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**Study on the feasibility of reducing obstacles to the transfer of
assets within a cross border banking group during a financial
crisis**

National Report

UNITED KINGDOM

By

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National report: England and Wales

Transfer of assets within a cross-border banking group during a financial crisis

Study on the feasibility of reducing obstacles to the transfer of assets within a cross-border banking group during a financial crisis and of establishing a legal framework for the reorganization and winding-up of cross-border banking groups.

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Part I - National regulation

1. Summary

This paper discusses the position in England and Wales in respect of asset transfer transactions entered into between a transferor and a transferee bank within the same group, with at least the former being incorporated in England and Wales. Consideration is given to transfers in both going concern and crisis situations.

Part 2 of this paper will examine asset transfers entered into between companies within a banking group according to general company law and insolvency law principles. Part 4 will briefly consider banking business transfers under Part VII of the Financial Services and Markets Act 2000 (**FSMA 2000**). The scope of this paper is limited as set out in Part 5.

2. Asset transfers

The fundamental principle of limited liability in English company law means that one company is not automatically responsible for the liabilities of another. Accordingly, transactions which may seem justifiable taking a corporate group as a whole do not necessarily stand up to scrutiny when considered on a "per company" basis.

In limited circumstances, English courts are willing to overreach the principle of limited liability, or to "pierce the corporate veil". However, as a general rule (and absent special circumstances, such as the existence of an agency relationship), other companies in a group will not have any responsibility for the liabilities of a single member of the group except in the case of fraud or improper conduct.

Transfers of assets made by one company within a group for the benefit of another company in the group must be *bona fide*, for a proper purpose and in the transferor's own interests. As an example, a parent may properly guarantee its subsidiaries' financial obligations where its motivation in so doing is to preserve the value of its investment in those companies. Likewise, a subsidiary may justifiably guarantee the obligations of another subsidiary in the group where it is concerned to protect and ensure the continuity of group support for its own financial obligations, for instance where the sister company in question performs a valuable treasury function within the group. By contrast, however, guarantees entered into by a subsidiary in respect of the obligations of its parent may be more difficult to sustain on such grounds.

There is no distinct concept in English law of a "group interest" which specifically facilitates intragroup transfers of assets. Further, there are no specific regulations in England and Wales applicable to cross-border transfers of assets.

3. Conditions and sanctions

Decisions to enter into transactions to transfer assets will normally be made by the board of directors of the transferor and the transferee, or pursuant to authority validly delegated by the board of directors. There is normally no need to obtain the prior consent or subsequent ratification of a particular course of action by the company's shareholders unless it would amount to an exercise of the directors' powers for an improper purpose. Where the company is insolvent or in financial difficulties, however, the interest of the company are identified with its general body of creditors rather than its shareholders; in such circumstances, the shareholders are therefore not able to ratify an improper exercise of the directors' powers.

There is generally no need to seek specific approvals for asset transfers from other third parties or supervisory bodies in England. In addition, there are no specific notification or publication requirements which must be complied with in the context of asset transfers.

As between the transferor and transferee, it is always prudent for evidential purposes to ensure that an agreement containing all the terms of the asset transfer is executed by its duly authorised representatives and a copy retained for future reference.

a) Reviewable transactions

In general terms, there is nothing to prevent a transferee within the same group of companies as the transferor from procuring the transfer of an asset or assets for full consideration in an arm's length transaction. Typically, one would expect any such transaction to be at market value. However, where this is not the case, the asset transfer may be susceptible to later challenge by aggrieved parties and/or insolvency office-holders subsequently appointed to the transferor and seeking to swell the available assets in his hands for the benefit of the company's creditors. Any such challenges are *ex post facto* in nature; the decision to transfer itself is not dependent in a strict sense on conditions relating to the financial health of the transferor or the transferee.

Unlawful distribution

The transfer of assets by a company to its parent company, at the direction of the parent, may be liable to be set aside by the court on the application of an insolvency office-holder if it is made at an undervalue, even in circumstances in which the transferor company was not insolvent at the time of the transfer. Under the common law, in order for a distribution to be lawful, the company making the distribution must have net assets after the distribution at least equal in value to its paid up share capital and share premium account. Further, the company must be satisfied that following the transfer it will be able to meet its liabilities, whether or not these liabilities appear on the company's balance sheet.

The Companies Act 2006 provisions on distributions achieve a similar result to the above common law rules, in that distributions must be made only out of realised profits and must be justified by the company's accounts. In particular, under section 830(1) Companies Act 2006, a company shall not make a distribution except out of profits available for the purpose. Further, provided the company has such profits, any transfer that is made at not less than book value will be deemed to have a distribution value of zero and will not therefore constitute a distribution for the purposes of section 830(1) (section 845(2)(a) Companies Act 2006). If any transfer is effected for a consideration of less than the book value of the asset concerned, the amount

of the distribution will equal the difference between the consideration received and the asset's book value, in respect of which the company must have distributable profits (section 845(2)(b) Companies Act 2006).

