

## **Annex 6**

# **Report of the Regulatory and Statutory Powers Working Group**

**3 November 2003**



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## Part A: Introduction and scope of work

### 1 Introduction

1 The members of the Working Group are William Blair QC (Chairman), Antony Beaves (Bank of England), Robert Purves and Megan Butler (FSA), Helen Cockroft (Royal Bank of Scotland), Simon Hills (British Bankers Association), Roger Jones (APACS), Patrick Mulvihill (Goldman Sachs), James Neilson (HMT), Robin Potts QC, and Geoffrey Yeowart (Lovells). The secretary is Justin Wray (HMT).

2 For an executive summary of the views of the Working Group on the relevant issues, please see Part H (gaps and options to fill them).

3 The background to the paper is the work which the UK's financial sector authorities, HM Treasury, the Bank of England and the Financial Services Authority, have been doing together to help co-ordinate business continuity planning within the UK's financial sector<sup>1</sup>. The events of 11 September 2001 have greatly heightened awareness of the risks and potential consequences of terrorist attacks and shown the importance of co-ordinating contingency preparations. Details can be found on the UK Financial Sector Continuity web site<sup>2</sup>.

4 The issues are receiving close attention internationally. In the European Union, central banks and regulators, including the Bank of England and the FSA, agreed in March 2003 on a Memorandum of Understanding (MOU) on high-level principles of co-operation in crisis management situations with a possible cross-border impact. The MOU is not a public document. It consists principles and procedures for cross-border co-operation between banking supervisors and central banks, and deals specifically with the identification of the authorities responsible for crisis management, the required flows of information between all the involved authorities, and the practical conditions for sharing information at the cross-border level. The MOU also provides for the setting-up of a logistical infrastructure to support the enhanced cross-border co-operation between authorities.

5 In the United States, on 8 April 2003 three federal regulatory agencies issued an "Interagency Paper on Sound Practices to Strengthen the Resilience of the US Financial System". Among other things, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Securities and Exchange Commission identified sound practices to strengthen the resilience of critical US financial markets and minimise the immediate systemic effects of a wide-scale disruption. The paper is directed at two categories of institution — core clearing and settlement organisations and firms that play a significant role in critical markets. Core clearing and settlement organisations are expected to be able to recover and resume activities within the normal business day, while firms are expected to be able to complete settlement of transactions already initiated<sup>3</sup>.

6 The issue at the heart of this paper is the extent to which new (albeit limited) legislative provision specific to the financial sector would assist in such disaster recovery, or conversely would or could complicate solutions. The issue is in no way unique to the United Kingdom, though the size of the financial sector in this country and the degree of its international connectivity<sup>4</sup> make the issue a particularly sensitive one here. The factual circumstances in which the issues might become relevant are labelled for convenience "major operational disruption" or "financial sector operational disruption". As well as a terrorist attack, examples include a natural disaster. A key issue is the way that the same issues are being addressed internationally, since there are obvious difficulties in any one jurisdiction becoming out of step with the others. Comparisons are included where appropriate through the paper.

### 2 The Green Paper and the consultation exercise

7 The paper is written following a consultation initiated by the UK Treasury in the form of a Green Paper published in February 2003 entitled "The financial system and major operational disruption" (Cm 5751<sup>5</sup>). In it, views were sought as to whether new statutory powers should be sought to assist in promoting

1 Eg *The Financial System and Major Operational Disruption: Summary of work by the authorities to improve financial sector business continuity* at: <http://www.hm-treasury.gov.uk/media//2C6A8/FSMODbkgd.pdf>

2 <http://www.financialsectorcontinuity.gov.uk/home/default.asp>. And see paragraph 2.11 of the Treasury Green Paper on "The financial system and major operational disruption", paragraphs 2.11, and 3.16.

3 See further *Bank of England Financial Stability Review*, June 2003, pages 80 and 83.

4 A point emphasised by the Federation of European Securities Exchanges (CESR) in its response to the Green Paper of 24 April 2003.

5 [http://www.hm-treasury.gov.uk/media//F0911/fin\\_disrup03.pdf](http://www.hm-treasury.gov.uk/media//F0911/fin_disrup03.pdf)

order in the financial system in extreme circumstances of operational disruption. Two potential new powers in particular were identified as possibilities, namely a power exercisable in extreme circumstances temporarily to suspend certain financial obligations (without preventing any two parties who wish to discharge their bilateral obligations from doing so), and a power to issue directions to financial infrastructure bodies, including exchanges, clearing houses and payment systems. Views were sought on whether such legislation would be justified by the nature and scale of the threat. The proposed Civil Contingencies Bill would be the vehicle for any legislation.

8 The idea mooted in the consultation paper is that in some extreme circumstances, new legislation might help to promote order in the financial system more effectively than market-based approaches by providing a breathing space to identify and address optional problems and their financial effects; and in some exceptional cases, enabling intervention, for example, to define market rules. It is recognised that any new legislation should only be used in extreme situations (and never in a purely financial crisis<sup>6</sup>) and only with support from the private sector (subject to the practical difficulties of taking urgent soundings during major operational disruption). To make potential new legislation workable, its powers would need to be exercised by secondary legislation or an administrative direction made in a flexible fashion during the disruption. Accountability would be important. As indicated in paragraph 7 above, the two powers suggested are (1) *a power to suspend certain financial obligations* by providing a breathing space, and (2) *a power to direct financial 'infrastructure'* providing a means of intervention (but only in formal markets and systems at the heart of the financial system).

9 Responses were given by a wide number of sources. The responses are also valuable, and a summary has been prepared by the Treasury, and can be found on its web site<sup>7</sup>. On the whole, respondents preferred a coordinated, voluntary approach to major operational disruption by the private sector and market infrastructure providers. Concerns regarding new legislative powers were based on amongst others the following points:

- (1) uncertainty about the circumstances that would trigger the exercise of the powers (in other words, what would constitute major operational disruption);
- (2) the unforeseen nature of the problems that arise after a major disruption;
- (3) the international nature of the UK financial system;
- (4) moral hazard: a market-based approach, it is said, maintains strong incentives to invest in contingency plans that will enable continued operation under a wide range of conditions, and legislation may have the unintended consequence of creating moral hazard because of the possible perception by firms that they will not have any relative advantage in being able to maintain operations even if other firms are disabled;
- (5) the possibility that action by the UK might prompt other states to take parallel but inconsistent approaches leading to a fragmented outcome which is not sensitive to market requirements; and
- (6) the possibility that powers might delay a response to the disruption.

10 In terms of the specific legislative proposal as regards a suspension power, concerns expressed included:

- (1) the possible adverse effect on the global settlement of foreign exchange and other transactions; and
- (2) the possible knock-on effects on counterparties outside the UK. Suspension of contractual obligations, it was said, could result in a technical event of default which could trigger cross-default clauses in contracts not governed by English law.

11 In terms of the specific legislative proposal as regards a suspension power, concerns expressed included:

- (1) again, the possible adverse effect on the global settlement of foreign exchange and other transactions;
- (2) the need to keep markets open in order to maintain confidence, as opposed to closure, and avoid disadvantaging participants with an adverse intra-day position; and
- (3) the possible resistance of quasi infrastructure to directions which might be counter to responses already deployed.

<sup>6</sup> Paragraph E10: this leaves open the question of a financial crisis with systemic implications. Whilst any powers may not be used in a purely financial crisis, the converse will not necessarily be true ie powers may need to be used in an operational crisis which happens to lead to a financial crisis.

<sup>7</sup> [http://www.hm-treasury.gov.uk/media//83FEB/fsmod\\_resp\\_sum\\_03\\_2.pdf](http://www.hm-treasury.gov.uk/media//83FEB/fsmod_resp_sum_03_2.pdf)

12 Regardless of whether respondents supported or rejected the proposals, the large majority suggested that more time was needed to consider the legal and policy implications of the legislative proposals including the following:

- (1) the powers currently at the disposal of the UK authorities;
- (2) the measures in place in other major financial centres;
- (3) the circumstances in which the legislation would apply and its scope and content;
- (4) the impact of the proposed new powers on cross border trading, clearing and settlement;
- (5) ways of avoiding uncertainty in respect of the exercise of the powers;
- (6) the feasibility of declaring same-day bank holidays or “non-business days” as an alternative approach; and
- (7) making it easier for firms to move management or other functions or personnel from one jurisdiction to another (as happened after September 11).

### 3 Terms of reference

A Task Force on Financial Sector Operational Disruption chaired by Sir Andrew Large was set up in June 2003 to take the matter forward. This paper is intended to address the aspects that concern legal powers. In the light of the proposals, and the response to them, the terms of reference of the Regulatory and Statutory Powers Working Group are as follows: *to advise the Task Force on the effectiveness of existing regulatory and statutory powers in minimising the impact of major operational disruption in the UK financial services sector, and on the need for and possible form of a legislative response*. Two other working groups are considering related (and to some extent prior) matters, namely contracts and infrastructures respectively. We have also been able to draw on a report by the FMLC Emergency Powers Legislation Working Group (“the FMLC report”), for whose assistance we are grateful.

## Part B: Statutory emergency powers

### 1 Emergency powers: international comparisons

14 Though this will not necessarily be the case, major operational disruption in the financial sector of the kind envisaged in this paper will potentially fall

within, or be caused by events which fall within, the definition of an “emergency” as it exists under the general law. The starting point of this paper therefore is the nature of emergency powers, and their relevance to the financial sector.

15 Most if not all legal systems allow for the exercise by the executive of extraordinary powers in times of emergency. For that reason, whilst such powers can be described as exceptional, they are in no way unusual. However, there is a wide difference in the way the powers are framed, and in the frequency of their use. In some countries, of which the United Kingdom is one, power to proclaim a state of emergency is seldom used (a limited exception arising from the terrorist campaign in Northern Ireland). In the UK, proclamations of emergency tend to be associated with very serious civil and industrial unrest. In other countries, including the United States, emergency powers are more frequently invoked, particularly in the face of natural and manmade disasters.

16 The powers must have a proper legal basis, and identifying such basis is a significant issue in constitutional law. In many countries, provision may be made in the constitution. An example from a common law jurisdiction is Part XVIII of the Indian Constitution which provides that “if the President is satisfied that a grave emergency exists whereby the security of India or of any part of the territory thereof is threatened, whether by war or external aggression or armed rebellion, he may, by Proclamation, make a declaration to that effect in respect of the whole of India or of such part of the territory thereof as may be specified in the Proclamation” (Article 352(1) as amended). There follow various safeguards such as the laying of Proclamations before Parliament, and time limits.

17 A yet broader example from a civil law jurisdiction is Article 16 of the 1958 French Constitution of 4 October 1958, the constitution establishing the Fifth Republic. Article 16 provides that:

“Where the institutions of the Republic, the independence of the Nation, the integrity of its territory or the fulfilment of its international commitments are under serious and immediate threat, and where the proper functioning of the constitutional public authorities is interrupted, the President of the Republic shall take the measures required

by these circumstances, after formally consulting the Prime Minister, the Presidents of the assemblies and the Constitutional Council. He shall inform the Nation of these measures in a message. The measures must stem from the desire to provide the constitutional public authorities, in the shortest possible time, with the means to carry out their duties. The Constitutional Council shall be consulted with regard to such measures. Parliament shall convene as of right. The National Assembly shall not be dissolved during the exercise of the emergency powers<sup>8</sup>.”

18 Further examples from European countries are found in the FMLC report. This shows however that there is a wide variation in the provision made in national laws in Europe. There are a few examples of legislation specifically intended to apply to the financial sector (see below), but mainly the powers have emergencies in a general sense in contemplation.

