Are investment banks special?

Henry Page reflects on the industry's use of special administrations for investment banks.

Special administrations for investment banks were introduced under the Investment Bank Special Administration Regulations 2011 (SAR), following the financial crash of 2008, and the failure of Lehman Brothers. The government highlighted that investment firms were central to the economy and improvements were needed to ensure that the relevant insolvency professionals had the ability to deal with future failures of investment banks. The SAR therefore sought to learn lessons from Lehman, and were seen to be a means of resolving the conflict between using a traditional administration and allowing for the protection and return of client money.

When do the SAR apply?

The SAR apply to investment banks (see box) and, with the exceptions of needing to achieve the objectives of the special administration (as set out opposite); needing a court appointment, and other minor technical differences such as setting bar dates for client money claims; the procedure is largely the same as that set out in Schedule B1. Therefore, while any insolvency of a financial institution does require careful planning and experience (as well as appropriate legal advice), the procedure for dealing with a special administration will be essentially familiar to everyone reading this article.

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The definition of an investment bank is broad, and will include entities that do not initially stand out as 'investment banks'. Examples may include foreign exchange brokers, asset managers or stockbrokers. If the SAR apply, because the entity falls within the definition above, special administration is the only option available unless certain conditions are met, essentially that the FCA consents to an alternative procedure, or otherwise does not object for a period of two weeks after being given notice of the preliminary steps taken in respect of the alternative procedure. It should be noted that, where the investment bank is a deposit taker, the bank (or building society) special administration or bank (or building society

What is an investment bank?

Investment banks are institutions, which for the purposes of the SAR, are defined in the Banking Act as:

- having permission under Part 4 of the Financial Services and Markets Act 2000 (FSMA) to carry on at least one of the following regulated activities:
  - *safeguarding and administering investments; and/or*
  - *dealing in investments as principal; and/or*
  - *dealing in investments as agent;*
- holding client assets (whether or not on trust and including money); and
- being incorporated or formed under the law of any part of the UK (this includes companies, limited liability partnerships and partnerships).

However, the regulations do not apply to insurance intermediaries.

insolvency regimes, established by the Banking Act 2009, apply.

Practically, this means that whenever acting in the financial sector an IP will need to ensure that they gain a full understanding of exactly what operations the business carries out, and whether it is authorised under Part 4 of the FSMA and/or the Banking Act.

The special administration objectives

While there are still three objectives to be achieved in a special administration, they are not prescriptively ranked by the SAR, or exclusive of each other, with all three objectives to be pursued, rather than the waterfall ranking of Paragraph 3(1) of Schedule B1 (which we all know and love!). This gives the special administrator the flexibility to prioritise the objectives within the special administration proposals (unless otherwise directed by the FCA) in order to achieve the best overall result for clients and creditors.

The special administration objectives are:

- to ensure the return of client assets as soon as is reasonably practicable;
- to ensure the timely engagement with the authorities (the Bank of England, the Treasury and the FCA) and market infrastructure bodies; and
- to rescue the investment bank as a going concern or to wind it up in the best interests of the creditors.

The FCA does have the power (after consultation with the Treasury and the Bank of England) to direct the insolvency practitioner to prioritise one of the objectives at the expense of another if necessary to maintain the public confidence in the stability of the UK financial markets. Although under the FSMA the FCA has always had the ability to override an administration appointment, they do not have the ability to intervene in the pursuit of an ordinary administrator's objectives. The ability to impose such a direction on a special administrator is a significant difference of the SAR regime.

As with a normal administration, the special administrators will set out how the special administration objectives will be achieved in a statement of proposals to be approved by the creditors, and circulated to both the creditors and the clients of the investment bank, along with the relevant authorities.

Potential for insolvencies great and small

The first special administration under the SAR was MF Global UK Limited, where KPMG were appointed on 31 October 2011, some eight months after the SAR came into force. At the time of writing MF Global is approaching its fourth anniversary, having largely achieved its objectives of returning substantially all client money, and having paid unsecured dividends approaching 90p in the pound.

> The scope of to whom the SAR apply is broad, encompassing many financial markets businesses, where options in insolvency will be restricted without the authority of the FCA.

However, over recent years the perception of the SAR has moved on from being solely associated with the likes of Lehman and MF Global style mega-insolvencies, to being a legitimate, usable tool in any relevant qualifying insolvency situation. Indeed, a qualifying investment bank, as defined above, must enter special administration as opposed to another insolvency process unless otherwise approved by the FCA, and indeed the regulation notes that some of the businesses may be small businesses. Recent special administrations undertaken by a number of medium-sized insolvency practices demonstrate the more widespread use of the SAR. Other such appointments include City Equities Limited, Hartmann Capital Limited, Pritchard Stockbrokers Limited, LQD Markets (UK) Limited and Boston Prime Limited.

Having been involved in various aspects of a number of special administrations since initially trading MF Global claims three years ago, it struck me earlier this year that the SAR apply to many financial markets businesses whose insolvency options are therefore limited. Advice in relation to various special administrations has included assisting investors with money tied up in special administrations on how to comply with conditions attached to bar-dates for submitting claims, as well as offering more general advice on the implications and requirements contained within the often acronym- and jargon-heavy proposals and reports issued by joint special administrators. We have also provided pre-appointment advice to corporate clients prior to entering special administration.

IPs have become used to regulation change and the absorption of new laws as part of our day-to-day working lives, and some of the changes made it more difficult to achieve a successful outcome from an insolvent situation.

However, having now got to a point where there have been a significant number of special administrations, undertaken by a number of different firms and with interaction broadly across the industry, we have a regime that seems to be working well. While it is still relatively early days with the legislation only in its fourth year, it seems to provide the ability to deal with client assets, and minimise disruption to the financial sector, as it set out to do.

Responding to crises

Credit must go to the profession for not approaching the SAR with trepidation, which others less used to regulation change might have done and for getting to grips with the regime and achieving successful outcomes for clients and creditors.

Other special administration regimes cover railways companies; water, electricity and gas transporters and suppliers; air traffic service providers; NHS and Foundation Trusts; and public–private partnerships. Other industries such as oil and gas are potentially ripe for the implementation of a special insolvency regime.

Special regimes are obviously something that are here to stay, and have become the standard response to crises in industries of national importance such as health, transport and the financial markets, where the underlying national interest must be promoted ahead of creditors. At a time when the profession is facing challenges in relation to its public perception on a number of issues, to be central to successive governments' response to such crises, ensuring that core services, logistics and markets are kept operational, is potentially rewarding.

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