Where a distribution is made in whole or in part in contravention of the Companies Act provisions, then if at the time the distribution is made a shareholder knows or has reasonable grounds for believing that it is so made, he is liable to repay it or a sum equal to the value of the distribution (that is, the extent of the undervalue element) (section 847(2) Companies Act 2006). The provision is without prejudice to any other obligation for a shareholder to repay an unlawful distribution, for example under the IA 1986 statutory clawback provisions available to an insolvency office-holder.

It is not necessary that the transferee in these circumstances is an immediate parent of the company making the distribution in order for these rules and provisions; they may apply equally between different subsidiaries of the same parent. The critical consideration for these purposes is that the asset transfer is effected at the instance of a shareholder. Nevertheless, it will normally be the case that an asset transfer from a parent to a subsidiary will not involve a distribution.

Transactions at an undervalue

The court may, on the application of the liquidator or administrator, set aside a transaction entered into by the company with any person at an undervalue within two years of the onset of insolvency (which is, broadly, the date of the commencement of the winding up or administration) (section 238 Insolvency Act 1986). A transaction is at an undervalue if it constitutes a gift or if the company enters into the transaction for a consideration the value of which (in money or money's worth) is "significantly less" than the value of the consideration (in money or money's worth) of the consideration provided by the company. Put simply, the court merely has to compare from the company's point-of-view the inflow and outflow of consideration in monetary terms (*Re MC Bacon Limited* [1990] BCC 78).

In assessing whether a sale has taken place at an undervalue, the court looks in the first instance to the value of the consideration received as at the date of the transaction, but is also entitled to have regard to events occurring after the sale takes place where the sale value is dependent on the occurrence or non-occurrence of those events. Nevertheless, the sensible view seems to be that the court will take into account only those *ex post facto* events affecting the value of the consideration received by the seller which are relevant and reasonably foreseeable at the time of the transfer of the asset.

On a successful application, the court may make such order as it thinks fit for restoring the parties to the position which otherwise would have existed if the transaction had not been entered into.

For an order to be made under section 241, the company must have been unable to pay its debts within the meaning of section 123 of the Insolvency Act 1986 at the time of the transaction or as a consequence of the transaction. There is a rebuttable presumption that this requirement is satisfied where the transaction is entered into with connected persons. There is a defence available in circumstances in which the company entered into the transaction in good faith and for the purpose of carrying on its business and there were reasonable grounds at that time for believing that the transaction would benefit the company.

Preferences

The court may, on the application of the liquidator or the administrator, set aside a preference given by the company to any person within six months of the onset of insolvency or within two years if the counterparty is a person connected to the company (section 239 Insolvency Act 1986). A company gives a preference if it does anything or suffers anything to be done which has the effect of putting one of its creditors into a position which, in the event of the company going into insolvent liquidation, will be better than the position that creditor would have been paid in had that thing not been done and if, in so doing, the company was influenced by a desire to produce that result. In *MC Bacon Limited* [1990] BCC 78, it was held that, in order to establish that a person had been influenced by such a desire, it was not sufficient to show that the better position of the allegedly preferred creditor was the natural consequence of the transaction. Instead there must be present a desire to produce the preferential effect. There is a rebuttable presumption of such influence if the person to whom the preference was given was connected with the company at that time.

On a successful application, the court may make such order as it thinks fit for restoring the position to what it would have been if the company had not given that preference. For an order to be made under section 241 the company must have been unable to pay its debts within the meaning of section 123 of the Insolvency Act 1986 at the time of or as a consequence of the preference.

Extortionate credit transactions

The court may, on the application of the liquidator or administrator, set aside or vary the terms of a transaction entered into by the company for or involving the provision of credit to the company if transaction is or was "extortionate" and was entered into within three years prior to the appointment of the administrator or the company going into liquidation

(section 244 Insolvency Act 1986). A transaction is extortionate for the purposes of such an application if, having regard to the risk accepted by the person providing the credit, the terms of it are such as to require grossly exorbitant payments to be made in respect of the provision of the credit or if it otherwise grossly contravened ordinary principles of fair dealing.

Transactions defrauding creditors

The court may, on the application of the liquidator or administrator or a "victim" of the transaction outside of winding up or administration, set aside a transaction entered into by the company "at an undervalue" if the company entered into the transaction for the purpose of putting assets beyond the reach of a person who is making, or may at some time make, a claim against it or of otherwise prejudicing the interests of such a person in relation to the claim which he is making or may make (section 423 Insolvency Act 1986). A victim for these purposes is someone who is, or is capable of being, prejudiced by the transaction; most obviously, this would include a creditor of the company.

