Implementation of the Credit Institutions Reorganisation and Winding Up Directive

Summary of consultation responses and HM Treasury decisions

The Government received 9 responses to the consultation document 'Implementation of the Credit Institutions Reorganisation and Winding Up Directive', published by the Treasury in November 2003. This note summarises the main responses and explains the decisions taken as a result of the consultation.

Answers to specific questions in the consultation document

Question 1 – Do consultees agree with our approach to the definition of a credit institution?

The approach to the definition of a credit institution laid out in the consultation document is, for the purposes of the application of the Regulations to UK credit institutions to use the definition in paragraph 4 of Schedule 2 to the Financial Services and Markets Act 2000 (FSMA) and article 5 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001. In relation to EEA credit institutions, the proposed approach is to use the definition set out in the Directive as defined in Article 1 (1) and (3) of Directive 200/12/EC relating to the taking up and pursuit of the business of credit institutions (the Banking Consolidation Directive).

One respondent states that the definition of UK credit institutions in the Regulations should abide by the definition used in the Directive so that the same coverage of institutions in all Member States can be guaranteed. Otherwise, the definition of a UK credit institution will be broader and capture a different range of institutions than the definition laid down in the Directive.

HMT response – The Treasury confirms that the Regulations will continue to follow the approach in the consultation document with several amendments to clarify that the definition includes electronic money institutions and excludes credit unions. This approach provides clarity on which institutions are within the Regulations. A definition based on the Banking Consolidation Directive might have left some institutions unclear about their position.

We have also determined that friendly societies and industrial and provident societies would be left outside the definition because of the exclusion of persons with Part 4 permission to effect or carry out contracts of insurance. Consequently, the references to the insolvency law applicable to those institutions in regulation 2(3) are removed.

Question 2 – Are consultees content that the Regulations include all the entities in the UK which may be credit institutions? Are there any entities included which should not be?

The consultation sets out that the Regulations will apply to the provisions of UK insolvency law in relation to companies, building societies, partnerships, limited liability partnerships, friendly societies and industrial and provident societies.

One respondent asks whether the Regulations should be restricted to apply to entities authorised to act as credit institutions under Part 4 of FSMA.

HMT response – As described above, the Regulations are amended to apply only to UK persons with permission under Part 4 of FSMA to accept deposits or issue electronic money subject to certain exemptions.

Question 3 – Do consultees agree that a proper implementation of the Directive requires us to treat any or all Administrations, CVAs or s.425 schemes as being within the scope of the Directive?

Two respondents consider that s.425 schemes should fall outside the scope of the Directive while the other respondent to this question disagrees. They however feel that it is not clear that the inclusion of administrations where the appointment is not by the court would be consistent with Article 3 of the Directive.

HMT response – The Treasury continues to take the view that s.425 schemes cannot be viewed in principle as reorganisation measures or winding up proceedings within the meaning of the Directive and therefore fall outside the scope of the Directive. In terms of administrations where the appointment is not by the court, the Treasury finds that inclusion of these administrations would indeed be inconsistent with Article 3 of the Directive. Article 3 requires that only the relevant judicial or administrative authorities of the home Member State shall be entitled to decide on reorganisation measures with respect to a credit institution, including branches in other Member States and Article 9 makes similar provisions for winding up measures. Therefore, the Regulations will not capture non-court routes into administration for credit institutions.

Question 4 – Are consultees content with our proposals for implementing the Directive requirements with regard to jurisdiction?

One respondent notes some inconsistencies with the drafting of regulation 4 and Article 3 of the Directive. The draft regulation provides that UK courts may impose s.425 schemes subject to informing the home country authorities and those authorities having no objection. In contrast, Article 3 states that the home Member State shall alone be empowered to decide on the implementation of one or more reorganisation measures.

HMT response – The Regulations bring EEA credit institutions within the type of entities capable of being subject to the s.425 regime by regulation 4(1). However, regulation 4(2) prevents the UK court approving a s.425 scheme (which has the characteristics of a Directive reorganisation measure or

winding up proceedings) when the EEA credit institution is subject to reorganisation measures or winding up proceedings unless:
(a) notice is given to the administrator/liquidator and the relevant administrative/judicial authority for the credit institution; and
(b) none of them has objected (regulation 4(2) and (3)).

The effect is that the s.425 regime is generally available to an EEA credit institution. However, when it is subject to reorganisation measures of winding up proceedings in its home Member State, the court can only approve a s.425 scheme (which has the characteristics of a Directive reorganisation measure of winding up proceedings) with the consent of the home Member State's authorities.

