SPECIAL ADMINISTRATION REGIME FOR INVESTMENT FIRMS

Comments by the Association of Business Recovery Professionals in response to the consultation document issued by HM Treasury in September 2010

Q1. Do you agree with the Government's proposal to clarify the scope of the SAR through an amending order to make it clear that 'client assets' includes client money? Will amending the order as described cover all the ways in which an investment firm can hold client assets?

1. Certainty is welcome and client money should in principle be treated the same as client assets. However where there are disputes about client money (for example segregation, identification etc) they should not hold up the return of client assets.

Would adapting the provisions of the SAR to apply in respect of LLPs or partnerships raise any significant consequences?

2. Special consideration needs to be given to how the proposed special administration regime would apply in the case of Scottish partnerships. Under Scots insolvency law these (but not limited liability partnerships) are dealt with under the sequestration regime; they are not treated as corporate entities as they are under the insolvency regime in England and Wales. Accordingly a completely new set of Rules would need to be put into place to facilitate this and it would be Holyrood rather than Westminster which would require to introduce them.

3. The legislation governing insolvent partnerships and limited partnerships in England & Wales is complicated: it is still possible for the affairs or an ordinary partnership to be wound up simply as part of bankruptcy orders being made against the individual members. The partnership insolvency legislation does not stand alone, but merely amends provisions of the Insolvency Act. As such it is difficult to navigate. Any proposal to adapt the provisions of SAR to ordinary or limited partnerships must therefore take into account the potential application of personal insolvency law to the partnership.

Q2. Do you agree with the proposals for initiation of the SAR, as set out above and in draft regulations 4 to 8?

4. Yes.

Q3. Should the scope of Objective 1 be amended in either of the ways set out in paragraph 2.23?

5. Broadly, the scope of Objective 1 should be as broad as possible so that there is no legislative impediment to the return of client assets where ownership is clear.

6. The principal issue is where the assets are held as collateral. One of the delays in returning assets relates to the potential liability of the administrator if he gives away collateral of the estate before he has established the full liability of the client (which may be quite complex). Where an investment firm goes into insolvency the normal balance is reversed – the client needs protection from the firm rather than the other way round. The administrator should be allowed to release collateral to the client in exchange for an undertaking to return it or cover any shortfall if necessary. If the undertaking is subsequently dishonoured the administrator should not be liable.

7. We note that in regulation 2 (Interpretation), 'return of client assets' means that 'the investment bank relinquishes full control over the assets for the benefit of the client…' We are not sure what is meant by 'full' in this context – it seems to us that the bank either relinquishes control or it does not.

Q4. Do you agree with the bar dates proposal as set out in draft regulation 11?

8. In principle, yes. However, we suggest that in regulation 11(3) the 'reasonable time' should be from the date of giving notice of the bar date, not the publication of the administration. This appears to be the intention indicated in paragraph 2.27 of the document. It might also be helpful to specify a minimum notice period.

Q5. Do you agree with the allocation of shortfalls proposal as set out in draft regulation 12?

9. Yes. In practice the calculation of the allocations will be difficult and complex but not impossible.

10. We have some difficulty in understanding the meaning and effect of regulation 12(3). We assume that it means that in the event of a shortfall, the secured party's rights are compromised to the same extent as the interest of the client – i.e. that the shortfall to the client will not give rise to a shortfall to the secured party which could result in claims against other assets.

Q6. Do you agree with Objective 2 as set out in draft regulation 13?

11. Yes – This is an extension of Part VII of the Companies Act, which works well.

12. We have some difficulty with the wording of regulation 13(3). There seems to be something circular about requiring the infrastructure body to provide the administrator with information to enable him to provide information to the infrastructure body. Perhaps the circularity could be resolved by removing the words 'in pursuit of Objective 2'.

Q7. Do you agree with Objective 3 as set out in draft regulation 10?

13. We agree with the objective, but have some reservations about the way the administrator's duties are expressed in regulation 10(2).

14. In regulation 10(2)(a), the words 'commence work on each objective' seem inapt. We suggest they should read 'commence work towards achieving each objective'.