It is not a condition of the making of such an order that the company have been insolvent at the time of the transaction. A transaction at an undervalue is defined under section 423 of the Act in substantially the same terms as under section 238.

The main barrier to a successful claim under s423 is establishing the subjective element of the action; that is, a claimant must show that the transaction was entered into for the purpose of putting assets beyond his reach.

Rescission of contracts by the court

If a company goes into liquidation, any person who is entitled to the benefit or subject to the burden of a contract with the company may apply to the court for an order rescinding the contract on such terms as to payment by or to either party to the contract or damages for non performance, or otherwise as the court thinks just (section 186 Insolvency Act 1986). Any damages payable under the order to such person may be proved by him as a debt in the winding up.

The object of this section is to enable persons dealing with a company to convert obligations to perform contracts into money claims if the company goes into liquidation and the contract itself does not make express provision to that effect.

b) Timing

The extent of the risks to which a party is exposed in respect of an asset transfer depends to a large degree on the timing of the commencement of any insolvency proceedings:

- (a) if the insolvency proceedings commence after payments have been made in respect of the asset transfer, it is possible that a liquidator or administrator subsequently appointed to a party would seek to overturn such payments pursuant to one of the statutory claw-back provisions; or
- (b) if insolvency proceedings commence in the period between an asset transfer being agreed and the making of any payments pursuant to the asset transfer, the solvent party will be able to recover any such amounts from the insolvent party, and will simply rank as an ordinary unsecured creditor to the extent of such amounts. Any payments purported to be made after the commencement of proceedings could be challenged on a number of grounds, including that they constitute a voidable preference, they offend against the mandatory set-off rules, or constitute an invalid disposition under section 127 of the Insolvency Act 1986.

Void dispositions in a winding up

Any disposition of the property of a company made after the presentation of a winding up petition on which a winding up order is subsequently made is void, unless the court otherwise orders (section 127 Insolvency Act 1986). It is immaterial that the other party to the transaction did not have notice of the petition. A disposition would include the effecting of an asset transfer. On the making of a winding up order, section 127 will have retroactive effect from the date of presentation of the petition, notwithstanding that there may be a considerable delay stretching to a matter of months between the presentation of the petition and the eventual making of the order.

The court has the discretion to validate a disposition if it was made honestly in the ordinary course of business and prior to the winding up order being made (*Denney v John Hudson* [1992] BCLC 901). In circumstances in which there has been an asset transfer for full value, a validation order should be available on the grounds that there has been no dissipation of the insolvent estate.

The pari passu principle

It is a fundamental principle of English insolvency law that all creditors of the same class should be treated equally in a winding up. In general terms, this means that any arrangement the effect of which is to remove from the estate on winding up assets for the benefit of particular which would otherwise have been available to the general body of creditors will be struck down by the English court and will not be binding on the liquidator of the company (*British*

Eagle International Air Lines Ltd v Compagnie Nationale Air France [1975] 2 All ER 390). As a matter of public policy, this is likely to be the case even in circumstances in which an asset transfer is governed by a law other than English law.

Nevertheless, the *pari passu* principle would not, of itself, be invoked to invalidate any asset transfers which had been completed prior to the commencement of insolvency proceedings in relation to the party (for example, the time of the appointment of the administrator in the case of administration).

Insolvency set-off

There are mandatory set-off provisions contained in Rule 4.90 of the Insolvency Rules 1986 in the case of a winding up and Rule 2.85 of the Insolvency Rules 1986 in the case of an administration. These rules operate to the exclusion of other forms of set-off (including contractual set-off) not already exercised by the commencement of the winding up or, in an administration, the administrator giving notice that he proposes to make a distribution to creditors.

The set-off rules are applicable as follows:

- the reciprocal claims must be monetary claims or claims which a party is entitled to have reduced to money;
- there must have been a mutuality of dealings between the parties;
- the mutual dealings must have taken place before the "cut-off" date (broadly the date of winding up or administration or the earlier date on which the creditor had notice of an administration application or filing, winding up petition or creditors' meeting in a voluntary winding up); and
- the claim of the solvent party must be a "provable debt" in the winding up or administration - this will include unmatured, unliquidated and contingent debts, subject to the rules as to the estimation of such claims.

c) Information and transparency

Supervisory authorities

The Financial Services Authority (**FSA**) is an independent non-governmental body which regulates the financial services industry in the United Kingdom. The FSA's general principles require regulated banks to deal with the FSA in

an open way and to disclose anything relating to the firm of which the FSA would reasonably expect notice.