19 In some countries, emergency powers are contained not in a constitutional instrument, but in specific statutes, as in the case of the Canadian Emergencies Act 1988 (revoking the War Measures Act). A particularly significant case for the purposes of the present discussion is that of the United States. In the US, legislation is found in the National Emergencies Act of 1976. The powers in this Act were invoked in Proclamation 7463 of 14 September 2001, by which the President declared that, “A national emergency<sup>9</sup> has existed since September 11, 2001, and, pursuant to the National Emergencies Act (50 U.S.C. 1601<sup>10</sup> et seq.), I intend to utilise the following statutes: sections 123, 123a, 527, 2201(c), 12006, and 12302 of title 10<sup>11</sup>, United States Code, and sections 331, 359, and 367 of title 14<sup>12</sup>, United States Code”. (The powers utilised concerned the armed forces and the coastguard, not the financial sector.) The proclamation states that the President makes it “by virtue of the authority vested in me as President by the Constitution and laws of the United States”, which suggests that there is no single legal source for his right to take such action.

Additionally, on 11 September itself, the Office of the Comptroller of the Currency (OCC) issued a proclamation under 12 U.S.C. § 95(b) authorising national banking associations at their discretion to close offices affected by the emergency<sup>15</sup>.

20 Equally if not more important in the legal sense were the measures taken at state level. On the same day as the 11 September attacks, the Governor of New York issued Executive Order 113, which declared a disaster emergency in the State of New York under section 28 of Article 2–B of the Executive Law of New York State (“State and Local Natural and Man-Made Disaster Preparedness”<sup>14</sup>). Amongst other things, this implemented the State Disaster Preparedness Plan.

21 The Executive Order had the effect, inter alia, of triggering the gubernatorial power in section 29a of the Executive Law, which provides for the suspension of other laws during a state disaster emergency. Since 11 September, the Governor issued in all 62 emergency executive orders in response to the tragedy, though these do not appear to have been aimed at the financial sector, except for identical orders issued between the time of the incident and 21 September allowing banks to, at their discretion, close any or all of their places of business affected by the emergency<sup>15</sup>. Clearly, to quote a press release issued by him the day of the attacks, the priority for the government was to “expedite all State personnel and equipment to help in the massive rescue and recovery effort in New York City”.

22 There are certain definitions in New York law which are relevant as comparisons. Section 20 of the Executive law provides that:

a. “disaster” means occurrence or imminent threat of wide spread or severe damage, injury, or loss of life or property resulting from any natural or man-made causes, including, but not limited to, fire, flood, earthquake, hurricane, tornado, high water, landslide, mudslide, wind, storm, wave action, volcanic activity, epidemic, air contamination,

<sup>8</sup> Translation taken from Assemblée nationale web site.

<sup>9</sup> There does not appear to be a definition of “emergency” in the National Emergencies Act.

<sup>10</sup> Codified in title 50, chapter 34, of the US Code.

<sup>11</sup> Armed Forces.

<sup>12</sup> Coast Guard.

<sup>13</sup> See the valuable analysis by Thomas C Baxter Jr, and Stephanie Heller, “How does the Commercial Law respond when the unthinkable happens?”, *Uniform Commercial Code Law Journal*, Fall 2002 [Vol 35 #2], page 1.

<sup>14</sup> <http://www.nysemo.state.ny.us/LEGAL/article2B.html#Section%2028>.

<sup>15</sup> Sources: FSA Memorandum 20 May 2002; HM Treasury Minute 6 August 2003. World Trade Center Emergency Executive Orders can be found collected at [http://www.state.ny.us/sept11/wtc\\_exeorders.html](http://www.state.ny.us/sept11/wtc_exeorders.html)

blight, drought, infestation, explosion, radiological accident, water contamination, bridge failure or bridge collapse.

b. “state disaster emergency” means a period beginning with a declaration by the governor that a disaster exists and ending upon the termination thereof.

23 As regards external threats to the United States, the International Economic Emergency Powers Act (IEEPA) (which is codified at 50 U.S.C. §§ 1701–1706) was enacted in 1977. Powers under this Act may be exercised to deal with any unusual and extraordinary threat which has its source in whole or substantial part outside the United States. (A purpose of IEEPA was apparently to limit the extensive economic powers granted to the President in peacetime emergencies by Section 5(b) of the Trading with the Enemy Act of 1947<sup>16</sup>.) IEEPA powers have been widely used in the financial field, for example in respect of financial sanctions imposed by the US authorities (six countries are currently designated).

24 These matters are not specifically covered at the European level. However Article 297 of the Treaty establishing the European Community provides that, “Member States shall consult each other with a view to taking together the steps needed to prevent the functioning of the common market being affected by measures which a Member State may be called upon to take in the event of serious internal disturbances affecting the maintenance of law and order, in the event of war, serious international tension constituting a threat of war, or in order to carry out obligations it has accepted for the purpose of maintaining peace and international security”. Mention may also be made of Article 58(1)b, which contemplates a derogation from the free movement of capital between member states on the basis of “measures which are justified on grounds of public policy or public security”.

25 Article 297 of the Treaty recently became relevant in the case of Finland. The Government has made a proposal (which we believe has now been enacted) which has given the authorities very wide-ranging and comprehensive emergency powers to intervene in the financial markets in cases of disruption.

The proposal broadly was that Finland’s Emergency Powers Act of 1991 be amended to give the Government (and if so decreed the Bank of Finland, the Financial Supervision Authority, and the Insurance Supervision Authority) power to regulate financial markets and the insurance industry in emergency conditions. The proposal was that credit institutions, certain financial institutions, management companies and the Central Securities Depository as well as insurance and pensions institutions and the Central Pension Security Institute be obliged to take precautionary measures for maintaining in emergency conditions activities essential to the functioning of financial markets and the insurance industry. It was proposed that provisions concerning the obligation to take precautionary measures be inserted to the Credit Institutions Act, the Investment Funds Act, the Act on the Book-entry Securities System, the Foreign Credit Institutions Act, the Insurance Companies Act, the Insurance Association Act, the Foreign Insurance Companies Act and other related acts.

26 As a member of the euro, the draft law was submitted by the Finnish Ministry of Finance for an Opinion from the European Central Bank (ECB), which was given on 31 October 2002<sup>17</sup>. The ECB raised objections on the basis that its own competencies in monetary policy were being infringed by a national law, and that the derogations to the Treaty contained in Article 297 of the Treaty (which is set out above) did not extend to combating the consequences of purely economic disruption. However as mentioned, we believe that the law has been enacted, and has not to our knowledge been challenged. We are not aware of any comparable modern enactment in any other country which specifically addresses the financial markets in the context of emergency powers legislation. However, the example is of limited significance in that the financial markets in the UK and Finland are clearly different in terms of scale. (It seems that the Finnish authorities may be reviewing the law in the light of the ECB’s points.)

## 2 Existing UK emergency powers

27 The United Kingdom does not have a written constitution, though it does have a body of constitutional law derived from sources such as decided cases and academic writing from which the powers of

<sup>16</sup> Source: FMLC Report section 6.10.1.

<sup>17</sup> <http://www.ecb.int/pub/legal/con200227en.pdf>

the executive may usually be readily ascertained. Whilst the Crown is considered to have emergency powers under the royal prerogative particularly in time of war or invasion, it has been said that these powers are generally too uncertain for the government to rely on them<sup>18</sup>. Though there is some case law<sup>19</sup>, there are no recent peacetime examples of their use. Clearly it would be unacceptable to rely on uncertain legal powers in response to major operational disruption in the financial sector, so the prerogative powers may be ignored for present purposes. There are also common law powers to deal with emergencies, particularly the use of force to maintain public order<sup>20</sup>. Again, there are no recent examples, and for the same reasons, these powers may also be ignored. It follows that that for practical purposes, the relevant provisions governing the use of emergency powers in the United Kingdom are found in statute law.

28 UK statutory powers for dealing with an emergency may be considered by reference to those exercisable in peacetime, and those exercisable in time of war. Examples of the latter are the Defence of the Realm Acts 1914–15, and the Emergency Powers (Defence) Acts 1939–40<sup>21</sup>. Powers exercisable in time of war are not generally speaking relevant as regards the present discussion, and are not specifically considered in this report, though it should be noted that peacetime powers sometimes have their origin in legislation originally enacted in wartime. (A full account of wartime powers, including economic powers, most of which have since been repealed, is found in Halsbury's Statutory Instruments, 2002 issue, volume 22, under War and Emergency<sup>22</sup>.)

### Emergency Powers Act 1920

29 As regards powers exercisable in peacetime, the principal statute presently in force is the Emergency Powers Act 1920. It is about to be repealed by the Civil Contingencies Bill, but remains in force for the time being. As amended by the Emergency Powers Act 1964, it applies to Great Britain (ie England, Wales and

Scotland). The legislation applying to Northern Ireland is the Emergency Powers (Northern Ireland) Act 1926 as amended by the Emergency Powers (Northern Ireland) Act 1964.

30 The Emergency Powers Act was introduced after the First World War “in the face of what was seen as the growing threat of nationally disruptive industrial action and the risk of civil unrest. It has been used twelve times in its eighty-year history, the last time being in 1974, and only ever in times of industrial unrest”<sup>23</sup>. Individual government departments have introduced many of their own emergency legislative measures to deal with times of crisis affecting their individual policy sectors, but these are not of general application<sup>24</sup>. There are also non-legislative measures of various kinds<sup>25</sup>.

31 Section 1(1) of the Act (as amended) empowers the Queen<sup>26</sup> to issue a proclamation of a state of emergency if at any time it appears to her that “there have occurred, or are about to occur, events of such a nature as to be calculated, by interfering with the supply and distribution of food, water, fuel, or light, or with the means of locomotion, to deprive the community, or any substantial portion of the community, of the essentials of life”. No such proclamation shall be in force for more than one month, without prejudice to the issue of another proclamation at or before the end of that period. Where a proclamation of emergency has been made, it is to be forthwith communicated to Parliament, and, if Parliament is not sitting, it has to sit within five days.

32 The detailed provisions which apply in an emergency will be made in the form of regulations, ie delegated legislation. Section 2(1) of the 1920 Act as amended is a key provision, and gives very wide power in this respect. It provides that where a proclamation of emergency has been made, the Queen in Council may, by order, make regulations “for securing the essentials of life to the community, and those regulations may confer or impose on a Secretary of State or other Government

18 Bradley & Ewing, *Constitutional and Administrative Law*, 12th edn (Longman, London, 1997) pages 278 and 677.

19 *Burmah Oil Co Ltd v Lord Advocate* [1965] AC 75.

20 O.Hood Phillips & Jackson, *Constitutional and Administrative Law*, 8th edn (Sweet & Maxwell, London, 2001) pages 395 et seq.

21 In the United States, specific provision is made for the exercise of Presidential powers as regards transactions in foreign exchange, gold etc in times of war in 12 U.S.C. § 95a.

22 Page 185.

23 Draft Civil Contingencies Bill: consultation document, chapter 5, paragraph 14. And see O. Hood Phillips, *ibid*, page 678.

24 *Ibid*.

25 See eg the recent decision of the Director General of Fair Trading on the Memorandum of Understanding regarding the supply of oil fuels in an emergency [2002] UKCLR 74.

26 The reference in the 1920 statute is to the King.

department, or any other persons in [Her] Majesty's service or acting on [Her] Majesty behalf, such powers and duties as [Her] Majesty may deem necessary for the preservation of the peace, for securing and regulating the supply and distribution of food, water, fuel, light, and other necessities, for maintaining the means of transit or locomotion, and for any other purposes essential to the public safety and the life of the community, and may make such provisions incidental to the powers aforesaid as may appear to [Her] Majesty to be required for making the exercise of those powers effective". The reference to "any other purposes essential to the life of the community" would seem to make the powers open-ended, in the sense that they are not limited in any way to securing the distribution of food, water, fuel, light, and other necessities, or maintaining the means of transit or locomotion. This implies that they could in principle be used in an emergency to regulate the financial sector (though there is no specific reference to the financial sector, in contrast to the draft of the proposed Civil Contingencies Bill), indeed we think that this is reasonably clear.