Question 5 – Do consultees agree with the approach to implementing Article 11?

Article 11 requires that the competent authorities of the home Member State be consulted before the governing bodies of a credit institution take any voluntary winding up decision. The consultation proposes that Article 11 captures both Creditors' and Members' voluntary winding up proceedings as in both cases the winding up is commenced by a resolution of the shareholders of the credit institution. The Regulations state that before or at the time of the service of a notice of a meeting at which such a resolution is to be moved, the credit institution must send a copy of the notice of the meeting to the FSA.

One response raises concerns that where members of a company resolve to make an application for an administration order or for the appointment of an administrator, this could be construed as a voluntary winding up, subject to Article 11, if the administrator is unable to rescue the company. Therefore, such an administration is within Article 11.

HMT response – The Treasury response whereby the Regulations will only apply to court based routes into administration means that these concerns no longer apply.

Question 6 – Do consultees agree with our approach to the implementation of Article 5?

Article 5 creates an obligation on the administrative or judicial authorities of the host Member State to inform the home Member State of any reorganisation measure in the host Member State.

Consultees agree that this appears to be at odds with the underlying scheme of the Directive which is that only the home Member State's authorities have power to decide on reorganisation measures or winding up proceedings.

The view taken in the consultation document to implementation of this Article is that this Article refers to implementation of reorganisation measures by the

UK courts in respect of a branch of an EEA credit institution on behalf of or at the request of the home Member State's authorities.

One respondent suggests that this Article may in fact be a reference to third country institutions, while another suggests that the word host has been incorrectly included in place of the word home. This response also puts forward an alternative construction – that Article 5 allows the administrative or judicial authorities of a host Member State to alert the competent authorities of the home Member State to the need to implement reorganisation measures on the basis that the administrative or judicial authorities of the host Member State would (but for Article 3), have implemented such measures themselves.

One response raises concerns that the approach laid out in the consultation document to the implementation of this Article, conflicts with the terms of regulation 3, which does not permit a reorganisation or winding up proceeding to begin in the UK at the request of the home State.

HMT response – Following investigations into how Article 5 is being implemented in other EU states the Treasury agrees with the approach taken in Germany. The German authorities implemented Directive 2001/24/EG into national law by means of the "Implementation of Supervisory Law Regulations on the Reorganisation and Winding Up of Insurance Undertakings and Credit Institutions" Act of 10 December 2003.

In the implementation of Article 5, the relevant legislative provision states:

"The Federal Supervisory Authority (BAFin) will support reorganisation measures by the authorities of the home Member State, in the case of a deposit-taker or e-money institution with its headquarters in another country of the European Economic Area. If it believes that it is necessary to carry out reorganisation measures in a deposit-taking institution or e-money institution which has its headquarters in another country of the EEA, it will inform the competent authorities of that country."

This is intended by the German authorities to cover the rare cases in which the host State is informed of irregularities before the home Member State, and then passes on this information to the home state's regulatory authority. This may occur for example in the course of examining an institution falling within its own area of responsibility, which is doing business with firms from the home member state, or for example more generally through complaints it has received.

However, in the UK, the relevant administrative or judicial authority is the court. The Treasury believes that there are no circumstances in which the UK court would become aware of such information and would be in a position to come to a conclusion that a reorganisation measure was necessary in respect of an EEA credit institution. Regulation 3 would prevent any matter regarding the branches of an EEA credit institution coming before the UK court. In the UK, this obligation falls to the FSA. Therefore, the Treasury decides that

Article 5 should be implemented within the UK by imposing this obligation on the FSA rather than the court – in regulation 10(3).

Question 7 – Are consultees content with the approach to implementation of Article 12?

Article 12 requires the authorisation of a credit institution which is the subject of winding up proceedings to be withdrawn. However, the Directive allows the credit institution to continue to carry out its activities subject to the competent authority's supervision. The consultation states that this is implemented by requiring the FSA to use its powers under section 45 of FSMA to vary or cancel the credit institution's permission to accept deposits.

Consultees responding to this question are broadly happy with the approach, however one respondent asks if regulation 11 should apply if the company is the subject of an administration order or appointment where the administrator is unable to rescue the company.

HMT response – The Treasury agrees that regulation 11 should apply if the institution is the subject of a court-ordered administration where the administrator concludes that he is unable to rescue the company. The Regulations are amended accordingly. Non-court appointed administrations are, as set out above, outside the scope of the Directive.

Question 8 – Are proposed cases where we have required publication of details in the OJEC and two national newspapers appropriate?

