

## **HMT CONSULTATION - ESTABLISHING RESOLUTION ARRANGEMENTS FOR INVESTMENT BANKS**

The Payments Council is pleased to respond to the HMT consultation paper “Establishing resolution arrangements for investment banks”. The Payments Council is the organisation that sets strategy for UK payments. It has been established to ensure that UK payment systems and services meet the needs of users, payment service providers and the wider economy. The Payments Council has three core objectives:

- to have a strategic vision for payments and lead the future development of co-operative payment services in the UK;
- to ensure payment systems are open, accountable and transparent;
- and to ensure the operational efficiency, effectiveness and integrity of payment services in the UK.

In this context, and in respect of its response to this consultation, the Payments Council is concerned with the smooth running and overall integrity of the UK’s payments systems; and also the legal, regulatory and operational underpinning of risk mitigation measures for the settlement banks in EUI who provide the liquidity and credit that facilitates the daily settlement of securities in the UK.

### **1. SUMMARY**

This Payments Council response concentrates on the aspects of the consultation dealing with:

1. Intra-day support (paragraphs 2.54-2.58). The Payments Council would be concerned if changes to legislation undermined the current protections afforded to its members who provide substantial amounts of liquidity and credit to their investment bank customers when settling open positions. It would be particularly concerned if legislation were introduced that imposed obligations on a settlement bank to provide liquidity or credit post-insolvency without adequate protection;
2. OTC Cash-equity trades and the AFME protocol (paragraphs 6.26 – 6.39). Settlement banks in EUI welcome the increased certainty provided by initiatives like the LIBA (now AFME) Protocol for OTC cash equity trades;



3. Settlement issues (paragraphs 6.68 – 6.80). Similarly settlement banks welcome the resolution of issues such as those highlighted by the EUI situation with outstanding matched but unsettled trades;
4. Recovery and Resolution Plans (Chapters 2 and 3). The Payments Council welcomes a wide debate about the role of RRP and is particularly interested in the authorities' views on where payments should fit in the plans of large complex firms that contain an investment bank and a payments bank. This must be achieved in a way that is consistent with the authorities' objective of maintaining the stable functioning of the payments systems, as expressed in the Banking Act 2009 and its accompanying Code of Practice, and does not affect the smooth running of the systems as a whole.

## 2. RESPONSES

The Payments Council is pleased to offer below more detailed comments on the points raised in the consultation paper that are relevant to the above.

1. Intraday support. Settlement banks in EUI provide liquidity and credit to support their customers' securities settlement activities by offering credit on an unsecured and/or secured basis. If secured, the collateral is the securities owned by the customer and held in CREST, subject to a floating charge. This practice is backed by a well-understood, if fortunately relatively untested, procedure under which EUI will, on disabling a failed participant and in response to the request of the settlement bank concerned, enable securities to be transferred into the bank's control. Central to this process is the exemption provided by Part 7 of the Companies Act 1989. Provided this process remains intact, and provided the collateral securities are capable of being valued and margined effectively (bearing in mind that market prices may be falling quickly), settlement banks should be prepared to go on providing liquidity and credit to a going-concern customer. But where the customer is effectively in run-off settlement banks would seek to discuss with the authorities what sort of special arrangements would be appropriate. If legislation provided backing for special arrangements of this kind (and particularly post-insolvency) it would be important to understand how the rights and responsibilities of liquidity and credit providers would be affected.



2. OTC equity trades. As stated above settlement banks welcome the improved certainty that would result from initiatives such as the AFME protocol. Care must be taken, however, to ensure that dealing with outstanding unsettled trades of insolvent parties in this way does not create an extra exposure or liability for a settlement bank that is acting as sponsor for an insolvent customer. For example, an insolvent party may have taken delivery of stock which is now under the control of its sponsoring settlement bank and that stock is the subject of a matched but unsettled sale instruction in CREST. The valuation put on the securities by the non-defaulting party (as per the AFME Protocol) should not bind the sponsoring settlement bank to accept that value if it seeks to realise the securities taken as collateral.
3. Settlement issues. Settlement banks welcome the additional certainty provided by EUI's proposed change in relation to matched but unsettled trades.
4. Payments Council has a strong interest in the debate about Recovery and Resolution Plans in the context of its overall responsibilities to ensure the operational efficiency, effectiveness and integrity of payment services in general. It welcomes many of the proposals, particularly those in relation to the maintenance of an orderly business structure, information and general operational effectiveness within a failing firm. We have been concerned that one of the first areas to suffer impairment when a firm's management is under stress can be the record-keeping that is essential to making payments on behalf of customers. One reason why the payments systems held up well during the turmoil of the recent years is that records in the payments areas of banks were, or appeared to be, in better shape than it appears the records of customer securities balances were at LBIE. RRP's are linked to the concept of special administration, being a tool designed to make the administrator's job easier. Nevertheless there are many areas of these concepts that remain unclear. For example:
  - The consultation paper proposes a special administration regime with specific objectives aimed at an orderly wind-down of the firm's affairs. During this time it needs to be made clear that a third party (for example a lending banker providing liquidity to facilitate closing out open positions) is not increasing its exposure to the failing firm without safeguards to enable it to recover outstanding debts.
  - It is possible that an investment bank is a member of a group that includes a deposit taker and a member of a payment system. The payments system operators that are contracted to the Payments Council have discretion (and in certain circumstances are required) to suspend a member if, for example,



they believe that that member threatens the integrity of their system. The authorities should be prepared to give guidance to payments system operators in these situations, especially if they wish to avoid a member's suspension.

- The paper envisages a period of several weeks where a firm which sees itself in difficulties puts in place certain internal procedures. Many of these procedures are, as the paper acknowledges, good practice which should be observed anyway. But to the extent that others involve identifying and possibly offering for sale parts of the business it may be difficult to prevent rumours springing up in the market. The clear concern is that this activity risks bringing about the very effect that it seeks to avoid. This is another example of the kind of circumstance in which payments system operators might wish to seek guidance from the authorities in respect of a potential threat to the integrity of their systems.
- There is a wider debate to be had on RRPs. If a firm which consists of both investment bank and deposit taking payments bank is required to make plans for the disposal of assets, including its business units, what is the strategic core which the firm aims to retain? In the Payments Council's view this should be the deposit taking payments units because this is likely to be the area of greatest public interest, and has the greatest impact on most of the Payments Council's members, but is possible that the bank's internal view puts greater emphasis on other areas of the bank. The Payments Council would welcome a dialogue with the authorities that led to greater certainty around these issues.

The Payments Council would be pleased to discuss any of these points with HMT and can be contacted as above.

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