33 There are provisos to the effect that there is no authority to make regulations imposing any form of compulsory military service or industrial conscription, or to make it an offence to take part in a strike, or peacefully to persuade any other person or persons to take part in a strike. Any regulations made are to be laid before Parliament as soon possible after they are made, and require a resolution passed by both houses providing for their continuance within seven days. Regulations may provide for the trial by courts of summary jurisdiction of persons guilty of offences against them. The maximum penalty is three months imprisonment or a fine.

34 In summary, under the 1920 Act the Queen may declare a state of emergency by proclamation if there is a threat to the nation's "essentials of life". The proclamation can remain in effect for no more than a month, though it can be renewed. It must be laid before Parliament within five days. There is a wide power to make regulations pursuant to the statutory powers. Whether or not such a proclamation is reviewable by the courts is doubtless academic, since in most foreseeable circumstances in the UK it is unlikely that the courts

would differ from the executive on such a matter. Regulations made under the Act are however clearly subject to judicial review. There are very few English cases in respect of regulations made under the 1920 Act<sup>27</sup>, though there are some decisions of the Privy Council in respect of certain analogous Commonwealth provisions<sup>28</sup>. By contrast, there are many cases reviewing wartime regulations<sup>29</sup>.

35 Whilst the Act is not concerned with major operational disruption in the financial sector, it seems possible that most such incidents would fall within its terms, as being events of such a nature as to be calculated, by interfering with the supply and distribution of food, water, fuel, or light, or with the means of locomotion, to deprive the community, or a substantial portion of the community, of the essentials of life. In our view, the power to make regulations is so wide, applying not only to distribution of food etc but to "any other purposes essential to the public safety and the life of the community", that if specific measures were required in the interests of continuity in the financial sector, there would possibly be power to make them<sup>30</sup>.

### Defence (Armed Forces) Regulations 1939

36 Specific mention should be made of the Defence (Armed Forces) Regulations 1939, by which the military authorities may by order authorise members of the armed forces to be temporarily employed in agricultural work or other urgent work of national importance. This has enabled the armed forces to be used to deal with various types of civil contingency without any need to declare a state of emergency. A comparison may be made with the major power outage affecting New York in August 2003, which led the State Governor to declare a state of emergency and place the National Guard on standby<sup>31</sup>. (During a similar blackout in 1977, the State Governor declared a bank holiday<sup>32</sup>.)

37 Notwithstanding the repeal<sup>33</sup> of the Emergency Powers (Defence) Act 1939 under which they were made, the 1939 Regulations were made permanent by section 2 Emergency Powers Act 1964, which provides that:

27 *France Fenwick & Co Ltd v The King* [1927] 1 K B 458.

28 *Teh Cheng Poh v Public Prosecutor* [1980] AC 458.

29 Compare *Liversidge v Anderson* [1942] AC 206, and *Inland Revenue Commissioners v Rossminster Ltd* [1980] AC 952.

30 Compare the view expressed in section 6.14.2 of the EMLC report.

31 Source: Washington Post 15 Aug. 03.

32 Source: Financial Times 15 Aug. 03.

33 By the Emergency Laws (Repeal) Act 1959.

“The Defence (Armed Forces) Regulations 1939 in the form set out in Part C of Schedule 2 to the Emergency Laws (Repeal) Act 1959 (which regulations enable the temporary employment in agricultural work or in other work, being urgent work of national importance, of members of the armed forces of the Crown to be authorised) shall become permanent.”

38 In the draft Civil Contingencies Bill consultation document, chapter 5, paragraph 37, which is discussed below, it is said that “Ministers have agreed that the proposed new special legislative measures framework will not affect the operation of military assistance in an emergency situation. Section 2 of the Emergency Powers Act 1964 provides an important legal basis for the provision of military assistance and will remain in place. No new powers will be granted to the military, their role will remain as it is at present”.

### Analogous powers

39 There are various specific powers to block or suspend financial obligations in addition to the general emergency powers described above. For example, the Treasury has power under article 4 of the Terrorism (United Nations Measures) Order 2001 (SI 2001 No. 3365) to order the freezing of funds belonging to suspected terrorists. This power has been used on a number of occasions. (There are similar provisions in relation to United Nations sanctions.) Section 4 of the Anti-Terrorism, Crime and Security Act 2001 gives the Treasury a more general power to make a freezing order in the case of foreign threats to the United Kingdom’s economy or its nationals. In this respect, it is similar to the US International Economic Emergency Powers Act. Orders can be made in respect of financial assets and economic benefits of any kind (s.5(6)). This power replaces a power contained in s.2 of the Emergency Laws (Re-enactments and Repeals) Act 1964, in relation to gold etc, which was itself derived from wartime powers. As the FMLC points out in section 6.5.1 of its report, it was used in 1990 to control gold, securities, payments and credits in relation to Kuwait and Iraq, and again in 1992 in relation to Serbia and Montenegro. These powers are unlikely to be of great relevance for present purposes.

## 3 Proposed UK Civil Contingencies Bill

40 In June 2003, the Government began a major consultation exercise on new emergency powers legislation for the UK, publishing a draft Civil Contingencies Bill to replace the 1920 Act. The Bill is only at present a proposed bill, and the content may change. The aim is to improve the UK’s resilience to disruptive challenge “by reducing the probability of their occurrence and their likely effects, responding effectively and efficiently when they occur and building institutions and structures in such a way as to minimise the possible effects of disruptions upon them. Disruptive challenges exist along a spectrum of severity ranging from local flooding to massive terrorist attack”<sup>34</sup>. The bill is expected to be laid before Parliament, and become law in the course of 2004. It is clearly important to take the proposed new legislation properly into account in this paper, since the new law addresses on a wider landscape issues that the Task Force is considering in the financial sphere.

41 As regards the 1920 Act, the Government says that “the existing legislation does not reflect the realities of the early twenty-first century. It is based upon an assumption regarding the services needed by society in the 1920s that no longer holds in the much more integrated, technologically dependent, twenty-first century. This narrow and outdated focus coupled with the fact that the 1920 legislation allows only for a Great Britain-wide response when emergencies tend to affect only part of the country at a time, and the fact that the legislation does not incorporate the devolution settlements, means it is in serious need of modernisation. As currently constituted the Act does not serve a useful function in the early twenty-first century. It cannot be used rapidly and effectively to provide temporary statutory powers in many situations where the lack of these can prevent effective measures being taken to deal with an emergency<sup>35</sup>.” This is the main rationale for the proposed new law.

42 Though financial sector continuity is not specifically addressed in the consultation document, it is identified as an issue. The Government says that “it is recognised that Business Continuity Management (BCM), as generally conceived, applies to a larger set of business interruptions than simply those caused by emergencies. By its focus on emergencies, the Bill

<sup>34</sup> Draft Civil Contingencies Bill: consultation document, executive summary, paragraph 1.

<sup>35</sup> Ibid, chapter 5, paragraph 15.

achieves coherence. Local responder bodies are of course free under other powers to develop a larger programme of BCM plans as part of good business and risk management practice”<sup>36</sup>.

43 The purpose of the Civil Contingencies Bill, and the accompanying non-legislative measures, is to deliver a single framework for civil protection in the United Kingdom<sup>37</sup>. The Government is also establishing a new regional civil protection tier, drawing together activity already organised on a regional basis and providing a bridge between the centre and local areas<sup>38</sup>. Legal powers in this respect are dealt with in Part 1 of the Bill (“Local Arrangements for Civil Protection”), and have no equivalent in the 1920 Act. This aspect of the reforms is not considered further here, save to mention that the fact that under the proposed Bill a state of emergency can be declared in a particular part of the country will bring the law in the UK closer to that of the US, where emergencies are routinely declared on a state, rather than a national, basis. It is clearly possible in the present context that a state of emergency might be declared as regards London alone.

### Legal Opinions

44 Despite the wide ambit of the Bill, it is believed that it can properly be considered as a modernisation and development of the law already contained in the Emergency Powers Act 1920<sup>39</sup>. This has some significance in the financial sector context as regards Legal Opinions, which are frequently required in financial transactions, and provide legal support on issues such as corporate capacity etc. So far as we know, emergency powers do not currently feature in such opinions (which is not surprising). It would not appear that the enactment of the Bill would require any additional reservations in standard legal opinions, but this is a matter for those giving such opinions. (The enactment of specific powers as envisaged in

the Green Paper, on the other hand, might require additional language, and possibly some explanation<sup>40</sup>.)

### Emergency defined

45 Part 2 of the bill (“Emergency Powers”) concerns emergency powers in general (Part 1 being concerned local Arrangements). The Act will create a wide-ranging power to make Regulations in the event of an “emergency”. A feature of the new legislation is a detailed definition of “emergency”. It is defined in cl.17(1) as an “event or situation which presents a serious threat to:

- (a) the welfare of all or part of the population of the United Kingdom or of a Part<sup>41</sup> or region<sup>42</sup>;
- (b) the environment of the United Kingdom or of a Part or region;
- (c) the political, administrative or economic stability of the United Kingdom or of a Part or region; or
- (d) the security of the United Kingdom or a Part or region.”

46 The term “emergency” is then sub-defined in more detail by explaining by reference to (a) to (d) the factual situations “in particular” in which an event or situation presents a threat of the relevant kind. We draw attention to cl.17(4), which provides that for the purposes of sub-clause (1)(c), an “event or situation presents a threat to political, administrative or economic stability if it causes or may cause disruption of:

- (a) the activities of Her Majesty’s Government;
- (b) the performance of public functions<sup>43</sup>; or
- (c) the activities of banks or other financial institutions<sup>44</sup>.”

For the purposes of subsection (1)(d), terrorism within the meaning of s.1 of the Terrorism Act 2000 (c.11) is one of the circumstances which is taken as presenting a threat to the security of the UK.

<sup>36</sup> Ibid, chapter 3, paragraph 22.

<sup>37</sup> Ibid, paragraph 5.

<sup>38</sup> Special arrangements have been made for London: *ibid*, chapter 7.

<sup>39</sup> This view is supported by the consultation paper which states that, “While significant structural changes to the special legislative measures framework are intended, the heart of the power will remain a broad regulation making power within clear limits. This changes little from the 1920 Act formulation. The process for obtaining Parliamentary approval, thus requiring the Government to account to Parliament for its use of special legislative measures, will remain unchanged. The existing safeguards within the legislation will be maintained”: *Ibid*, chapter 5, paragraph 28.

<sup>40</sup> In its response of 24 April 2003 to the Green Paper, Freshfields Bruckhaus Deringer says that “if any contingency legislation is introduced, thought will need to be given to how its potential application will be addressed in legal opinions, particularly with a view to avoiding alarmist conclusions being drawn”.

<sup>41</sup> Each of England, Wales, Scotland and Northern Ireland (and their adjacent territorial sea) is a “part” for the purposes of the Bill.

<sup>42</sup> “Region” in the Bill means an area which is a region for the purposes of the Regional Development Agencies Act 1998 (c. 45), together with its adjacent territorial sea.

<sup>43</sup> “Public functions” means statutory functions, and other functions of Ministers or other office holders (including functions of the Scottish Parliament and Ministers, and their counterparts in Northern Ireland and Wales).

<sup>44</sup> The terms “bank” and “financial institution” are not further defined in the draft Bill.

47 The consultation document comments<sup>45</sup> that the definition is a starting point only. It is not intended that all incidents that fit the definitions will result in the use of Emergency Powers. The decision to use them in the event of an incident falling within the definition should be based on three guiding principles — seriousness, the need for special legislative measures, and relevant geographical extent (a UK emergency should not be declared where the declaration of a regional emergency will be sufficient). Whether the three tests are met will be a matter for the Government to determine and to advise. The Queen who will then normally make the formal declaration. The converse point should also be made. The use of the term “in particular” shows that the lists in cl.17 are not intended to be exclusive.

### Procedure for declaring emergency

48 We understand that the procedures may be changed following the consultation process, but presently it is envisaged that Her Majesty in Council may declare herself satisfied by royal proclamation that an emergency has occurred, is occurring or is about to occur, and that it is necessary to use the regulation-making power in the Bill to prevent, control or mitigate the effects of the emergency (cl.18). According to the consultation paper, the “declaration by the Queen, acting on advice of Ministers, will be that she is satisfied that an emergency has occurred, is occurring or is about to occur, and that it is necessary to make emergency regulations. This replaces the declaration of a ‘state of emergency’. This more accurately reflects what these powers actually are and when they may be used ie only in situations where existing statutory provision is ineffective or hampers response and recovery efforts<sup>46</sup>”.