Banks typically report to the FSA on a quarterly basis, but for larger banks there is a continuous regulatory relationship and a constant flow of information to the FSA. As part of the FSA's routine supervision, a bank must provide information to the FSA that enables the FSA to determine whether:

- (a) the bank's business plan lacks credibility;
- (b) the bank may, at some future point, fail to satisfy the threshold conditions (which, under FSMA 2000 include legal status, location of offices, close links that might prevent effective supervision, adequate resources and suitability); or
- (c) there is a threat to consumer protection,

There is at present nothing to require banks specifically to disclose matters to the FSA on a transaction-by-transaction basis. Nevertheless, the FSA's level of supervision can be raised to a heightened supervisory regime following the occurrence of either a bank-specific or market-wide event which may have a negative impact on the market. If the FSA determines that a bank may breach the threshold conditions, it has a wide range of regulatory powers and sanctions to require the bank to address the situation. Furthermore, the FSA is in discussions over future proposals to require banks to provide evidence to the FSA at short notice, under certain circumstances, to demonstrate that they are meeting the threshold conditions.

There are no additional requirements to notify any of shareholders, employees or other third parties in relation to the transfer of bank assets.

d) Third parties

Third parties and individual stakeholder interests not directly affected by an asset transfer have extremely limited rights in relation to the transfer, including rights to prior notification or approval and rights of opposition. The FSA regulatory position is set out above. Employees and minority shareholders are unlikely to have direct rights of redress, except in the remote event that, for example, a shareholder is able to establish that the asset transfer amounts to conduct which is unfairly prejudicial to its interests under section 994 Companies Act 2006.

Similarly, deposit holders will have limited scope for opposing or directly overturning an asset transfer. They will, nevertheless, be able to claim compensation of up to £35,000 where their loss is a type recoverable under the Financial Services Compensation Scheme. The Financial Services Compensation Scheme is established under Part XV of FSMA 2000 as a compulsory scheme the purpose of which is to compensate customers who

suffer financial loss as a consequence of the inability of a bank or other firm regulated under FSMA 2000 to meet its liabilities arising from claims made in connection with regulated activities.

There is no specific right or obligation on the home Member State in relation to a transfer of assets in the event of a transfer to/from a transferee/transferor located in another Member State.

e) Private international law

Outside of insolvency, it is thought that the transferor and transferee's choice of governing law in respect of the asset transfer will normally prevail within the European Union. Nevertheless, the law of the jurisdiction in which the insolvency proceedings are commenced will likely determine matters of substance and procedure arising during the course of those insolvency proceedings. As is the case with insolvency proceedings opened in England, there may be certain mandatory provisions in other jurisdictions (such as claw-back provisions or restrictions on post-insolvency set-off) which could affect the asset transfer.

In bank insolvencies, the conflict of law rules which govern such matters as where insolvency proceedings should be commenced in a particular case, the applicable law and the coordination of insolvency proceedings in different jurisdictions should be coordinated may be resolved by reference to Directive 2001/24/EC of 4 April 2001 on the reorganisation and winding up of credit institutions (which is the appropriate legislation in the case of a credit institution, rather than the EC Regulation on insolvency proceedings, which applies to companies generally). The Directive was implemented in the UK by the Credit Institutions (Reorganisation and Winding up) Regulations 2004.

The general rule is that the law of the home Member State shall determine the effects of the insolvency (or reorganisation) proceedings. Nevertheless, there are exceptions to this general rule; for example, Article 23 of the Directive provides that the opening of insolvency proceedings shall not affect the rights of creditors to demand the set-off of their claims against the claims of the credit institution where such a set-off is permitted by the law applicable to the credit institution's claim.

If a party could be subject to insolvency proceedings in a jurisdiction other than England, the mandatory insolvency provisions of that jurisdiction could have an impact on the transactions that give effect to an asset transfer. In respect of parties with their head offices or branches in the European Union, the Directive may assist in determining where such insolvency proceedings may be commenced.

4. Banking business transfers

Banking businesses in the UK can be transferred by various methods, the most practical of which is by court order under Part VII of FSMA 2000. This was introduced in 2001 to facilitate a smooth means of transferring banking businesses which was less cumbersome and time-consuming than the other available alternatives (for example, multiple novation arrangements to which every individual account holder must consent).

The court procedure can be used for transfers of most businesses which include accepting deposits. In order to qualify, both the transferor and the transferee must either be authorised and regulated by the FSA and have permission for the taking of deposits, or have an equivalent regulatory authorisation and permission from an overseas regulator (section 106(2) FSMA 2000). As well as the power to sanction transfers of assets and liabilities located overseas, the court is also able to order the completion of any additional procedures that may be required overseas to perfect the transfer of the business (sections 106(4) and 112(4) FSMA 2000). However, recognition of the court's order in jurisdictions in which relevant assets are located will be a matter for the laws of that jurisdiction. Care must therefore be taken that rights relative to those assets are not prejudiced by the transfer.

