

The Association of Corporate Treasurers

Comments in response to
***Financial stability and depositor protection- the
Special Resolution Regime***
Consultation by HMT, Bank of England and FSA,
July 2008

19th September 2008

The Association of Corporate Treasurers (ACT)

The ACT is a professional body for those working in corporate treasury, risk and corporate finance. Further information is provided at the back of these comments and on our website www.treasurers.org.

Contact details are also at the back of these comments.

We canvassed the opinion of our members through The Treasurer magazine, and our Policy and Technical Committee in this case.

General

The ACT welcomes the opportunity to comment on this matter. We have focussed on the major issue.

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ACT members working for companies have, on behalf of their companies, significant volumes of dealings with banks and therefore take a keen interest in your proposals. Deals done with banks for deposits, investments, FX transactions and other financial instruments can mean that companies have material amounts due to them from banks. As creditors of banks, and being dependant on other bank services, Treasurers would have grave concerns in the event of a bank failure.

Recognising the importance of banks to the economic wellbeing of the country we fully appreciate your interest in devising measures that help towards preserving the stability of the financial system.

The ACT is concerned, however, about both the direct effect of some of your proposals on UK corporates as counterparties of banks as well as the indirect effect of them on the competitiveness of UK incorporated banks relative to those incorporated elsewhere. For example:

- We believe that the consequence of the proposals would be a relative increase in both the cost of capital and the operating costs for financial operations and risk management in both UK corporates and the affected banks.

- If the proposals were implemented we wonder if companies would get satisfactory legal opinions in relation to financial contracts with UK incorporated banks due to the uncertainties which would exist about the recourse to the assets of a bank subject to the SRR regime. This could mean that, embarrassingly, the ACT might need to recommend to members that they consider a policy of minimising their transactions with institutions which would be subject to the SRR regime.

Specific issues

The SRR undermines the rights of counterparties and threatens the legal certainty upon which markets currently operate. If the partial transfer tool were to be used, the authorities would have the ability to cherry-pick which assets and liabilities are transferred to a bridge bank and which are left behind in the rump bank. Any arbitrary restructuring such as this would be extremely damaging and destabilising to the financial system.

Commercial depositors with banks would become nervous that they will become subordinated to other claims of a failing bank, as would any party entering into a contract with a bank. There could even be problems in the case of a borrowing relationship since a partial transfer could leave the borrower reliant on a severely weakened rump bank.

A bank seeking to fund itself through the bond markets may find that the required legal opinions were qualified to warn of the possibility of certain types of depositor ranking ahead of the bonds. Such bonds would not be saleable or would require a much increased rate.

One of the prime reasons for most international issues in the Euromarkets being governed by English law has been the sanctity of contract and the reasonably high degree of certainty that that brings. The powers being proposed for the authorities to over-ride some security arrangements, master netting agreements and structured finance arrangements would be extremely damaging to the City's reputation for stability and the sanctity of contract. It is proposed that some netting arrangements in 'qualifying financial contracts' (swaps, futures, options, forwards and certain deposits) would not be overridden but no mention is made of protecting debt obligations generally.

We accept that there are valid reasons for there to be arrangements to protect retail depositors but this should not be at the expense of groups of other creditors selected arbitrarily as part of the partial transfer arrangements. The new special administration regime for the rump bank must not prejudice creditors and counterparties that have not been transferred. An inevitable consequence would be a trend for banks to split their business into two separate legal entities – a retail depositor base and a commercial base. This would defeat the object of the proposals and result in two weakened entities.

The ACT sees no objection to a power to cause a majority, or even all, of the bank's share capital to be transferred to a new controlling shareholder or to a power to dismiss and replace managers and/or directors, as both of these impact only the equity value or shareholder control of the bank and are consistent with the shares taking the first hit on a downturn in fortunes. (Any divestment of shares could be made subject to compensation being assessed later as at the date of transfer and payable by the transferee.)

We urge that careful attention be given to finding ways of avoiding, in any proposed legislation, guidelines and other arrangements, the detrimental effects referred to above.

The Association of Corporate Treasurers

The ACT is the international body for finance professionals working in treasury, risk and corporate finance. Through the ACT we come together as practitioners, technical experts and educators in a range of disciplines that underpin the financial security and prosperity of an organisation.

The ACT defines and promotes best practice in treasury and makes representations to government, regulators and standard setters.

We are also the world's leading examining body for treasury, providing benchmark qualifications and continuing development through training, conferences, publications, including *The Treasurer* magazine and the annual *Treasurer's Handbook*, and online.

Our 3,600 members work widely in companies of all sizes through industry, commerce professional service firms.

Further information is available on our website (below).

Our policy with regards to policy and technical matters is available at <http://www.treasurers.org/technical/resources/manifestoMay2007.pdf>.

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