49 As a matter of comment, practice in this country and internationally shows that it is the Head of State who should make a proclamation of such importance, even when it has to be made at very short notice. Logistic difficulties should not normally stand in the way. A similar, albeit local, power was exercised on the day of 11 September by the Governor of the State of New York under circumstances of extreme difficulty. In the UK, the Head of State is the Queen, who alone has the power to proclaim an emergency under the existing legislation,

the Emergency Powers Act 1920. However, there may be extreme<sup>47</sup> occasions in which it is not possible to obtain a royal proclamation in time. An innovation in the Bill is that the Secretary of State may make a similar declaration by order if he is satisfied of the same matters and it is not possible to arrange for the making of a royal proclamation without a “serious delay”<sup>48</sup>. The proclamation (or order) must state (a) the nature of the emergency, and (b) the Parts of the United Kingdom or regions in relation to which the regulations may have effect.

50 States of emergency, by their nature, are intended to be of limited duration. By cl.23 of the Bill, a proclamation of an emergency, together with any regulations made under it, lapses 30 days after it is made, but can be extended by a further proclamation. Even in an emergency, there must be constitutional safeguards. In cl.24, the Bill contains arrangements to ensure that Parliament is notified of any proclamation made under it, and that both Houses meet within five days of such a proclamation being made. Emergency regulations must be laid before Parliament as soon as is reasonably practicable. Regulations so laid lapse seven days from the date of laying unless approved by resolution of each House, although this does not prevent the making of new regulations.

### Emergency regulations

51 Where a royal proclamation or order of the kind mentioned above is in force, the Queen may make regulations by order in council, or if it would not be possible to arrange for an order in council without a serious delay, the Secretary of State may make such regulations (cl.20(1) and (2)). Regulations may only be made if and in so far as the person making them thinks it necessary for the purpose of preventing, controlling or mitigating a serious aspect or serious effect of the emergency specified in the proclamation or order.

52 Despite this limitation, the power to make regulations is critical to the effective handling of the legal aspects of an emergency, since the statute itself cannot and does not seek to anticipate the detailed provisions that may need to be made. This is not unique to the UK legislation as the experience cited above in the US shows. It also reflects the UK’s experience under

45 Chapter 5, paragraphs 19 to 20.

46 Chapter 5, paragraph 24.

47 Ibid, paragraph 25.

48 A “serious delay” is one that may result in serious damage of a kind that might be prevented or controlled by emergency regulations under the Bill: s.19(3).

the Emergency Powers (Defence) Act 1939, where typically detailed provision was made by regulations made under statutory powers<sup>49</sup>. The Bill provides that the regulations may make any provision the person making the regulations thinks necessary for the stated purpose (cl.21(1)(b)). There follows a wide list of the kind of things for which regulations may make provision. As well as the protection of human life, health and safety, the list includes matters potentially relevant specifically in the financial sphere such as protecting or restoring property, electronic or other systems of communication, transport etc (cl.21(3)). In any case, the language of the section makes it clear that the list is not exclusive.

53 Emergency regulations may make provision of any kind that could be made by Act of Parliament or in the exercise of the Royal Prerogative. This in effect gives full power to do by regulation anything which would otherwise be done by statute, or pursuant to the inherent powers of the Crown. The illustrative list that follows in cl.21(3) is again clearly intentionally wide, and includes conferring discretionary powers on Ministers, or other specified persons, to requisition, confiscate or destroy property, and, significantly, the power to disapply or modify an enactment or a provision made under of by virtue of an enactment. Echoing restrictions in the 1920 Act, regulations may not require military or industrial service, or prohibit industrial action. There are also limiting provisions in respect of the nature of offences which may be created under regulations (cl.21(4)).

## Human Rights

54 The European Convention on Human Rights recognises that rights otherwise available may have to be qualified in the case of emergency. Article 15(1) states that, “In time of war or other public emergency threatening the life of the nation any High Contracting Party may take measures derogating from its obligations under this Convention to the extent strictly required by the exigencies of the situation, provided that such measures are not inconsistent with its other obligations under international law”. It has been said that<sup>50</sup> Article 15(1) allows a State to limit the application of certain Convention provisions domestically, excepting the non-derogable rights listed in Article 15(2). Suspension of Convention rights is permitted only when a public

emergency threatening the life of the nation, which the European Court of Human Rights has interpreted<sup>51</sup> to mean “...an exceptional situation of crisis or emergency which affects the whole population and constitutes a threat to the organised life of the community of which it is composed ...”. None of this seems inconsistent with UK law, actual or proposed. (The UK has made a number of derogations in connection with terrorism.)

55 A potential issue is the effect of human rights legislation on regulations made under the Civil Contingencies Bill. For the purposes of the Human Rights Act 1998 (c.42),<sup>52</sup> the Bill provides that an instrument containing emergency regulations shall be treated as if it was an Act of Parliament (cl.25), in other words as primary rather than subordinate legislation. Section 3 of that Act provides that though so far as it is possible to do so, primary legislation and subordinate legislation must be read and given effect in a way which is compatible with the Convention rights, this does not affect the validity, continuing operation or enforcement of any incompatible primary legislation, and does not affect the validity, continuing operation or enforcement of any incompatible subordinate legislation if (disregarding any possibility of revocation) primary legislation prevents removal of the incompatibility<sup>53</sup>.

56 The effect of s.3 is that it is generally impossible for a court or tribunal in the United Kingdom to hold primary legislation to be invalid, or anything done in reliance on it to be unlawful, by reason only of an incompatibility with any of the Convention rights which became part of national law by virtue of the Human Rights Act. Thus, by deeming them primary legislation, the effect of the Civil Contingencies Bill is that the courts could not strike down emergency regulations.

57 The Government sets out the case for and against this provision in the consultation paper<sup>54</sup>. In our view, there is clearly force in the argument that “the reasons for considering emergency regulations as primary legislation are that they would only be introduced in extreme, and very rare, special circumstances; they operate in effect as temporary primary legislation; they have a limited life-span; and, they have to be approved by Parliament as soon as practicable once made. The proposal would prevent the

49 Eg, the Defence (General) Regulations 1939.

50 British Institute of Human Rights, May 2002.

51 *Lawless v Ireland Series A*, No. 31 page 56.

52 This Act incorporates the European Convention on Human Rights into UK law.

53 See also s.6(2)(b).

54 Chapter 5, paragraphs 33–36.

suspension or quashing of emergency regulations themselves, but it would not prevent courts suspending or quashing the actions of persons under the regulations on human rights grounds unless any violation of human rights were specifically required by the regulations<sup>55</sup>.” A contrary view has been expressed in the Fifteenth Report of the Joint Parliamentary Committee On Human Rights.

### Civil Contingencies Bill and Financial Sector Operational Disruption

58 The Civil Contingencies Bill has significant implications for the legislative proposals in the Green Paper (which pre-dates the publication of the consultation paper on the Bill) because:

- (1) By making reference to the activities of banks or other financial institutions within the definition of “emergency” (see above), the proposed bill expressly recognises major operational disruption in the financial sector as a potential emergency situation, assuming that it is of a scale which presents a serious threat to economic stability. This view is confirmed in the consultation paper, which says that the wide definition of emergency will ensure that use of special legislative powers will be possible, where appropriate, in the event of serious economic crises (both financial and non-financial in origin)<sup>56</sup>.
- (2) On the other hand, it would seem unlikely that major operational disruption on the scale required to amount to an emergency would take place in the context of a purely financial crisis, or that the Government would or should invoke emergency powers in such a crisis.
- (3) Assuming that the circumstances were such as to lead to the proclamation of an emergency, the key point from the legal perspective is the wide power given in the Bill to make emergency regulations. Broadly, the power is to make regulations where “necessary for the purpose of preventing, controlling or mitigating a serious aspect or serious effect of the emergency” (cl.21(1)(a)). This is capable of covering financial sector issues, if it was thought to be appropriate to deal with these by way of specific regulations, in the context of encouraging market-led solutions.
- (4) Because of the breadth of the powers, further statutory powers in an emergency aimed

specifically at the financial sector would seem to be redundant (we think that there is no case for a “carve-out” in relation to the financial sector).

- (5) It is important to state that this last point does not mean that we think that in an emergency it would be appropriate to create powers by way of emergency regulation that correspond to those proposed in the Green Paper. We explain below why in our view the suspensory power is not viable in the form proposed, and why we do not support the proposed directory power. This conclusion applies whether the situation is an emergency within the meaning of the Bill, or not, in other words it is not conditioned on the availability of legal powers.
- (6) We note that the London Investment Banking Association expressed the view by letter of 22 September 2003 in response to the Bill that it was important to clarify that the power to make emergency regulations would not override the Task Force’s conclusion in this regard.
- (7) The powers include the power by regulation to disapply or modify an enactment or a provision made under of by virtue of an enactment (cl.21(3)(j)). This means that in an emergency, financial services and other legislation and rules made under such legislation could potentially be modified by regulations (again subject to the general conditions in the Bill). This may be important, as potentially facilitating the temporary lifting of onerous statutory requirements, as was done by the SEC in the US following 11 September (see below).
- (8) The Green Paper emphasises in a number of places that the Government has concluded that powers under consideration in it would never be used in a purely financial crisis, and would only be used in extreme circumstances (see eg paragraph 4.16). These are the kind of circumstances that might entail the proclamation of an emergency. On the other hand, if it was thought that powers might be required in circumstances where no proclamation of emergency was going to be made, then the Civil Contingencies Bill would not appear to be an appropriate vehicle for introducing such powers<sup>57</sup>.

59 Finally in this context, we have already mentioned that powers to make regulations covering the

<sup>55</sup> Ibid, paragraphs 35.

<sup>56</sup> Ibid, paragraphs 17.

<sup>57</sup> Contrary to the assertion in paragraph E2 of the Green Paper.

financial sector may have existed under the Emergency Powers Act 1920 (though a more limited view is possible), since that also is in very wide terms, albeit not so specific. Whether this is right or not, the proposed legislation does not change the law in the sense of introducing new provisions which were previously without parallel. There are several reasons why this may be of some importance. It would in our view be wrong to give the impression that the UK was introducing draconian new powers. The discussion in this paper clearly shows that the new powers rationalise and modernise existing powers in the Emergency Powers Act 1920. Further, wide though they undoubtedly are, as the above discussion shows, the UK is not in any way unique in having such powers available to the Executive in the case of an emergency. There are safeguards in the proposed new law, just as there were in the 1920 Act, and so far as we can see such safeguards are at least commensurate with those that apply in other countries. (A financial sector-specific consequence as mentioned above, is that standard Legal Opinions would not appear to have to take account of the legislation, but this is a matter for those giving such opinions. This is on the assumption that specific provisions for the financial sector are, as at present, not included in it.)

#### 4 Other statutory powers

60 There are other statutory powers which would or might be relevant in an emergency. In some of these statutes, specific provision is made for emergencies, in others not. For present purposes it is sufficient to summarise the contents of the Matrix of Sector Emergency Powers which has been made available to us by the Cabinet Office. Powers relate to gas, electricity, water, oil, civil nuclear power, strategic chemicals, radioactive substances, environmental protection and waste disposal, health services, medicines (human), social services (and private health care), food protection, plant health, animal health, flood and coastal defence, shipping, railway, civil aviation, broadcasting, telecommunications, postal services, benefits, financial services, fire, housing, local government and planning. This list is useful in showing the potential scope of measures which might have to be invoked depending on the seriousness of the emergency, and of course go far beyond financial services.