Following a preliminary hearing, there will be public notification of the proposed business transfer under the Financial Services and Markets Act 2000 (Control of Business Transfers) (Requirements on Applications) Regulations 2001 (SI 2001/3626). The general public are then given the right to raise objections at the final hearing. If in all the circumstances of the case it is appropriate to make the transfer, the court will make an order sanctioning a business transfer scheme. The transfer of assets and liabilities takes effect pursuant to the order, even in circumstances in which any underlying contracts contain prohibitions on assignment (s 112(2)(a) FSMA 2000).

The documents will typically be substantively agreed by the parties in advance of the hearing and will be subject to review by the FSA, which will be concerned to ensure that customers are treated fairly and that its rules are complied with. It will consider certain legal and regulatory questions such as whether the correct regulatory permissions are in place and sufficient regulatory capital exists in the transferee. On a multi-jurisdictional transaction, the FSA will co-ordinate any communications with overseas regulators (paragraph 7(1)(b), Schedule 12 FSMA 2000). As a prerequisite to the court ordering the transfer, the FSA must provide a certificate stating that the transferee will, following the transfer, possess sufficient financial resources (section 111(2)(a) and paragraph 7, Schedule 12 FSMA 2000).

5. Scope of paper

For the purposes of this paper, a number of assumptions have been made, including that:

the directors of the transferor and the transferee, in entering into asset transfers, have acted in accordance with their duties under all applicable laws and under the constitution of the companies of which they are directors; and

there is no bad faith, fraud, coercion, duress or undue influence on the part of the transferor or transferee, their directors, employees, agents and advisers.

The information set out in this paper is subject to a number of qualifications, including that the protective regime contained in Part VII of the Companies Act 1989 and Part XXIV of FSMA 2000 relating to recognised investment exchanges and clearing houses does not apply in relation to an asset transfer.

This paper only considers, and is limited to, matters of English law.

Part II -Evaluation of potential solutions

1. Transfers from the parent company to the subsidiary or from the subsidiary to the parent at arm's length:

- **Proposal Number 1**

i) national measures to be revised

This proposal would, as regards the transfer itself, require alterations to English law.

There are no laws in place that currently prevent the transfers of assets between group companies in the first instance. This is because English law controls transfers from the point of view of a liquidator or administrator in

the event of a subsequent insolvency or from a common law perspective at the time of the transfer.

If the liquidator or administrator feels that the transfer was at an undervalue, or a preference, then he can challenge that transfer and claw back the money pursuant to s238 (transactions at an undervalue) or s239 (preferences) or s423 (transactions defrauding creditors) of the Insolvency Act 1986. These provisions would need disapplying so that, if the transferor company were to go into insolvency proceedings, a liquidator or administrator could not bring proceedings against the other group companies.

There are also long established common law principles that any transfer must be in the best interests of the transferor company. In the case of a market value transaction with the parent by the subsidiary this may be an obstacle. If there were minority shareholder there could be serious problems regarding their rights and unfair prejudice (s994 Companies Act 2000). In terms of what would essentially be a gift from parent to subsidiary the burden would be quite high to prove that this was in the best interests of the parent. Statute would need to be passed creating an exception from the 'best interests' rule in this situation. A similar exception would need to be made in respect of the Companies Act.

Changes would also need to be made to the Unlawful Distribution laws codified in s830(1) Companies Act 2006. At the moment a company cannot make a distribution except out of profits available for the purpose. This provision would need to be repealed.

ii) the feasibility of this solution from an English law perspective

This solution would require major overhaul of, and therefore disruption to, the English legal system.

It is a longstanding principle of English law that a company is an individual legal entity. There is no concept of 'the best interests of the group'. There is also no concept of a group as a legal entity in its own right.

This proposal would require drafting new legislation detailing the precise nature of how and when such transfers could be effected as there is nothing of this sort in place at the moment. There would also need to be a major overhaul of the insolvency legislation in order to prevent such transfers being challenged if the company were later to go into insolvency procedures.

Generally, we question the merit of making such changes given the current proposals that are set out in the Banking Bill and having regard to the interim Banking (Special Provisions) Act 2009.

iii) effect of this proposal on the interests of stakeholders

It seems to be that this proposal has little to recommend it. There is a large scope for certain stakeholders' interests to be overlooked for the greater good of a group, which can be a damaging concept. Even if a subsidiary is selling an asset at market value it may be biased by considering the parent's need for the asset as well as their own. The decision to transfer an asset at an undervalue or as a gift is likely to be controversial one and there is great potential for conflict.

