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The Financial System and Major Operational Disruption 24 April 2003
FSM team,
Room 4/16,
HM Treasury,
1, Horse Guards Road,
London,
SW1A 2HQ

Dear Sir,

HM TREASURY CONSULTATION PAPER

The Financial System and Major Operational Disruption – February 2003 (CM5751)

As you are no doubt aware, Lloyds TSB is one of the leading UK-based financial services groups, whose businesses provide a comprehensive range of banking and financial services in the UK and overseas. As such, we welcome the opportunity to comment on HM Treasury's consultation paper on the financial system and major operational disruption.

We agree that new or amended legislation should be considered. However, bearing in mind the interlinkages between markets and the global dimension of the City of London, we strongly believe that further in depth investigations are required before any legislative changes are considered. Specifically:

- We agree that new or amended legislation should be considered.
- Bearing in mind the inherent complexities and interlinkages, we believe in depth research is essential before any legislative changes are contemplated.
- Key elements of such complexity/interlinking are the global dimension and the need for ultimate cash settlement in a variety of currencies to underpin many market infrastructures.
- Finally, it is understood that a large number of trade associations, meeting under the auspices of the Financial Markets Law Committee (FMLC), have agreed to co-operate in research and Lloyds TSB will be pleased to support this initiative through the infrastructure bodies and trade associations of which it is a member.

However, we do not believe that the case is not yet made that the legal uncertainties resolved by the proposed powers would outweigh those created by them. Arguments for and against the proposed legislation cannot be assessed without a clearer understanding of how matters lie as regards existing legislation used in market dealings and powers available to public authorities. Therefore, we feel there is indeed more to be done in developing market-based approaches to catering for major disruption. An analytical exercise is needed, in the form of a 'gap analysis', to identify whether such gaps in preparedness exist and, if so, how they should be addressed.

Any analysis must be conducted from a City wide perspective and include the international dimension, at least as regards other main financial market places. It will need to cover various strands of work:

- powers currently available to public authorities
- comparisons and interdependencies with other jurisdictions/market places
- contracts currently used as standard in wholesale financial markets, especially as regards as events of default, frustration, force majeure clauses and similar; business dates; preventing others from taking unreasonable advantage etc.

The FMLC is considered to be the natural grouping to co-ordinate this legal analysis. It is believed that most market participants, infrastructure bodies and trade associations will happily contribute to this work. If there is wider work to be done, outside the legal sphere, the Bank of England is seen as the body best placed to co-ordinate it.

The greatest measure of legal certainty is considered desirable in the interests of orderly markets, particularly at times of crisis including major operational disruption. Whilst many market infrastructures and trade associations are upgrading their legal documentation in order to seek to achieve this, such private sector initiatives do require an appropriate legislative framework.

Answers to Questions

In view of the need for further research, we have restricted our responses to the key broad questions shown in Box 1.1

3 (b) Is there more that could usefully be done by the private sector to strengthen the contingency provisions in contracts and other legal instruments? Is there a role for the authorities in assisting with this?

We believe the answer is 'yes'. However, in view of the international and multi jurisdictional nature of the London market combined with complex interlinkages between market infrastructures, our view is that considerable investigation work is required before attempting to draft any legislation (see also 3 (c) below).

3 (c) Is there more that could be usefully done in the private sector to strengthen market co-operation? Is there a role for the authorities in assisting with this?

We believe that again the answer is 'yes' particularly to manage major disruption that could arise from a terrorist attack; for example if a significant area is uninhabitable for a period of time. Our view is that initial research should be undertaken by market specialists under the auspices of bodies such as the Financial Markets Law Committee and Bank of England. Whilst there may well be a role for the authorities, we do not consider this will become clear until after the initial research has been done.

4 (a) In principle, would it be useful to have new legislation to help promote order in the financial system in the face of major operational disruption?

At first sight there would appear to be merit in either new or amended legislation e.g. neither the Emergency Powers Act (1920 as amended in 1964) nor the Financial Dealings & Markets Act 1971 were designed with 21st Century conditions in mind. However, we believe the complexity referred to in '3(b)' above requires that any such legislative changes should be thought through very carefully, to avoid the possibility of creating more problems than are solved.

4 (b) Have you any comments on: how new legislation might address risks; the possible disadvantages and limitations of new legislation; and the general constraints on the use of new legislation?

Our initial view is that any legislation should set down a framework laying out principles, rather than go into great detail, be market infrastructure/technology independent, probably enacted in conjunction with similar legislation in other major financial centres and contain comprehensive safeguards to restrict use to operational disaster situations.

4 (c) If new legislation were to be sought, are the suspension and direction powers the right choices? Are there any other types of legislation that might be useful to help promote order in the financial system?

Suspension Powers could fulfil a useful purpose. However, we retain an open mind on Direction Powers. In practice, we believe that it is important that market experts are involved in the decision making on an ongoing basis during a period of crisis. We do not believe it is sensible to comment on any other types of legislation pending the research referred to above.

6 (I) Do you support the idea of a suspension power, subject to the constraints of paragraph 6.28?

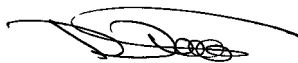
We believe that Suspension Powers on the lines described is worthy of consideration but do not believe sufficient information is available at the present time to give a comprehensive response.

7 (f) Do you support the idea of a direction power, subject to the constraints of paragraph 7.29?

We are less convinced about the need for Direction Powers for the reasons outlined in 4(c) above but retain an open mind pending in depth research.

In summary, we therefore believe the HMT paper provides an excellent stimulus to discussion, which needs to take place. However, due to the complexity and interdependencies of financial markets, substantive research is required before contemplating legislation. Such research is best carried out by the private sector including market specialists co-ordinated by bodies such as the Financial Markets Law Committee and Bank of England.

Yours faithfully



R J Whatford,

Director of Group Operations