ALLEN & OVERY

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Restructuring Across Borders

The Credit Institutions Regulations

Contents

Overview

The Credit Institutions Regulations 2004 (the **Regulations**) determine in which EEA Member State[1] reorganisation or insolvency proceedings can be commenced in respect of a credit institution, and the law that governs those proceedings. (Credit institutions are outside the scope of the EC Regulation on Insolvency Proceedings.) The Regulations implement in the UK the Reorganisation and Winding Up of Credit Institutions Directive (2001/24/EC) (the **Directive**). Each EEA Member State was required to pass national law giving effect to the Directive by 5 May 2004.

Broadly, the Directive and the Regulations establish a unified system for the reorganisation and winding up of EEA credit institutions by ensuring that a credit institution (and its EEA branches) is subject to a single set of reorganisation/insolvency proceedings in the home member state in which the credit institution is authorised. Local liquidations of local branches are not permitted.

A credit institution is a bank or other entity authorised by the relevant EEA Member State's regulator to carry on the regulated activity of accepting deposits. Certain entities may have been excluded by an EEA Member State from the definition of a credit institution. For example in the UK, the Regulations do not apply to credit unions, friendly societies and industrial and provident societies. Also excluded generally from the definition are the central banks of Member States and post office giro institutions and, in the UK, the National Savings Bank, the Commonwealth Development Finance Company Ltd, the Agricultural Mortgage Corporation Ltd, the Scottish Agricultural Securities Corporation Ltd, the Crown Agents for overseas governments and administrations.

Proceedings (and, subject to limited exceptions, the effects of those proceedings – including, importantly, whether there is a stay on legal proceedings and any discharge of debt enabled by the proceedings) which fall within the scope of the Directive will be automatically recognised in all EEA Member States.

Given the requirement for implementing national legislation in each EEA Member State, differences may arise for example between the UK Regulations and other EEA Member State's equivalent, which may lead to interpretation/conflict of law issues. This note considers the UK's implementation of the Directive.

[1] The EEA comprises the 27 EU Member States plus Norway, Iceland and Liechtenstein.

Jurisdiction to commence insolvency proceedings

As noted, the main purpose of the Directive is to ensure that only one set of reorganisation or winding-up proceedings is opened in the EEA in respect of a credit institution (including any branches in the EEA) and that those proceedings are opened in the EEA Member State in which the credit institution is regulated. Unlike companies which are regulated by the EC Insolvency Regulation, a credit institution's CoMI does not determine where proceedings may be opened. Local liquidations of local EEA branches, subject to

local law, are not permitted (ie there can be no secondary or ancillary proceedings in the EEA). This means that only a UK credit institution can be placed into UK reorganisation measures or UK winding-up proceedings under the Regulations (although a UK credit institution may be able to make use of insolvency procedures not covered by the Directive/Regulations and it may be possible for English insolvency proceedings to be opened in respect of a credit institution which is regulated outside the EEA).

The Regulations apply to "reorganisation measures" and "winding-up proceedings" (defined by reference to the Directive but with no list of which of the EEA Member States' proceedings constitute reorganisation measures/winding up proceedings). Reorganisation measures means measures which are intended to preserve or restore the financial situation of a credit institution and which could affect third parties' pre-existing rights, including measures involving the possibility of a suspension of payments, suspension of enforcement measures or reduction of claims. Winding-up proceedings means collective proceedings (ie insolvency proceedings for the benefit of all creditors) opened and monitored by the administrative and judicial authorities of a Member State with the aim of realising assets under the supervision of those authorities, including where the proceedings are terminated by a composition or other similar measure. Accordingly, it will be necessary to consider whether the proceeding in question falls within the definition of a "reorganisation measure" or "winding-up proceedings" This will usually be obvious, but not always so, particularly in relation to some of the specific bank insolvency procedures which have been implemented in EEA Member States in response to the financial crisis (for example, the appointment of the resolution committee to certain of the Icelandic banks in October 2008). It should be noted that the question of whether a reorganisation measure or a winding up proceeding that is commenced solely by way of a legislative act falls within the scope of the Regulations and the Directive has yet to be definitively answered.

If a procedure does not fall within the definition of "reorganisation measures" or "winding-up proceedings", then the Directive (and the consequences of the Directive) will not apply. Notably, there will be no automatic recognition of the procedure across EEA Member States including recognition of any stay provided for by the procedure and recognition of any discharge of debt enabled by such a procedure. For further information, refer to our Bulletin: No Holes in Your Bucket.