The biggest problem with any proposal of this kind is the lack of legal certainty it can engender. This is particularly a concern under English law as companies contract with each other in their individual capacity, not as groups. This is particularly an issue for creditors as they may have security over most valuable assets. Freely transferring assets around a group in this way could be very prejudicial to their interests.

Put simply, moving assets around a group affects the ability of all parties to come to a judgement about the soundness of the company in relation to their loans, deposits or jobs.

iv) The only legal obstacles are those outlined in i)

2. Transfers from the subsidiary to the parent company (in preferential conditions)

a) Prior and overall agreements

▪ **Proposal Number 2**

i) national measures to be revised

There are the same points as were made above regarding the best interests of the companies entering into the agreement.

Regarding the disapplication of insolvency laws, this would not be a major change under English law. Transactions at an undervalue (under s238 IA 1986) and preferences (s239 IA 1986) are only capable of challenge by a liquidator or administrator if the company was unable to pay its debts at the time of the transfer or becomes so unable as a result of the transfer (s240 IA 1986). If the point above regarding the transferor's solvency were maintained then insolvency law should not be affected.

What would require change would be the fundamental principle of insolvency law that all creditors of the same class should be treated equally in a winding-up. Placing a transferor above all the other creditors would require changes to the order of priority as set down in Insolvency Act 1986. As above, the rules on unlawful distributions would have to be revised.

ii) the feasibility of this solution from an English law perspective

This arrangement is feasible from an English law perspective. This agreement would seem to be simply an agreement to transfer assets at a point in the future, conditional on the happening of certain events.

What would need to be considered would be the best interests of the individual companies at each point - both entering into the contract and at the time it was carried out.

The biggest change that would be required would be the change in the order of priority on a winding up and we feel that this will create uncertainty given the already numerous laws and procedures which are applicable in this area and the present arrangements that are being debated under the Banking Bill.

iii) effect of this proposal on the interests of stakeholders

The biggest problem with all the transfer proposals envisaged in this document is the lack of legal certainty it creates. This proposal has the advantage that the transfer would be following a set format in an agreement that has been considered by the Financial Services Authority (FSA). If this were a public document available for inspection then at least anyone who entered into a business relationship with the bank would be aware of its existence and its terms.

There is a risk to the interest of minority shareholders if they do not have an interest in the sister of parent to whom the asset is being transferred to. This could be ameliorated by thorough consultation when the agreement is entered into. Under this scheme there is less chance of the transferor company losing out as the value of the asset it transferred can be recovered.

Deposit holders are likely to benefit from a scheme such as this as each member of the scheme is more financially secure. There is a risk, however, that if all the companies in the group are in financial difficulty then they may not be able to honour their terms under the agreement and it would therefore be useless.

The group most detrimentally affected by this proposal are creditors. As there is no obligation on the transferee company to pay the consideration for the asset to the transferor immediately there is a clear risk that the value of the company would decrease after the transfer. If, on insolvency, the transferor is entitled to reclaim the value of the asset then the outcome for

creditors is worse than it would be if the transferee had entered into insolvency proceedings rather than accept the asset. Much would depend on the nature of the asset. If it had been sold and converted into money which was then spent then the outcome for creditors is poor. The transferor is taking the value of the asset back from the pool of funds that would otherwise be available for creditors.

There is also a risk for the creditors of the transferor company. Many debentures contain provisions for fixed and floating charges over all the assets of a company. Consequently any asset given away to another group company might well be secured. The security could transfer to the new company and the proceeds of sale of the asset (if it is sold) but there is a risk that, when assets are sent into companies in financial difficulty, it will not be possible to recover them. The creditor's position is ameliorated by the fact that the transferor company must not be made insolvent, however it is very possible that if one company in the group is in severe difficulty then problems may spread to another. In that case the creditor will suffer from having less security.

b) Strong guarantees covering the risk of outstanding payment

- **Proposal Number 3**

i) national measures to be revised

Directive 2002/47/EC was implemented in the UK as the Financial Collateral Arrangements (Number 2) Regulations 2003. The purpose of this note is not to comment on changes already proposed to the Directive¹, albeit analysis undertaken by others as to the means by which changes to the Directive would be implemented may be of relevance.

There are already provisions relating to the right of appropriation of the collateral taker which state that if the collateral taker has the right, and exercises that right, to "use and dispose of" the financial collateral then it must replace that collateral. This could form the basis of a provision as imagined in the proposals about replacing the original financial collateral to the transferor.

