or another recognised clearing house of whom a Participant Member is a member;
- “eligible position” means any position which may be included in the set off calculation;
- “Participant Member” means a person who—
- (a) is a member of the clearing house;

(b) is a member or participant of AP; and

(c) chooses to participate, in accordance with the rules of the clearing house, in such agreement.

(1C) The property, contribution, funds or resources referred to in paragraph (1)(c), against which the net sum is to be set off (or with which it is to be aggregated) are subject to any unsatisfied claims arising out of the default of a defaulter before the default in relation to which the calculation is being made.”;

(i) after paragraph 25, insert—

“25A. The rules of the clearing house must provide that in the event of a default, any default fund contribution provided by the defaulter shall only be used in accordance with paragraph 25(1)(c)(i) or (ii).”;

(j) in paragraph (27)—

(k) “in paragraph 27 at the end insert—

“or the default of a recognised investment exchange or another recognised clearing house”.

(l) in paragraph 28(1), at the end insert, “other than a client account of the defaulter.”;

(m) after paragraph 28(2), insert—

“(3) For the purposes of this paragraph, “client account” means an account held by the clearing house in the name of the defaulter in which relevant transactions effected by the defaulter have been recorded.

(4) In sub-paragraph (3) “relevant transaction” has the same meaning as in regulation 16(1) of the Financial Markets and Insolvency Regulations 1991.”

[ ] 2009 Two of the Lords Commissioners of Her Majesty’s Treasury

[ ] 2009 Parliamentary Under Secretary of State  
Department for Business Enterprise and Regulatory Reform

### EXPLANATORY NOTE

*(This note is not part of the Regulations)*

These Regulations change the insolvency regime that applies to any exchange that runs in-house clearing arrangements which is a “recognised investment exchange” (“RIE”) and any central counterparty clearing house which is a “recognised clearing house” (“RCH”) within the meaning of the Financial Services and Markets Act 2000 (c. 8). They do so by amending Part 7 of the Companies Act 1989 (c. 40) (“Part 7”); the Financial Markets and Insolvency Regulations 1991 (S.I. 1991/880) (the “1991 Regulations”) and the Financial Services and Markets Act 2000 (Recognition Requirements for Investment Exchanges and Clearing Houses) Regulations 2001 (S.I. 2001/995) (the “2001 Regulations”).

These Regulations amend Part 7, the 1991 Regulations and the 2001 Regulations so that they provide further protection for the actions of RIEs and RCHs in the event of default by any of their members on the obligations they have entered into in the course of buying or selling financial instruments. The amendments comprise

- a broadening of the definition of “market contracts” to which Part 7 applies;
- inclusion of default fund contributions within the protections of Part 7;
- provisions amending Part 7 so that it takes account of administration on a basis equivalent to bankruptcy and winding up;
- provision to ensure default rules refer to and take into account cross margining agreements; and

- provisions enabling the extension of the default rules of RIEs and RCHs so that a surplus held on a house account of a member may be used to make up a deficit on the client account of the same members.

Regulation 2 amends Part 7 as follows.

Paragraph (2) makes a consequential amendment to section 154. Paragraph (3) amends section 155 (market contracts). The effect of these amendments is that market contracts no longer have to relate to transactions in investments only and include contracts with members for the purposes of providing central counterparty clearing services to them, make provision to allow for interoperability arrangements (including parallel clearing and margin set-off agreements) between RIEs and RCHs. Paragraphs (4) to (7), (10) and (12) amend various sections of Part 7 so that they take account of administration on an equivalent basis to bankruptcy and winding up. Paragraphs (8) and (9), (11), (13) and (14) amend various sections of Part 7 so that where certain provisions of the Insolvency Act 1986 are disapplied in relation to margin, they are also disapplied in relation to default fund contribution (as defined by the amendment in paragraph (15)). This provides for equivalent protection in the application by a RIE or RCH of property held as default fund contribution as for property held as margin.

Regulation 3 amends the 1991 Regulations as follows.

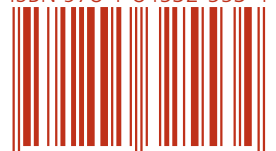
Paragraph (4) amends paragraph (1) of regulation 10 (extent to which charge granted in favour of recognised investment exchange to be treated as market charge) so that it also applies to a charge granted over property provided as default fund contribution to a RIE and, in the case of a recognised UK investment exchange, it secures the obligation to pay to the exchange any sum due to it from a member in respect of unsettled market contracts. Paragraph (5) amends regulation 11 (extent to which charge granted in favour of recognised clearing house to be treated as market charge) in the same ways as does the previous provision in relation to RCHs. Paragraph (6) amends regulation 16 (circumstances in which member or designated non-member dealing as principal to be treated as acting in different capacities) omitting paragraphs (3) and (4) to remove the definition of relevant investment to which the reference in sub-paragraph (a) is also removed to broaden the scope of contracts falling within the regulation. The reference to client rules is updated to refer to the clients' money rules made by the Financial Services Authority, in particular a consequential amendment is made to cover interoperability arrangements between RIEs and RCHs.

Regulation 4 amends the 2001 Regulations as follows.

Paragraph (3) amends the Schedule to the 2001 Regulations. Sub-paragraphs (a) to (f) amend the requirements relating to default rules in respect of market contracts with RIEs in Part 2 (recognition requirements for investment exchanges: default rules in respect of market contracts) of the Schedule. These amendments change the requirements for the default rules relating to set off and aggregation so that, where applicable and in the prescribed order, they must also take account of a defaulter's house account surpluses, margin set off agreements, default fund contribution and the default fund more generally. There is also provision that where an RIE has specified arrangements with another RIE or RCH its default rules must provide rules dealing with default of such other exchanges and clearing houses. The RIE and RCH must also be able and willing to share information with the Secretary of State (who is responsible for insolvency), any relevant insolvency practitioner and other specified authorities and bodies in relation to the default of another RIE, RCH. Sub-paragraphs (g) to (m) make equivalent amendments to the requirements relating to default rules in respect of market contracts with RCHs in Part 4 (recognition requirements applying to clearing houses: default rules in respect of market contracts) of the Schedule.

An impact assessment of the effect of this instrument on the costs to business, charities or voluntary bodies has been prepared. It may be obtained from the [Financial Stability Resolution] Team, HM Treasury, 1 Horseguards Road, LONDON SW1A 2HQ. It is also available on HM Treasury's web-site ([www.hm-treasury.gov.uk](http://www.hm-treasury.gov.uk)). Copies of the document have been placed in the libraries of both Houses of Parliament.

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