The Directive and the Regulations also apply to "third country credit institutions" ie credit institutions with their primary place of regulation outside the EEA but with one or more regulated branches in the EEA. In the case of such third country credit institutions, winding up proceedings or reorganisation measures can be commenced in the EEA in respect of each regulated branch in the EEA as if it were a separate legal entity. The Directive and the Regulations provide an obligation for notice of reorganisation measures or winding up proceedings commenced in respect of a third country credit institution to be given to the relevant EEA administrative or judicial authorities (in the UK, the Financial Conduct Authority).

Reorganisation and winding-up proceedings applying to UK credit institutions

In the event a UK credit institution finds itself in financial difficulties, the tools and procedures under the Banking Act 2009 (as amended by the Financial Services (Banking Reform) Act 2013)[1], known as the "special resolution regime" (the **SRR**), would be the most relevant.

The purpose of the SRR is to provide a range of tools to enable the rescue, and reduce the impact, of a failing bank. The main focus is on protecting the financial stability of banking systems and protecting depositors and public funds in order to ensure continuity of banking services.

There are two limbs to the SRR:

- The pre-insolvency "stabilisation" tools aimed at transferring all or part of the undertaking of the failing bank to a public or private sector entity and/or a bail-in of the failing bank by writing down and/or converting liabilities of the bank (subject to certain exceptions) into equity (broadly in a manner that respects the hierarchy of claims that would apply in an insolvent liquidation) and which may also entail a procedure known as bank administration (similar to the ordinary administration process for corporate entities) but which applies only to the 'residual' bank where there has been a part-transfer pursuant to the stabilisation tools; and
- A post-insolvency process – a special modified liquidation procedure (known as bank insolvency) aimed at ensuring the liquidator assists the FSCS in paying protected depositors.

For further information on the SRR and the Banking Act 2009, refer to our Bulletins: Special Resolution Regime for Failing UK Banks: an Introduction and New Insolvency Procedures for Banks and Building Societies.

The pre-insolvency stabilisation tools are likely to constitute a "reorganisation measure" for the purpose of the Regulations and the Directive but, given the flexible nature of the powers afforded by the stabilisation tools, their use would have to be assessed on a case-by-case basis. The post-insolvency process should constitute a "winding up proceeding" for the purpose of the Regulations and the Directive.

The general corporate restructuring and insolvency procedures (administration, liquidation, company voluntary arrangements and schemes of arrangement) may also apply to a UK credit institution but are less likely given the tailored nature of the SRR and the priority it is afforded.

[1] The Financial Services (Banking Reform) Act 2013 will introduce a new bail-in stabilisation option into the resolution toolkit – the implementing legislation is yet to come into force (expected spring 2014).

Recognition and choice of law

Reorganisation and winding-up proceedings which fall within the Directive must be recognised across the EEA without further formality.[1] In the UK, the Regulations provide that such proceedings will have effect in the UK in relation to: (i) any branch of that credit institution; (ii) any property or other assets of that credit institution; and (iii) any debt or liability of that credit institution, as if they were part of the general law of the UK.[2] Further, the officeholder appointed must be recognised and is entitled to exercise his or her powers in the UK.[3]

The same should apply across the EEA as regards recognition of UK reorganisation and winding-up proceedings.

As with the EC Insolvency Regulation, the Directive and Regulations provide that reorganisation measures and winding-up proceedings are to be governed by the law of the home Member State. So, in the case of an insolvency or reorganisation of a UK credit institution, English insolvency laws will apply as the starting point including English laws relating to the voidness, voidability or unenforceability of legal acts detrimental to all creditors (ie claw-back), whether there is a stay on the enforcement of security and the conditions under which set-offs may be invoked.[4]

However, as with the EC Insolvency Regulation, there are also exceptions to the general rule which, in certain circumstances, provide for the application of another law to that of the law of the home Member State. Where such an exception applies, it may be possible for the law of another Member State to be used as a defence against the application of the law of the home Member State. These exceptions include specific protections in respect of the enforcement of security, set-off and claw-back.[5] The broad aim of these exceptions is to uphold the legitimate expectations of third parties of the validity of the act in question in accordance with the law which would normally govern the transaction.

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1 Regulation 5 of the Regulations and Art.3(2) and 10 of the Directive. (There is no public policy exception to recognition as under the EC Insolvency Regulation.)

2 Regulation 5 of the Regulations. The precise scope of this wording is unclear. However, from the Scottish decision in *The winding-up board of Landsbanki Islands hf v Mills & ors* [2010] CSOH100, it can be implied that this wording provides for a similar effect as under the EC Insolvency Regulation (ie subject to certain exceptions, the insolvency proceedings commenced in respect of the credit institution will have the same effect in the UK as they do under the law of the State where the insolvency proceedings have been commenced).

3 Regulation 5 of the Regulations.

4 Regulation 22 of the Regulations and Arts.3 and 10 of the Directive.

5 Regulations 23 – 35 of the Regulations and Arts.20 – 33 of the Directive.

Key contacts

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