Consultees responding to this question agree that the cases where we have required publication in the Official Journal of the European Communities and two national newspapers are appropriate.

Question 9 – Do consultees agree with our approach to the implementation of Article 15?

Article 15 provides that a person who "honours an obligation" to a credit institution which is not a "legal person" and which is the subject of winding up proceedings in "another Member State" is deemed to have discharged his obligation to the credit institution if he was unaware of the winding up proceedings. The consultation document proposes to implement this Article in relation to a creditor who is outside the UK and who has discharged an obligation to a UK credit institution which is being wound up.

One response asks whether regulation 13 is necessary, as the concern that Article 15 addresses does not appear to arise under UK insolvency law. The response argues that Article 15 deals with a situation where a bank's debtor paid the bank, rather than its insolvency officer, and as a consequence did not get a good discharge of his obligation. In the UK, it is argued that it is not possible for a payment to be made to an insolvent person but not amount to a good discharge, unless the insolvent person is an individual – payment to the insolvency officer or to the person amounts to the same thing. In the UK,

individuals are not permitted to become banks and therefore there is no need for regulation 13.

HMT response – Article 15 refers to a "credit institution which is not a legal person". The Treasury takes the view that this means credit institutions which are not bodies corporate. This will include partnerships, and therefore this Article must be implemented.

Question 10 – Do consultees agree with the approach to Article 7?

Respondents either have no comments or agree with the approach to Article 7.

Question 11 – Is the proposed timescale for notifying creditors appropriate?

Consultees responding to this question broadly agree that "as soon as is practically possible" is sufficient to cover the requirement of Article 14 that creditors be notified of the commencement of winding up proceedings "without delay".

One response however, comments that regulation 14 creates an offence where the liquidator fails without reasonable excuse to make the required notification, while the Directive does not require this. The response asks whether the Treasury has the power to create such an offence.

This response also asks whether the requirement to notify creditors on the making of an administration order or on the appointment of an administrator where the order or appointment "is made for the achievement of a purpose mentioned in paragraph 3(1)(b) or (c) of Schedule B1 to that Act…" properly reflects how the regime under paragraph 3 of Schedule B1 of the Insolvency Act 1986 is intended to operate. The response suggests that the obligation to give notice should arise when the administrator has resolved that Paragraph 3(1)(b) or (c) should apply and the administrator has given notice in accordance with the Insolvency Rules or resolved that he will make a distribution to one or more classes of creditor.

HMT response – The Treasury is obliged to implement the Directive, in a way that is effective and enforceable. The Treasury has the power to create an offence under section 2(2) of the European Communities Act 1972, to ensure that the obligations placed on, amongst other people, liquidators are effective and enforceable.

The Treasury accepts the response regarding administrations and the Regulations are amended to include a provision whereby notification needs to take place where there is a relevant order. This is defined to mean, where the administrator has made a statement to the court that the company cannot be saved as a going concern (i.e. the objective under paragraph 3(1)(a) of Schedule B1) under rule 2.2 of the Insolvency Rules 1986.

Question 12 – Is the definition of a “known” creditor adequate?

As set out in regulation 14(9) a “known” creditor is defined as one if the appointed officer is aware of, or should reasonably be aware of his identity, his claim or potential claim, and a recent address where he is likely to receive a communication.

One response notes that regulation 14(9) does not limit the concept of a “known” creditor to any creditor who has his domicile, place of residence or head office in any other EEA Member State. The response argues that regulation 14 should not apply to any creditor who has his domicile, place of residence or head office in the UK as this would impose the requirements of Article 14, at potentially significant cost in a small domestic insolvency.

HMT response – The Treasury does not propose to alter the fact that regulation 14(9) does not limit the concept of a “known” creditor to any creditor who has his domicile, place of residence or head office in any other EEA Member State. This would have the effect that creditors outside the UK might be better informed than those inside.

Question 13 – Are any additional requirements in reporting to creditors necessary in order to comply with the Directive?

Article 18 provides that liquidators keep creditors regularly informed of the progress of winding up proceedings.

One respondent asks what forms of liquidation this is intended to cover.

HMT response – The Treasury confirms that regulation 16 will apply where there is a creditors’ voluntary winding up, a provisional liquidation, a court-ordered winding up, an administration and where an administration moves to a creditors’ voluntary liquidation under Schedule B1 to the Insolvency Act 1986.

Question 14 – Do consultees agree with our proposals for draft regulation 17?

Regulation 17 permits any document which is required to be given to be sent either using post, or using electronic means of communication.
Consultees responding to this question broadly welcome the decision to permit notices to be sent by electronic means.