¹ draft (Brussels 17 March 2008) Proposal for a Directive (the "Proposal") of the Commission for the European Communities amending Directive 98/26/EC on settlement finality in payment and securities settlement systems (the "SFD") and Directive 2002/47/EC on financial collateral arrangements

The provisions on insolvency are slightly different to how they currently stand in English law. This proposal envisages the transferor being able to recover their collateral in priority in the case of a winding up. There are already substantial carve outs in English insolvency law with regard to the position of the collateral provider on a winding up. If the security is a floating charge (although it appears only one that has crystallised), the fund to be set aside for unsecured creditors out of floating charge realisations (introduced by the Enterprise Act 2002 - the Prescribed Part provisions) is disapplied. Section 245 of the Insolvency Act regarding the challenging of floating charges is also disapplied. The Regulations disapply paragraph 43(2) of Schedule B1 of the Insolvency Act 1986, as well as section 10(1)(b) and 11(3)(c) to enable creditors to enforce security against a company in administration.

As can be seen by this précis of the situation in the UK, allowing the collateral provider to recover their collateral in priority in a winding up is one step further than what the legislation currently provides.

ii) the feasibility of this solution from an English law perspective

The proposal is feasible from an English law perspective. It would require altering the Financial Collateral Arrangements (Number 2) Regulations 2003. However, we question the benefits of doing this at a time of flux, given the Banking Bill and the Government's recapitalisation scheme.

iii) effect of this proposal on the interests of stakeholders

The proposal would be in the interests of the parent as it would aid liquidity in times of crisis. The proposed changes to the insolvency procedures would substantially protect the subsidiary. This proposal would benefit deposit-holders and employees as it would reduce the risk of the bank collapsing. It may be considered unsatisfactory by creditors and minority shareholders in the subsidiary; however it would also not be in their interests for the parent to become insolvent.

c) Liability of the parent company for the subsidiary's debts

▪ Proposal Number 4

i) national measures to be revised

There are already some provisions under English law in which shareholders can be held liable for the behaviour of the company they control. If a distribution is made to another group company in contravention of s830

Companies Act 2006 (ie. it is not made from profits available for the purpose) and the shareholders are aware of this, they are liable to repay a sum equal to the amount of the distribution.

As for the creation of a preferred share, the rights attaching to shares are laid out in a company's articles. It would therefore be possible to alter articles by special resolution (pursuant to s21(1) of the Companies Act 2006) to include the details of this special sort of share.

There is, however in English company law, a fundamental principle of limited liability which means that one company is not automatically responsible for the liabilities of another. There are circumstances in which the courts will 'pierce the corporate veil' but they are limited. Generally, a shareholder's risk in relation to their investment will extend only to the value of that investment.

Even if a subsidiary goes into liquidation with no surplus, the parent will only lose the value of their shares in that subsidiary. This proposal changes that substantially. If a parent is systematically responsible for the actions of its subsidiary then that fundamentally alters the concept of limited liability and risk isolation.

ii) the feasibility of this solution from an English law perspective

Although this solution is achievable from an English law perspective, it would entail making substantial changes to long-held principles.

As to the idea of special preference shares, this might be more achievable as some kind of super-guarantee. Many parents already guarantee certain aspects of their subsidiary's business although I would imagine most would strongly resist subscribing to shares of this sort as it would defeat the object of isolating risk in a subsidiary.

iii) effect of this proposal on the interests of stakeholders

The obvious stakeholders who would be disadvantaged by this proposal are the shareholders themselves. There are serious consequences for a parent who owns shares in a subsidiary, if they are then liable for all the actions of that subsidiary. There is a clear risk of insolvency then running up the chain of companies and the failure of one company causing the failure of all the other companies in the group.

It also causes problems as to legal certainty for the parent who is assuming that kind of liability. It would be hard for creditors of the parent to accurately assess the potential liabilities of that parent if they had a subsidiary, or held shares, of the type envisioned in this proposal. There could also be huge knock-on effects if the parent were itself a company automatically indemnified by its shareholders. Large banks would find it nearly impossible

to sell their shares if they came with this sort of liability. As to existing shareholders in banks, these are often large companies such as pension funds and insurers. If they were liable for the decisions of that company then a poor decision by the directors of one company could have knock-on effects through the whole economy.

As for deposit holders, there is clearly an extra level of security for them provided by an arrangement of this kind. However, any indemnity or guarantee is only as good as the person giving it. If the whole group were in financial trouble then it may not be possible to find the funds to compensate those who have lost out due to the poor decisions of a company.

Creditors of a company of this type would also benefit. Knowing that extra funds were available would give them considerable more recourse to recover their assets. On the other hand, this is counterbalanced by the risk to creditors of the shareholders who would be exposing themselves to a much increased risk.

There are no remaining legal obstacles beyond those outlined above.

- d) Improving transferability transfer through the introduction of a new concept of "banking group"

- **Proposal Number 5**

i) national measures to be revised

This sort of law would be a substantial deviation from existing English law. As outlined above, English law views each company in a group as a distinct legal entity. Parent companies are unable to appropriate the assets of their subsidiaries when they see fit.