## Part C: Bank holidays, public holidays, and non-business days

61 The term 'bank holiday' may be taken as synonymous with terms such as 'public holiday' and 'legal holiday'. They are all descriptions of days recognised by the state as holidays. Bank holidays in the United Kingdom were first provided for by the Bank Holiday Act 1871, which was introduced into Parliament by a well-known banker and social reformer<sup>58</sup>. Though the effect of the Act was to institute paid, public holidays for all workers, its terms were limited to banks. An important part of its provisions were concerned to ensure that payment obligations on bills and notes falling due on holidays were postponed to the following day. The Act also provided for the appointment of special bank holidays by royal proclamation.

62 The term 'non-business day' is sometimes used in statutory provisions. By section 92 of the UK Bills of Exchange 1882 (as amended by the Banking and Financial Dealings Act 1971) provides as follows:

"Non-business days" for the purposes of this Act mean:

- (a) Saturday, Sunday, Good Friday, Christmas Day.
- (b) A bank holiday under the Banking and Financial Dealings Act 1971.
- (c) A day appointed by Royal proclamation as a public fast or thanksgiving day.
- (d) A day declared by an order under section 2 of the Banking and Financial Dealings Act 1971 to be a non-business day.

Any other day is a business day.

63 Of more relevance to modern financial contracts, terms such as 'Business Day', 'Non-business Day', 'Local Business Day', 'Exchange Business Day', 'Clearance System Business Day', 'Settlement Day', 'Banking Day', etc, are routinely used in contractual documentation supporting financial transactions<sup>59</sup>. The terms are subject to express definition in the documentation concerned. A survey is contained in Chapter 4 of the FMLC report. The question arises as regards the Green Paper proposals therefore whether it is appropriate to provide in legislation in a possibly inconsistent way for issues which parties in the market

<sup>58</sup> Sir John Lubbock, MP for Maidstone.

<sup>59</sup> In its response of 24 April 2003 to the Green Paper, ISDA pointed out that "the notion of business day is crucial to transactions such as OTC derivatives".

may have foreseen, and through standard terms made provision for.

## 1 International comparisons

64 We begin by discussing bank holidays. The potential effectiveness of a bank holiday in times of disruption was famously demonstrated in the United States by President Roosevelt's response to the banking crisis of 1933. He declared a national emergency and proclaimed a banking holiday on March 6, 1933 for March 6–9 inclusive, relying on the Trading with the Enemy Act (which has since been amended to apply only in times of war). The order applied to "all banking institutions and all branches thereof located in the United States of America, including the territories and insular possessions<sup>60</sup>...". Later that year, Congress enacted the Banking Act of 1933 as part of an extensive package of financial and regulatory reforms, and the crisis eased.

65 Currently, provisions as to banking and public holidays in the United States are to be found in federal and state law. Specific provision is made for declaring a bank holiday to meet emergency situations. As regards federal law, 12 U.S.C. § 95(b)(1) provides that, "In the event of natural calamity, riot, insurrection, war, or other emergency conditions occurring in any State ... the Comptroller of the Currency may designate by proclamation any day a legal holiday for the national banking associations located in that State. In the event that the emergency conditions affect only part of a State, the Comptroller of the Currency may designate the part so affected and may proclaim a legal holiday for the national banking associations located in that affected part". The section goes on provide that where the state authorities designate a legal holiday "for ceremonial or emergency reasons", it will apply to national banks located in the state.

66 At the state level, power is given to the New York State Governor (for example) to proclaim a bank holiday<sup>61</sup> in an emergency by § 24-a(3)(a) of the General Construction Law. The law provides that upon such proclamation, banks may (not must) close any or all of their places of business in the holiday area. Even if the Governor has not declared an emergency, the

officers of a bank can close one or more of its offices, or its principal office, or suspend the business operation or the function of the bank (after satisfying certain requirements and under certain circumstances) in an emergency situation (§ 24-a(3)(b)-(d)).

67 The law provides that, unless the contract expressly or impliedly indicates a different intent, if a contract requires the payment of money on a holiday, such payment may be made on the next succeeding business day: section 25. Section 24-a(3)(h) provides that any holidays declared will not be considered "full business days" nor banking days within the meaning of such terms as used in the Uniform Commercial Code ("NYUCC"). This means that an obligation that is due on a "banking day" pursuant to Article 4 of the NYUCC (Bank Deposits and Collections), for example, would not be due on a day declared to be a holiday.

68 On 11 September, our understanding is that the powers invoked by the State Governor were the emergency laws provided in section 28 of Article 2B of the Executive Law of the State which provides for the suspension of other laws during a state disaster emergency together with the General construction Law (see paragraph 114 below)<sup>62</sup>.

69 In Europe, the dates of public holidays vary from country to country. There is nothing in the core Regulations on the introduction of the euro (1103/97/EC, 974/98/EC and 2866/98/EC) which make provision in respect of bank holidays, and these matters appear to remain subject to national law. Joining the euro would not therefore appear to involve a legal impediment to domestic powers in respect of the declaration of bank holidays. As regards days when settlement in euro may be effected, this is ultimately a matter for TARGET (Trans-European Automated Real-Time Gross Settlement Express Transfer), the settlement system for the euro. TARGET closing dates informally take account of, but do not necessarily coincide with, national bank holidays. A description of the legal framework of TARGET is contained in the FMLC report.

70 As has been pointed out already, a key issue in respect of financial contracts is contractual provision for

60 Source for this and following three paragraphs: US Financial Markets Lawyers Group, Summary of relevant holiday laws, December 31, 1999 holiday project, which also contains a list of provisions. It was made available to us by the UK Financial Markets Law Committee, Emergency Powers Legislation Working Group.

61 In §4–104 of the Uniform Commercial Code as enacted in the State of New York, a banking day is defined as "that part of any day on which a bank is open to the public for carrying on substantially all of its banking functions".

62 HM Treasury Minute 6 August 2005.

payment, in other words when, where and in what currency payment may or must be made. Many examples could be given (see Chapter 4 of the FMLC report). In the European context, Annex 1 of the 2001 ISDA Euro Protocol (where it was adhered to) in effect combined relevant national business days with the days on which TARGET was open for settlement to arrive at a definition of “business day”. However, such days are treated separately in Section 1.16 (“Business Day”) of the 2003 ISDA Credit Derivatives Definitions. This is worth quoting in full as a contemporary definition of business day (which takes account of the transnational nature of TARGET):

““Business Day” means a day on which commercial banks and foreign exchange markets are generally open to settle payments in the place or places and on the days specified for that purpose in the relevant Confirmation, a TARGET Settlement Day (if “TARGET” or “TARGET Settlement Day” is specified for that purpose in the related Confirmation), or if a place or places or such terms are not so specified, a day on which commercial banks and foreign exchange markets are generally open to settle payments in the jurisdiction of the currency of the Floating Rate Payer Calculation Amount.”

71 For present purposes, the significance of the bank holiday is as a potential tool for alleviating the effects of major operational disruption. In this scenario, a day or days would be designated as bank holidays, either at the time of the disrupting event, or retrospectively. Whilst potentially useful, several possible limitations as regards this approach are noted below.

72 As regards Japan and Hong Kong, we refer to the discussion in the FMLC report sections 6.12 and 6.13, and the helpful information made available by Japan’s FSA, and the Hong Kong Monetary Authority, and the Hong Kong Association of Banks. It may be commented as regards Hong Kong that the typhoon analogy is useful though not exact, in that severe weather conditions are generally the subject of prior warning.

## 2. Bank holiday legislation in the UK

73 The current UK legislation is contained in the Banking and Financial Dealings Act 1971 (which repealed the 1871 Act). The Act specifies bank holidays in England, Scotland and Northern Ireland. It is discussed in Annex A to the Green Paper. There is power in s.1(2) for the Queen to vary the dates on which bank holidays fall. More significantly, s.1(3) provides that:

“Her Majesty may from time to time by proclamation appoint a special day to be, either throughout the United Kingdom or in any place or locality in the United Kingdom, a bank holiday under this Act.”

This permits the Queen to proclaim a special bank holiday not only nationally but also in any place or locality in the UK. It is not known whether a bank holiday has ever been proclaimed for a particular locality, though it is certainly the case in Scotland that there are public holidays both within Scotland as a whole and in parts of it.

74 It is not believed that this provision was enacted with emergencies in mind, financial sector operational disruption<sup>63</sup>, though it was used to close the banks at the time of the devaluation of sterling in 1967<sup>64</sup>. There is a full and valuable analysis in the FMLC report. As in the case of a declaration of a state of emergency, however, the power is exercisable by royal proclamation. There is no fall back provision as will be introduced under the Civil Contingencies Bill, which will permit the Secretary of State<sup>65</sup> to declare an emergency where it is not possible to arrange for a royal proclamation without serious delay: see clause 19. Nothing in the provision suggests that a bank holiday can be declared retrospectively, so that if this route were ever to be used in dealing with an emergency, in practice action would likely have to be taken on the day of the incident concerned. However the FMLC expresses the view that “the power to proclaim a special bank holiday is not specifically designed to deal with a major operational disruption in the financial markets and it is likely that the UK Government would consider that it was not appropriate to use it for this purpose for the same

<sup>63</sup> According to David Kynaston, three days bank holidays were declared at the beginning of the First World War, against the advice, he notes, of JM Keynes who believed that suspension would damage the market, and set a bad example: Kynaston, *The City of London*, vol II (Pimlico, London, 1995), pages 606–7.

<sup>64</sup> See also the FMLC report section 6.4.1 on the background of special bank holidays, which were proclaimed in the context of financial crises on 20 November 1967 (devaluation) and 15–16 March 1968 (gold speculation).

<sup>65</sup> Not specified.

reasons that led to the enactment of s.2 BDFSA 1971". (FMLC report section 6.14.3).

75 An important question is the legal effect of declaring a day to be a bank holiday. Section 1(4) provides that:

"No person shall be compellable to make any payment or to do any act on a bank holiday under this Act which he would not be compellable to make or do on Christmas Day or Good Friday; and where a person would, apart from this subsection, be compellable to make any payment or to do any act on a bank holiday under this Act, his obligation to make the payment or to do the act shall be deemed to be complied with if he makes or does it on the next following day on which he is compellable to make or do it."

76 Does this mean that payment and/or other obligations to be performed on a bank holiday are postponed to the following day, which is functionally the same as a suspension? On one reading, the wording of the section suggests that this is the effect. But in normal times, this would be commercially inconvenient, because the parties to financial contracts generally make provision for time of payment, and there is no reason to override their choice. The question specifically arose in the context of the introduction of the euro. It was the subject of a Note dated 26 May 1999 by a sub-committee of the City of London Joint Working Group on EMU legislation after consultation with Mr. Robin Potts QC, which concluded that the provision should be given a narrow interpretation. The sub-committee pointed out that it was possible for euro payments to be made in London on a bank holiday, because TARGET might be open on that day.

77 The sub-committee concluded that (while the question is not free from doubt) the better view is that s.1(4) permits a person to make a payment or do an act on the day after a bank holiday only in cases where the payment or act would otherwise be compellable on the bank holiday by legal process such as a court order. Section 1(4) should not apply simply because a party to a contract is contractually bound to perform his

obligation on a bank holiday. Rights conferred by the contract, such as a right to receive interest for late payment or to debit an account or to set off or enforce collateral, would be unaffected by s.1(4). In addition, s.1(4) would not apply where the place of performance specified in the contract is outside the United Kingdom.

78 We agree with this interpretation, which in the absence of any judicial decision can be treated as widely accepted, though it would be preferable if the wording of the section was clearer. Our understanding is that it is consistent with the effect under New York law of the proclamation by the Governor of a bank holiday in an emergency, which postpones the payment obligation "unless the contract expressly or impliedly indicates a different intent": see above. The effect is that, although banks and exchanges located in the UK would close, or be deemed to have closed, the declaration of a bank holiday would not operate to displace contractual terms as to payment. Where the relevant contractual terms refer to business days in the UK, the effect would be to postpone payment because banks here would not be open for business on that day. But it may be noted that in the case of US dollar denominated contracts, for example, the declaration of a bank holiday in the UK might not operate to affect the payment obligation at all where, as would normally be the case, payment is to be made to a specified account in New York. In that case, the relevant "business day" may be the New York rather than the London day.