15. Regulation 10(2)(a) says that the administrator must 'commence work on each objective … in order to achieve the best result overall for clients and creditors'. But the interests of the clients and the interests of the creditors may be in conflict; what is in the best interests of one may not be in the best interests of the other. We suggest that the words 'in order to achieve the best result overall for clients and creditors' are deleted.

16. Furthermore, it is simplistic to imagine that the administrator will work on each objective separately as a discrete area of activity at different times. It is inevitable that work will involve elements of working towards different objectives at the same time. For example, work towards Objective 1 is bound to involve engagement with market infrastructure bodies, and therefore overlap to an extent with Objective 2.

17. For this reason, we believe that the requirement in regulation 10(2)(b) to set out in the proposals the order in which the administrator intends to pursue the objectives is unnecessary and unhelpful. It is merely setting up a conflict which does not need to exist. The statement of proposals should simply be required to set out the manner in which the administrator proposes to achieve each or any of the objectives.

18. In the light of the foregoing, we believe that regulation 10(3) is unnecessary and should be deleted.

Q8. Do you agree with giving the FSA a power of direction as set out above and in draft regulations 16 to 20?

19. The suggested consultation with creditors is unwieldy. In practice these decisions will have to be made at great speed and the creditor process will drag it down. The court application subsequently is no great safeguard, as the decision by the court will come after the event. The thought that the court may decline to give the requested order even though the administrator may have already (quite properly) operated on the FSA's direction will be troublesome for the administrator. We therefore suggest that where the FSA directs the administrator to prioritise one or more special administration objectives creditor approval of the proposal is dispensed with.

20. We also suggest that there should be provision for the administrator to be able to apply to court to challenge the direction. In circumstances where that power is exercised, the administrator should be relieved of the obligation to report to creditors until the court has ruled on the application.

Q9. Do you agree that the continuity of service provisions should be extended as set out above and in draft regulation 14?

21. The services need to be on the same terms. Otherwise, yes, subject to the comments below.

22. We believe that the requirement to show 'hardship' in regulation 14(2)(a)(iii) is too light a test. There is a risk that it could prove too easy to show some degree of hardship in every case, which could render the entire provision useless. To avoid this danger, we suggest that the requirement should be for the supplier to show that the continued provision of the supply would cause 'unfair harm'.

23. In regulation 14(4) the second 'by' should presumably read 'for'.

24. The known deficiencies of section 233 of the Insolvency Act 1986 itself in respect of other services would of course continue to apply during the special administration regime.

Q10. Do you agree with the modifications to Schedule B1 administration as set out above and in draft regulation 15?

25. The justification of this in paragraph 2.49 is wholly unsatisfactory. The statement that it 'goes a long way' to helping him when he goes out on a limb to help clients is going to be of little use in practice. The result of this is that the administrator's lawyers will advise him that he will be taking a material personal risk. This will result in a visit to court, quite possibly a contested hearing or an unsatisfactory outcome from the court, as in the Lehman case. His liability has effectively been extended by the specific duty to clients. The clients will sue him for failing to hand over client assets; if he does so he is potentially on the hook for a loss to the estate if the estate suffers a loss to that client. Please see response to question 3 at paragraph 5 above, which may ameliorate part of this problem.

26. The paragraph 99 change is welcome, removing the need for expensive Berkeley Applegate applications, but the share-out of the costs amongst the client assets (and monies) will be complex. Furthermore, the majority of the costs will be incurred in identifying client assets before they are actually returned to the clients, and this will need to be recognised in the relevant drafting.

Q11. Do you agree with the interaction of the SAR and Bank Insolvency Procedure as set out above and in Schedule 1 to the draft regulations?

27. Yes.

Q12. Do you agree with the interaction of the SAR and the Bank Administration Procedure as set out above and in Schedule 2 to the draft regulations?

28. This process is excessively democratic. There will simply not be time at the start of the case to have this engagement with creditors. What is the administrator supposed to do in the meantime? If he waits for the creditors and the clients and

the court before he takes action there is the danger of a significant value loss. It will make the situation much more uncertain and unattractive to the private sector purchaser which will have a substantial negative effect on public funds.

Q13. Do you agree that the Government should ring-fence the operational reserve in legislation so that it can only be used to pay certain suppliers of key services?

29. We are not convinced of the need for this. A Bank of England overdraft on day one would solve the problem much more simply.

Association of Business Recovery Professionals
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