This is contained in common law provisions regarding corporate benefit. Companies are unable to transfer assets, especially upstream, without it being in the best interests of the company itself.

The provisions in insolvency law relating the order of priority and reviewable transactions would need to be largely rewritten, as discussed above.

Again, this proposal goes against the fundamental principle of English Law that each company is a separate legal entity. We currently have no provisions relating to group benefit or group best interests.

The law on unlawful distributions would also need to be changed, as discussed above.

Various provisions would need to be changed in relation to subsidiary directors' duties. Directors have duties to promote the success of the company and exercise independent judgement (s171 and s172 Companies Act 2006). These provisions would need to change to allow directors to behave in the way imagined in this proposal.

The provisions on unfair prejudice in respect of minority shareholders (s994 Companies Act 2006) would also need changing to include a carve-out relating to transfers of this sort.

ii) the feasibility of this solution from an English law perspective

Implementing this measure would mean a substantial overhaul of English law. As we currently have no concept of a group of companies as a single entity this would need to be entered into the statute books. Another huge change would be that the directors of subsidiary company would no longer owe their primary duty to their company, but to the group as a whole. Changing the law so as to make companies in a group no longer separate legal entities but merely tools of the parent would cause a lot of disruption and confusion.

iii) effect of this proposal on the interests of stakeholders

This proposal is clearly very advantageous to the parent company who may move assets around the group as they see fit. There would also be advantages for depositors, as their deposits could be backed with assets from the whole group.

From an English law perspective, there would be substantial issues with legal certainty. If group identity was eroded in this way it would be hard for creditors and third parties to make accurate assessments about the assets and liabilities of the company they were contracting with.

There could be problems for creditors as well in that the transferor would come first in the order of priority if the transferee were wound up. If the value of the company or the assets transferred had fallen since the transfer was made then there would be a risk that the transferor would be taking money that would otherwise have gone to the creditors. As with all the proposals there is also the question of what would happen to the assets if they were secured.

There could also be problems with investor certainty if companies could freely transfer assets to other companies in trouble with the only recourse being in a winding up.

There are also major issues with minority shareholder rights in a situation when the parent (majority shareholder's) rights come before those of the company.

There are no further obstacles other than the ones outlined above.

- **Proposal Number 6**

i) national measures to be revised

This proposal has the most in common with the Banking Bill currently under consideration in the UK. This is not expected to come into force until February 2009. The Bill relates not to intra-group transfers but to transfers out of the group altogether. The Financial Services Authority (FSA) could authorise assets to be moved into a bridge bank, to a private company or into public ownership even when this would leave the bank insolvent with few assets. The purpose the Bill is to protect depositors and the stability of the financial system generally.

This proposal also has elements in common with the interim Banking (Special Provisions) Act 2008 which is currently in force. This Act allows the Treasury to make an order to transfer to the public sector securities issued by (and/or property, rights and liabilities of) any UK undertaking which is authorised under Part 4 of the Financial Services and Markets Act 2000 (the FSMA) to accept deposits (such as banks and building societies).

With regard to the proposal in this paper, the FSA would have to be given the power to authorise certain laws to be overridden. These would include the provisions on unlawful distributions and best interests of the company (see above). It is unclear from the wording of the question whether the FSA would also be providing some sort of immunity from insolvency proceedings for the transferor. If this were the case it would require more substantial alteration to the Insolvency Act 1986.

There would also, as above, need to be a change to the provisions dealing with the ranking of creditors in the event of a winding up so as to allow the transferor to recover the amount of its transfer in the event that the transferee goes into insolvency proceedings.

ii) the feasibility of this solution from an English law perspective

This could potentially be done without wholesale alteration to existing law. If it were done in such a way as to give the FSA the power to waive certain provisions with respect to transfers this could be done by statutory

instrument or a variation of the Financial Services and Markets Act (FSMA). The foundations of such as solution can also be found in the Banking (Special Provisions) Act which could be amended to cover intra-group transfers at the behest of the Treasury.

iii) effect of this proposal on the interests of stakeholders

This is potentially a more advantageous proposal from the point of view of most stakeholders. Supervision and authorisation from the FSA on a case-by-case basis is a more flexible approach. It would also avoid the necessity to alter many fundamental laws by allowing them simply to be waived in a given situation. This would be advantageous for depositors as they would be less likely to lose their deposits. There are the usual problems with regard to legal certainty and investor confidence from the point of view of the stakeholders of the parent company, however any transfer proposal would have this effect.

This proposal might also not be in the best interests of creditors, especially those who had security over the asset being transferred. Further proposals might need to be considered in order to protect the interests of creditors of the transferor and the transferee. Additionally, it would be important to ensure the FSA were not unduly swayed by political influences, which would tend to put the interests of the deposit holders over the interests of other stakeholders.