Question 15 – Do consultees agree with our approach to implementation of Articles 20 to 27 and 30 to 32?

Articles 20 to 27 and 30 to 32 confer protection in relation to rights against a credit institution, which are, broadly connected with property situated in another Member State, and which are to be determined according to the law of that other Member State. The regulations adopt the approach largely of

copying out the terms of the Directive in relation to these exceptions to the rule that the home Member State law applies.

Two responses question why regulation 28, implementing Article 23 of the Directive, has been limited by requiring set-off to be permitted by the law of the EEA State applicable to the credit institutions' claim, as this excludes set-off where the law applicable to the credit institution's claim is not the law of an EEA state (such as New York law). This also does not seem to match with the underlying Directive and with the provisions of the Council Regulation on Insolvency Proceedings.

One response highlights that in terms of implementing Article 27, different insolvency measures deal with regulated markets in different ways, leading to a situation where different entity types operating in the same market would be subject to different insolvency principles. The response suggests that the Regulations should reflect the language used in Article 9 of the EU Insolvency Regulation. There are also concerns that regulation 29 does not cover certain transactions carried out in the context of a pure payment system e.g. CHAPS, markets such as the LME and IPE and settlement systems such as Euroclear.

A number of responses raise concerns as to the overlap of these Regulations, other EU legislation and the Financial Collateral Arrangements (No.2) Regulations 2003.

A different response asks for further clarity with regard to: whether the law referred to regulation 34, implementing Article 25, is the contract law of the relevant jurisdiction or encompasses the insolvency law of that jurisdiction; and the relationship between regulations 28 and 34.

One response asks whether draft regulation 34 should include a specific reference to master netting agreements.

HMT response – The Treasury agrees with the responses on regulation 28. The regulation has therefore been amended to remove the limitation which requires set-off to be permitted by the law of the applicable EEA State. The amended regulation reflects the wording of Article 23 by referring to the "law applicable to the credit institution's claim".

With regard to the how regulation 29 deals with regulated markets, this term is defined in Article 2. The Treasury takes the view in implementing the Directive, that the scope of regulation 29 cannot be extended beyond the definition without a substantial risk either of going beyond the power in section 2(2) of the European Communities Act 1972 to implement the Directive or of improperly implementing the Directive.

Similarly, the Treasury response to queries about the possible overlap and inconsistencies in regulations 28 (creditors' rights to set off), 29 (regulated markets), 33 (lex rei sitae) and 34 (netting agreements) created by the interplay between similar but different provisions in the Directive, the Insurers Reorganisation and Winding Up Directive (2001/17/EC), the Insolvency

Regulation (1346/2000/EC), the Settlement Finality Directive (98/26/EC) and the Financial Collateral Directive (2002/47/EC) and the need for further clarity in some areas, is that the Treasury's obligation is to implement this Directive properly in accordance with its terms. An attempt to revise these Regulations (or indeed the legislation implementing the other Directives) to create a harmonised system applicable to set-off, netting agreements, regulated markets and the lex rei sitae would run a significant risk of failing to implement the Directive properly and effectively.

Our approach to the derogations from the application of home Member State law is largely to copy out the terms of the Directive. These exceptions set out where UK law will not necessarily apply and therefore the exceptions must encompass concepts which may not be familiar under UK law but which arise under other Member States' legal systems. Any attempt by the Treasury to implement these exceptions by using concepts under UK insolvency laws would run the risk of failing to implement properly.

Question 16 – can a realistic estimate of the monetary value of the savings to be made from implementing the Directive be made?

Question 17 – can the compliance costs be estimated?

No consultees have been able to provide estimates of the savings or costs of implementing the Directive.

Other responses – Third Country Credit Institutions

One respondent asks for clarification as to the intended effect of treating the UK branch of a non-EC credit institution as a UK credit institution for the purposes of the Regulations.

HMT response – The Treasury confirms that Articles 8 and 19 of the Directive in fact do not provide sufficient scope for a branch of a third country credit institution situated in the UK, to be treated as if it were a UK credit institution, notwithstanding recitals 21 and 22. The Regulations therefore apply only the notification requirements set out in regulations 9 and 10 to branches of third country credit institutions. These require that the UK court shall without delay, inform the FSA of the implementation of reorganisation measures or winding up proceedings on the branch of a third country credit institution. The FSA must notify the competent authorities of the other host Member States in which the institution has set up branches.

Other responses

In addition, a number of respondents highlight small drafting changes to be made throughout the Regulations. The Treasury has incorporated these changes where appropriate.