79 This is not to suggest that the declaration of a bank holiday may not be a sensible course in certain circumstances. There may be circumstance in which the authorities might wish to take such a course if the ability to do so was more flexible than it is at present<sup>66</sup>. The legal effect in a market like London will inevitably be limited, because payment and settlement provisions in many London contracts are conditioned in whole or in part on business days in other jurisdictions, but this simply reflects market realities, and should not be seen as a reason for not taking action.

80 For completeness, we flag the point that declaring a bank holiday under present legislation entails other economic consequences, such as in relation to wage costs. In the context of financial sector

<sup>66</sup> A point made in the FMLC report requires consideration in this context. It is said that, "Similar issues can arise with respect to preceding business day conventions. For example, where performance is scheduled to take place on a Monday but, due to an operational disruption arising due to events over the weekend, it turns out that Monday is not a business day, then a preceding day convention would suggest that performance should have been made on the preceding Friday (before it was known that the problem existed). In some cases, it may be appropriate to address these issues in contracts by distinguishing the treatment of cases where the non-business day was an unscheduled event."

operational disruption, there may be benefit in considering the creation of an “emergency bank holiday” power, which would be restricted to enabling financial institutions to close on the day or days in question, perhaps limited to the affected area, and would not require to be implemented by royal proclamation.

## Part D: Powers to suspend financial dealings

81 The powers considered above are twofold, namely emergency powers arising under the general law, and the power to declare a bank holiday (this power not being necessarily conditioned on an emergency). Internationally, there are also powers specifically tailored to the financial sector that are analogous in many respect to emergency powers, but which are not tied to bank holidays, and more significantly, do not depend for their exercise on the proclamation of a state of emergency, which in the UK, at least, may be considered as a step of last resort. These powers are important in the present context, because they provide a direct comparison with those proposed in the Green Paper.

### 1 The UK position

82 In the United Kingdom, the Banking and Financial Dealings Act 1971 contains a general power to suspend certain financial transactions. Section 2 entitled “Power to suspend financial dealings” confers various closure powers on the Treasury, where necessary in the national interest, without having recourse to the bank holiday legislation. It is therefore directly relevant to the present discussion, and is discussed in Annex A to the Green Paper.

83 During the legislative process leading up to its enactment in 1971, it was explained in Parliament that under the former law, when it was necessary to close the banks (eg at the time of the sterling devaluation in 1967) the only way to do so was to proclaim a special bank holiday under the Bank Holiday Act 1871<sup>67</sup>. But this gave rise to uncertainties in relation to other matters, such as the effect on wage agreements, so that new legislation was required<sup>68</sup>.

Section 2 (as amended) of the Banking and Financial Dealings Act 1971 provides as follows:

- (1) if it appears to the Treasury necessary or expedient so to do in the national interest, they may by order (made by statutory instrument, which shall be laid before Parliament after being made) give, with respect to a day specified in the order, all or any of the following directions, namely:
  - (a) a direction that, subject to any exceptions for which provision may be made by the order, no person carrying on the business of a banker shall, except with permission granted by or on behalf of the Treasury, effect on that day, in the course of that business, any transaction or, according as may be specified in the order, a transaction of such kind as may be so specified<sup>69</sup>;
  - (b) a direction that, subject as aforesaid, no person shall, on that day, except with permission so granted, deal in any foreign currency or, according as may be specified in the order, foreign currency of such kind as may be so specified;
  - (c) a direction that, subject as aforesaid, no person shall on that day, except with permission so granted, deal in any gold or, according as may be specified in the order, gold of such kind as may be so specified;
  - (d) a direction that, subject as aforesaid, no person shall on that day, except with permission so granted, deal in silver bullion;
  - (e) a direction that, subject as aforesaid, no member of any commodity exchange<sup>70</sup> or, as the case may be, of any such commodity exchange as may be specified in the order, shall, on that day, except with permission so granted, deal thereon in futures in any commodity or, according as may be so specified, in futures in a commodity of such kind as may be so specified;
  - (f) . . . repealed;
  - (g) a direction that no member of a stock exchange in the United Kingdom shall, on that day, effect any transaction on that exchange; and

<sup>67</sup> Halsbury's Statutes, vol 30 (Money), page 212.

<sup>68</sup> 825 H of C Official Report 1457–1458.

<sup>69</sup> Does not include savings bank business: s.2(2).

<sup>70</sup> Defined in s. 2(6) as “an association established in the United Kingdom for the purpose of facilitating dealings by the members thereof in a commodity”.

- (h) a direction that, subject as aforesaid, no building society shall, on that day, except with permission so granted, effect in the course of its business any transaction or, according as may be specified in the order, a transaction of such kind as may be so specified.

85 Clearly, these are wide powers, and in effect include to a greater or lesser degree both powers to suspend obligations, and power to direct infrastructure. In summary, the Treasury may, in the national interest, with respect to a specified day<sup>71</sup>, order the suspension of banking and building society business, foreign currency dealing, dealing in gold or silver, commodity futures dealing, and stock exchange dealing. A person who knowingly or recklessly contravenes a direction given by an order is guilty of an offence (sub-section (4)). The Act applies in Great Britain and Northern Ireland (s.5). The threshold test, namely the national interest, appears considerably lower than the threshold for a proclamation of emergency.

86 The effect on financial obligations caught by an order made by the Treasury is dealt with in sub-section (3) which provides that:

An obligation on a person to do a thing on a day on which he is prevented from doing it by an order under this section, or is unable to do it by reason of any such order, shall be deemed to be complied with if he does it so soon as practicable thereafter.

The effect of this is that where a person is prevented from complying with an obligation because of an order under the section, for example because the banks are closed that day, he is deemed to have complied if he does so as soon as practicable afterwards. This appears to be a problematic provision. Unlike the position that applies in relation to bank holidays (see the discussion above), it would appear to override contractual payment clauses. Another objection is that its operation is uncertain, since in every case there would be scope for argument as to whether performance was rendered as soon as practicable.

87 Further, wide though they are, the powers reflect the financial markets as they were in 1971. There are obvious omissions. It is unclear for example whether the powers would extend to LIFFE, or the OTC derivatives market. There is force in the comment made by the

Financial Markets Law Committee that the powers were designed for use when the City of London was a relatively insular financial centre (subject to exchange controls). The powers are now incomplete and ill-suited to the more open, complex, international financial centre of today (FMLC report section 6.14.4). (It is also noteworthy that the legislation was enacted before there was any substantial legislation regulating financial services. A modern draft would for example refer to Recognised Investments Exchanges within the meaning of the Financial Services and Markets Act 2000, rather than refer to commodity or stock exchanges.)

88 It is necessary to decide whether s.2 should be modernised or repealed. In this context, it is worth pointing out that the powers have never been exercised. It is also unclear how far they have been reflected in the contractual documentation of clearing and settlement systems, though according to the FMLC report, CREST defines a business day (except for settlement in euros or US dollars) as “a day on which the CRESTCo systems are operational other than a Saturday, Sunday, Christmas Day, Good Friday or a day which is a bank holiday in England or on which banking transactions in England are suspended under section 2 of the Banking and Financial Dealings Act 1971”. The CREST documentation contemplates settlement of transactions only on business days (as so defined), being the days on which CREST Settlement Banks operate.

89 Generally speaking, the views expressed in the Green Paper as regards section 2 seem persuasive in this regard. It is pointed out in paragraphs A9–A11 that the prohibitive powers in the section go considerably beyond the kind of power envisaged as useful in responding to major operational disruption. The emphasis is strongly on prohibition, whereas the Green Paper is rightly concerned to provide for facilitation. The conclusion is that the powers are likely to be of limited use. The FMLC report section 6.14.4 expresses the view that it “would be pointless trying to extend and update this description to cover all financial markets because the international nature of the current UK wholesale financial markets and the large number of OTC transactions (even listed securities can be traded OTC when the stock exchange on which they are listed is closed) mean that there is no realistic way in which the Government could unilaterally assert control over all transactions in the UK wholesale financial markets.”

<sup>71</sup> Day or presumably days.

## 2 International comparisons

90 In the United States, as regards federal law, 12 U.S.C. § 95(a)<sup>72</sup> provides the President the following power:

In order to provide for the safer and more effective operation of the national Banking System and the Federal Reserve System, to preserve for the people the full benefits of the currency provided for by the Congress through the national banking system and the Federal reserve system, and to relieve interstate commerce of the burdens and obstructions resulting from the receipt on an unsound or unsafe basis of deposits subject to withdrawal by check, during such emergency period as the President of the United States by proclamation may prescribe, no member bank of the Federal reserve system shall transact any banking business except to such extent and subject to such regulations, limitations and restrictions as may be prescribed by the Secretary of the Treasury, with the approval of the President.

This effect of the section is to give the President power by proclamation to prohibit the transaction of banking business by member banks of the Federal reserve system for an emergency period. Violation is an offence. The power is significantly narrower than the power contained in s.2 of the UK Banking and Financial Dealings Act 1971, though the SEC also has extensive powers as regards the markets within its regulatory remit. These powers are described in Part E below.

91 As has already been pointed out above, more recently enacted powers under the International Economic Emergency Powers Act (IEEPA) (codified at 50 U.S.C. §§ 1701–1706) may be exercised to deal with any unusual and extraordinary threat which has its source in whole or substantial part outside the United States. Section 1702(a)(1) gives the President power to:

- (A) Investigate, regulate, or prohibit —
  - (i) any transactions in foreign exchange;
  - (ii) transfers of credit or payments between, by, through, or to any banking institution, to the

extent that such transfers or payments involve any interest of any foreign country or a national thereof;

(iii) the importing or exporting of currency or securities; and

- (B) investigate, regulate, direct and compel, nullify, void, prevent or prohibit, any acquisition, holding, withholding, use, transfer, withdrawal, transportation, importation or exportation of, or dealing in, or exercising any right, power, or privilege with respect to, or transactions involving, any property in which any foreign country or a national thereof has any interest;
  - (i) by any person, or with respect to any property, subject to the jurisdiction of the United States.

Compliance with any regulation, instruction, or direction issued under these powers “shall to the extent thereof be a full acquittance and discharge for all purposes of the obligation of the person making the same” (§ 1702(a)(3)).

92 As regards Europe, the review in Appendix 6 of the FMLC report has shown that at least in certain European countries some comparable powers specifically applicable to financial markets do exist. Given the multiplicity of sources of relevant powers, and the infrequency with which they are used, the review is unlikely to have picked up everything. The summary that follows includes regulatory powers:

- (1) **Belgium** Article 13 of La Loi du 2 août 2002 relative à la surveillance du secteur financier et aux services financiers<sup>73</sup> provides that:

§1. When an exceptional event disturbs the regular operation of a Belgian regulated market, the CBF<sup>74</sup> may, following discussion with the regulated market concerned, suspend all or part of the operations on this market for a maximum of two consecutive trading days.

§2. In the event of a sudden crisis on the financial markets, the King may, on the recommendation of the BNB<sup>75</sup> and the CBF, take all necessary protection measures with regard to Belgian regulated markets, including the temporary derogation from the

<sup>72</sup> 12 U.S.C. § 95(b)(1) giving the Comptroller of the Currency power to designate by proclamation any day a legal holiday for a national bank has been noted above.

<sup>73</sup> Law of 2 August 2002 in relation to the supervision of the financial sector and financial services.

<sup>74</sup> La Commission bancaire et financière.

<sup>75</sup> Banque nationale de Belgique.

provisions of this chapter. Decisions taken on the basis of the first paragraph cease to have effects if they are not confirmed in a law within twelve months of their entry into force.

In its explanatory memorandum, the Government notes that article expands the range of tools available to the public authorities for crisis management: “For instance, the CBF has been granted the authority to suspend operations on a regulated market for a maximum of two consecutive days of trading in the event of exceptional market disruption. Incidentally, the French financial market authorities have similar powers (see article 42. III of law no. 96–597 of 2 July 1996). Moreover, in the event of a sudden crisis on the financial markets, the King may take any protective measures required *vis-à-vis* the Belgian regulated markets, including temporary dispensations from the provisions of chapter II of this draft law. However, these provisions do not detract from the fact that the market companies are themselves responsible for elaborating suitable structural measures and drawing up emergency plans to overcome any market disruptions (article 4, 6° of this draft law), and that the market rules must provide for suitable order freezing measures or measures to interrupt transactions in the event of excessive price volatility (article 9, 4°).”

(2) **Finland** The Emergency Powers Act of 1991 has recently been amended to give the Government (and if so decreed the Bank of Finland, the Financial Supervision Authority, and the Insurance Supervision Authority) power to regulate financial markets and the insurance industry in emergency conditions. This is discussed above in the context of emergency powers.

(3) **France** Article L421-5 of the Code Monétaire et Financier<sup>76</sup> provides for the suspension of regulated markets (eg the Stock Exchange) in exceptional circumstances<sup>77</sup>:

When an exceptional event disturbs the regular operation of a regulated market, the president of the council of financial markets or, in the event of prevention, his representative designated for this purpose by him, can suspend whole or part of its operations for a duration not exceeding two

days of consecutive operations. Beyond this duration, the suspension is pronounced by decree of the minister in charge of the economy taken on a proposal from the president of the council of the financial markets.

If the suspension of a regulated market lasts more than two consecutive days of operations, operations in progress at the date of suspension can be compensated and liquidated under the conditions defined by the rules of the market.

(4) **Germany** German law contains two types of emergency procedures, which entitle the Federal Government to act in crisis situations affecting the financial sector. The first type is contained in §§ 47, 48 of the German Banking Act (Kreditwesengesetz) which enable certain emergency measures in narrowly defined cases where economic trouble within credit institutions threatens to affect the national economy as a whole. The provisions were introduced into the Banking Act as a consequence of the banking crisis of 1931, and have never been used since. They are designed to achieve a short-term freeze of financial activities in cases of an economic crisis caused by difficulties within credit institutions. Measures are by regulation made after consultation with the Deutsche Bundesbank. A regulation may stay in force for a maximum of three months. It may grant a moratorium, so that no insolvency proceedings may be initiated against the credit institution, order closure of credit institutions by way of bank holidays (limited to certain types of credit institutions or certain types of bank business), and closure of exchanges (stock exchanges and commodity exchanges). The second type of procedure is contained in § 1(2) of the Act on the Safeguarding of the Economy (Wirtschaftssicherstellungsgesetz). This gives the Federal Government emergency powers in case of actual or imminent military attack on Germany. In such a situation, the Federal Government is empowered to take measure to regulate the supply of cash and credit, including restrictions to the business of banks as well as temporary closures of credit institutions and Stock Exchanges.

<sup>76</sup> Monetary and financial code.

<sup>77</sup> It is believed that further emergency measures relating to the financial markets may be contemplated in an amendment to Article L.621-7-1 of the Code: to be confirmed.

- (5) **Ireland** A power which appears to be based on s.2 of the UK Banking and Financial Dealings Act 1971 is contained in s.134 of the Irish Central Bank Act 1989, though the language is somewhat different. It is exercisable by the Minister for Finance after consulting the Central Bank (s.134(1)). The list of activities included in the s.134 list is broadly the same as the s.2 list, except that it also includes financial futures. As in the case of the UK statute, where a person is prevented from complying with an obligation because of an order, he is deemed to have complied if he does so as soon as practicable afterwards (s.134(5)).
- (6) **Netherlands** The Noodwet financieel verkeer<sup>78</sup> of 25 May 1978 (as amended) contains emergency powers enabling the Minister of Finance to take all necessary steps regarding the financial sector. Emergencies are described as covering armed attack on the Netherlands, violation of the country's territorial integrity, war and threat of war and natural catastrophes. Prior to exercising the emergency powers, a Royal Decree is required. The Noodwet financieel verkeer gives the following powers to the Minister of Finance in the event of emergencies. Power to prohibit or impose conditions and other requirements on export and import of foreign currency and other means of payment, to regulate interest rates applicable in the financial markets, to regulate and restrict lending activities and deposit-taking by credit institutions, to prohibit or restrict issuance and trade of securities, to suspend or restrict the functioning of clearing and settlement systems, to restrict and regulate payment transfers and payment systems; require the DNB<sup>79</sup> to provide the Minister credits and advances in derogation to the Central Bank Act, to regulate on accounting and financial statements of credit institutions and insurance companies, to impose other restrictions concerning the activities and pricing policies of credit institutions and insurance companies, to issue temporary emergency banknotes.
- (7) **Switzerland** In Switzerland, there are existing and proposed provisions by which the Federal Banking Commission can order a moratorium in respect of bank payments, but this is in the context of bank insolvency, and is not directly relevant to the

operational disruption issue. The Swiss National Bank has indicated that wider emergency powers in the case of major operational disruption could be vested in the Government under Article 185(3) of the Federal Constitution.

## Part E: UK regulatory powers

94 There is no precise line between statutory powers of the kind under consideration above, and regulatory powers vested in the financial regulators. Regulatory powers typically exist in a variety of forms, including statute, statutory instrument, regulations made by the authorities pursuant to delegated powers, and 'soft' law such as codes, guidance, etc. So far as the UK is concerned, since the coming into force of the Financial Services and Markets Act 2000 on 1 December 2001, the relevant regulatory powers have been vested in the single regulator, the Financial Services Authority (FSA). Whilst the FSA will play a crucial role, it is thought that formal regulatory powers may play a relatively limited role in the immediate response to serious disruption, though there is likely to be scope in an emergency for temporary relaxation of, eg, capital requirements. A further possibility is lifting the ban on companies buying their own shares, to allow companies to go into the markets to buy their own shares thus relieving downward pressure on the markets at a key time. There is no power at present in the Financial Services and Markets Act 2000 enabling the FSA to take such action.

### 1 Interaction between the authorities

94 It is universally understood that interaction between the authorities will be a key factor in dealing effectively with an emergency. When the regulation of banks was transferred from the Bank of England to the Financial Services Authority (the UK's single financial regulator), it was recognised that clear lines of responsibility between the Government, the new regulator and the Bank of England as the country's central bank had to be established to deal with future cases of financial disruption. The 1997 Memorandum of Understanding between HM Treasury, the Bank of England and the Financial Services Authority establishes a framework for co-operation between them in the field of financial stability. It sets out the role of each institution, and explains how they will work together.

<sup>78</sup> Emergency law financial transactions.

<sup>79</sup> De Nederlandsche Bank N.V.

95 In summary, the Bank is responsible for the overall stability of the financial system as a whole including, in exceptional circumstances, the responsibility for undertaking official financial operations, such as support operations. (Liquidity measures taken by the Federal Reserve were a key element in the post-September 11 stabilisation process.) As regards the FSA, operations may include but are not restricted to the changing of capital or other regulatory requirements and the facilitation of a market solution involving, for example, an introduction of new capital into a troubled firm by one or more third parties.

96 The Treasury is responsible for the overall institutional structure of regulation, and the legislation which governs it, but has no operational responsibility for the activities of the FSA and the Bank. But there are a variety of circumstances where the Treasury will need to be involved, including major operational disruption. The examples given in the MoU include circumstances “where a serious problem arises which could cause wider economic disruption” or “where there is or could be a need for a support operation” or “where diplomatic or foreign relations problems might arise”. Exceptional circumstances are dealt with in more detail later in the MoU.

97 We now consider the position of the FSA, HM Treasury and Bank of England respectively as regards emergency powers.

## 2 Financial Services Authority

98 Annex 6A contains a description of the statutory and rule based powers available to the FSA in the event of major operational disruption to the financial system<sup>80</sup>. Another good description is in section 6.7 of the FMLC report. In summary, as one would expect, the FSA’s powers are not specifically tailored to deal with major operational disruption. There are three specific matters to mention.

99 The first is that emergency provisions do exist in GEN (the part of the Handbook containing General Provisions). The Handbook says that “FSA recognises that there may be occasions when, because of a particular emergency, a person ... may be unable to

comply with a particular rule in the Handbook. The purpose of GEN 1.3.2 R is to provide appropriate relief from the consequences of contravention of such a rule in those circumstances”. The rule provides that:

- (1) If any emergency arises which: (a) makes it impracticable for a person to comply with a particular rule in the Handbook; (b) could not have been avoided by the person taking all reasonable steps; and (c) is outside the control of the person, its associates and agents (and of its and their employees); the person will not be in contravention of that rule to the extent that, in consequence of the emergency, compliance with that rule is impracticable.
- (2) Paragraph (1) applies only for so long as: (a) the consequences of the emergency continue; and (b) the person can demonstrate that it is taking all practicable steps to deal with those consequences, to comply with the rule, and to mitigate losses and potential losses to its clients (if any).
- (3) The person must notify the FSA as soon as practicable of the emergency and of the steps it is taking and proposes to take to deal with the consequences of the emergency.

Whilst this provision is sensible, particularly since it is self-executing in the sense that it requires no action as such by the FSA which in some circumstances might be impractical, the provisions in sub-rule (4) as regards notice seem too formal for use in a major emergency and could usefully be reviewed, perhaps by adding words such as ‘as soon as practicable<sup>81</sup>’.

100 The second comes from the FMLC report, and relates to powers to close exchanges (this being one of the matters dealt with in the Green Paper). According to section 6.7.2:

“The FSA could use its powers of direction under s.296 Financial Services and Markets Act (FSMA) 2000 to, for example: (a) direct a recognised investment exchange to halt trading in one stock or the market as a whole; (b) direct a recognised investment exchange to extend settlement periods; or (c) direct a recognised clearing house to suspend

<sup>80</sup> Prepared by Mr Robert Purves of the FSA.

<sup>81</sup> Sub-rule (4) provides that “A notification under (3) must be given to or addressed and delivered in accordance with SUP 15.7 (Form and method of notification) (whether or not the person is a firm). If the person is not a firm, the notification must be given to or addressed for the attention of: IFD Contact Centre 11th Floor The Financial Services Authority 25 The North Colonnade Canary Wharf E14 5HS (tel: 0845 606 9966)”.

settlement operations. However, the legal effect of these steps is to require action to be taken or not taken by a recognised body. The legal effect on individual unsettled contracts between market participants is uncertain, and such interventions can have no impact on existing contractual obligations between parties to OTC transactions or operate to prevent parties from entering into such contracts. FSMA 2000 prescribes a procedure to be followed when giving a direction, which requires written notice to be given, and grants the recognised body and other affected persons the right to make representations. However, the FSA may give a direction without notice, to take immediate effect, if it considers it essential so to do<sup>82</sup>. The FSA's formal powers of direction have never been used and are wholly untested. The relationship between the FSA and the small recognised body community is a close one, involving mutual cooperation and constructive development of regulatory standards. It is expected that the FSA and the recognised bodies would work together, through the sharing of information and otherwise to ensure an appropriate response to any major operational disruption.”

101 It should be noted that the powers referred to in the passage quoted above arise only where the exchange “has failed, or is likely to fail, to satisfy the recognition requirements, or has failed to comply with any other obligation imposed on it by or under this Act” (s.296(1)). In the event of major operational disruption, an exchange may find itself unable to continue to meet the Recognition Requirements due to circumstances beyond its control, but in such a circumstance it is unlikely that the FSA would need to have immediate resort to its power of direction.

102 But whilst it is true as stated here that exercise of such powers would have no application to OTC transactions, the same would be true as regards the directory powers envisaged in the Green Paper. We question whether such powers could ever be realistically exercised in the OTC market. In a response to proposed rule changes by the US Municipal Securities Rulemaking

Board (see footnote 96 below), the US Bond Market Association expressed the view that imposing a regulatory trading halt was unnecessary, and could be harmful, citing the fact that most OTC markets today are interrelated and global<sup>83</sup>.

103 In any case, the more critical issue is likely to centre on the exchange's own powers to suspend operations, which are reviewed in chapter 5 of the FMLC report and chapter 7, where it is concluded that they seem adequate to deal with disruption. The exercise of own powers should also answer the issue raised in the passage just quoted as regards unsettled contracts between market participants, which would fall to be dealt with in accordance with the rules of the system concerned.

104 The third is that the power to waive or modify rules as they apply to authorised persons is potentially significant: see the FMLC report section 6.7.2.

### 3 HM Treasury

105 So far as presently relevant, the Treasury does not have responsibility for the conduct of financial regulation. Its role in the case of operational disruption as set out in the 1997 Memorandum of Understanding has been noted above, as have the emergency powers that it has under s.2 Banking and Financial Dealings Act 1971. The FMLC report also notes that the UK Debt Management Office (DMO) (which is part of the Treasury, and is responsible for issuing gilts) also undertakes a number of official operations in the gilts secondary markets, which includes creating stock for swap purposes if the DMO considers that there is sufficient evidence of “severe market dislocation or disruption”<sup>84</sup>. This it is said “could be of use following an event of major operational disruption if much of a particular Government stock is temporarily removed from the market (this would cause liquidity problems as Government stock is commonly used as collateral in payment systems). The US Treasury issued ten-year notes following 11 September 2001 for this reason”.

### 4 Bank of England

As clearly demonstrated by the role of the Federal Reserve at the time of September 11, the role of the Bank of England will be central in the case of major

<sup>82</sup> FSMA s.298(7).

<sup>83</sup> [http://www.bondmarkets.com/regulatory/january\\_16\\_2003\\_letter.pdf](http://www.bondmarkets.com/regulatory/january_16_2003_letter.pdf)

<sup>84</sup> See “Official Operations in the Gilt-Edged Market: Operational Notice by the UK Debt Management Office”, November 2001.

operational disruption in the financial sector. But the fulfilment of its role does not depend on formal powers. Since the Bank of England Act 1998, which vested the regulation of banks in the Financial Services Authority, the Bank has had relatively few formal statutory powers of a regulatory nature, and the powers that it does have arise in relation to payment and settlement systems. They principally relate to the designation of payment systems under the UK implementing regulations<sup>85</sup> for the EU Settlement Finality Directive<sup>86</sup> (the Bank must also be consulted by the FSA in relation to the FSA's designation of embedded payment systems within securities settlement systems). The Bank of England's oversight of UK payment systems is critical to the operation of many London markets.

107 Under the regulations, the Bank has the power to revoke the designation of a designated system if it appears to the Bank that the system no longer satisfies the designation requirements under the regulations, or if the system has failed to comply with any obligation to which it is subject by virtue of the regulations<sup>87</sup>. Given that revocation of designation depends upon a degree of breach by the system of its obligations under the regulations (and even then only results in a removal of various insolvency protections for the system's rules and default arrangements — as distinct from the ability of the Bank to impose any particular requirements on the system), such revocation is unlikely to be contemplated in dealing with the consequences of a major operational disruption and can be ignored for present purposes.

108 On a broader perspective, section 4 of the Bank of England Act 1946 enables the Treasury, if it thinks it necessary in the public interest, to give directions (outside the sphere of monetary policy) to the Bank and then for the Bank itself, if it thinks it necessary in the public interest, to request information from, and make recommendations to, “bankers”. However, the section only gives the Bank the power to issue directions if the banker has been given an opportunity to make representations, the Treasury has authorised such directions and the banker has been previously designated as such by a Treasury Order. Furthermore, if the Treasury has not declared anyone to be a “banker”,

then these powers cannot be used until it does so. Given the cumbersome nature of the procedures which must be gone through, s.4 is therefore unlikely to be invoked in dealing with the consequences of major operational disruption, and again nothing more need be said about it here.

## 5 International comparisons

109 Some international comparisons are found in the FMLC report. Of particular note, the US Securities and Exchange Commission (SEC) has power to intervene in emergencies under powers contained in the Securities Exchange Act of 1934 as amended. There is power to suspend trading on any national securities exchange if the public interest and the protection of investors so require (s.12(k)(1)B). However the power does not apply to exempted securities, which form a wide category including government securities and shares in collective investment schemes: see the definition in section 3a(B). There are certain checks and balances as regards this power, in that it will not take effect unless the SEC notifies the President of its decision and the President notifies the SEC that the President does not disapprove of such decision, though powers of judicial review seem to be circumscribed.

110 The SEC, in an emergency<sup>88</sup>, may by order summarily take such action to alter, supplement, suspend, or impose requirements or restrictions with respect to any matter or action subject to regulation by the SEC or a self-regulatory organisation, as the SEC determines is necessary in the public interest and for the protection of investors to maintain or restore fair and orderly securities markets (other than markets in exempted securities), or to ensure prompt, accurate, and safe clearance and settlement of transactions in securities (other than exempted securities). (s.12(k)(2)).

111 Subject to significant limitations, the effect of these provisions is to give the SEC wide power to suspend market trading and regulatory requirements in an emergency, but it is believed that neither power was exercised with respect to the events of 11 September. Section 12k is set out in Annex 6B, along with the definition of exempted securities in section 3.

<sup>85</sup> The Financial Markets and Insolvency (Settlement Finality) Regulations 1999 No. 2979.

<sup>86</sup> Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on Settlement Finality in payment and securities settlement systems (OJ No. L166, 11.6.98, p.45).

<sup>87</sup> Regulation 7(1).

<sup>88</sup> For these purposes, “emergency” means a major market disturbance characterised by or constituting either (a) sudden and excessive fluctuations of securities prices generally, or a substantial threat thereof, that threaten fair and orderly markets; or (b) a substantial disruption of the safe or efficient operation of the national system for clearance and settlement of securities, or a substantial threat thereof.

112 There is no power that we are aware of by which the US authorities can suspend operations in the OTC markets<sup>89</sup>.

## Part F: 11 September case study

### 1 United States

113 The 11 September incident consisted of a co-ordinated attack on the political<sup>90</sup>, military and financial institutions of the United States. The purpose of this section is not to describe the effects on the financial markets and the response of the US and other authorities to the resulting financial disruption (there being a good description in chapter 2 of the FMLC report, and in the other places referred to there) but rather to draw out some aspects of that response which seem particularly relevant to the present discussion. We are grateful in this regard for the assistance we have received from HM Treasury, the Bank of England, and the FSA.

114 The key points are as follows:

- (1) Coping with the effects of the attack clearly required a massive effort by the Government (at state and federal levels), the Federal Reserve, the regulatory authorities, exchanges, market associations, individual financial institutions, etc, as well as a crucial contribution by companies and individuals. But so far as relevant in the present context, there appears to have been relatively little recourse to formal legal powers. (That is not to suggest that provisions in the rules of exchanges, clearing houses, etc, as well as provisions in market contracts, did not play a vital part in controlling legal risk.) By comparison, there was a considerable body of guidance issued by the regulatory authorities in the retail insurance field<sup>91</sup>.
- (2) As regards the use of formal legal powers by the authorities at the national level, in Proclamation 7463 of 14 September 2001, President Bush invoked those contained in the National Emergencies Act of 1976. This proclamation is directly comparable to such as might be expected to be made by the Queen should such an incident happen in the United Kingdom. But the powers thereby utilised concerned the armed forces and the coastguard, and not the financial sector. (See further paragraph 19 above.)
- (3) Specifically in the banking context, on September 11 the Office of the Comptroller of the Currency (OCC) issued a proclamation under 12 U.S.C. § 95(b) authorising national banking associations at their discretion to close offices affected by the emergency<sup>92</sup>.
- (4) As regards the use of formal legal powers by the authorities at the state level, on 11 September 2001, Governor Pataki of New York State issued Executive Order 113, which declared a disaster emergency in the State under section 28 of Article 2\_B of the Executive Law<sup>93</sup>. Since then, he issued in all 62 emergency executive orders in response to the tragedy. But these do not appear to have been aimed at the financial sector, except for a series of identical orders issued between the time of the incident and 21 September, allowing banks, at their discretion, to close any or all of their places of business affected by the emergency. (See further paragraphs 20 and 21 above.)
- (5) In that regard, the Governor proclaimed that “Further, pursuant to the provisions of Section 24-a of the General Construction Law ... I find that an emergency exists and determine that banking organisations may, at their discretion, close any and all of their places of business affected by the emergency” (this is a reference to the emergency bank holiday powers described in paragraph 66 above). The legal effect of the action appears to be permissive not mandatory, and appears not to override contractual stipulations.
- (6) Further, though empowered to close, banks were actively encouraged to remain open. On 12 September 2001, the New York State Banking Department issued a statement declaring that banking organisations affected by the disaster could close their offices at their discretion, but it also “strongly encouraged all banks, both branches and principal offices, to continue doing everything possible to serve the public by conducting operations and performing transactions for the convenience of their customers”. It stated that it was “expected that only those bank offices directly affected by the emergency will close and will make

<sup>89</sup> A point made by the Bond Market Association in its response to the Green Paper of 2 May 2003.

<sup>90</sup> Flight UA 93 crashed short of its target following resistance by the passengers.

<sup>91</sup> See FSA internal memorandum of 20 May 2002.

<sup>92</sup> See Thomas C Baxter Jr, and Stephanie Heller, article cited in footnote 13 above, where the legal effect of these measures is thoroughly analysed.

<sup>93</sup> The speed of this response may be noted.

- every effort to reopen as quickly as possible to address the banking and liquidity needs of their customers<sup>94</sup>.
- (7) Action was also taken that was intended to ease the position of people who were unable to access bank accounts because of the death or disappearance of the account holder. It similarly applied as regards death benefits payable under insurance policies<sup>95</sup>.
- (8) Other significant formal regulatory action (in other words, action dependent on the use of formal legal powers) is the temporary relief that we understand was granted by the Securities and Exchange Commission from certain regulatory requirements to allow market participants to focus on resuming operations. According to the FMLC report, these relaxations included extending deadlines for disclosure and reporting requirements, postponing the implementation date for new reporting requirements, temporarily waiving some capital regulation requirements, relaxing rules that restrict buy-backs of quoted shares, and simplified registration requirements for airline and insurance industries to enable them to raise capital more easily<sup>96</sup>.
- (9) Specifically, as regards redemptions by holders of investments in mutual funds, the SEC did not use its power to declare an emergency so as to suspend redemptions. It did however issue an order on 14 September 2001, providing funds with temporary exemptions from certain borrowing restrictions, so as to facilitate redemptions<sup>97</sup>.
- (10) Action of the kind described in the last two sub-paragraphs might usefully be deployed in the UK in similar circumstances (though they are not the kind of actions directly contemplated in the legislation proposed in the Green Paper, and may be covered by existing regulatory powers, except as regards buy-backs of quoted shares).
- (11) Since 11 September resilience reviews have been carried out in the United States, as in the United Kingdom and elsewhere. As regards the US, we refer in particular to the consultation by the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency<sup>98</sup>, and the Securities and Exchange Commission noted in above, followed by the White Paper of 8 April 2003. It is right to say that this was concerned with sound practices rather than legal issues.
- (12) However we draw attention to the statement on page 2 of the White Paper that, "In general, commenters prefer that the agencies retain a 'sound practices paper format' rather than adopt a regulatory approach that could be susceptible to a 'one size fits all' application". This has a significant resonance with market response in the consultation to the UK Green Paper.
- (13) Furthermore, we are not aware of any moves in the United States to introduce major changes to the body of its financial or regulatory law in the light of the 11 September experience. Caution needs to be exercised in this regard, given the considerable number of agencies with responsibility for financial regulation, and the volume of such regulation. However we have had no indication that as regards the formal legal powers available to them, the US authorities consider that 11 September exposed significant legal or regulatory shortcomings in the financial sphere<sup>99</sup>. We believe that the general sentiment is to keep markets open and let the private sector deal with the position (except in catastrophic situations where some form of nationally declared bank holiday/trading halt would be facilitated by the relevant governmental agencies at the highest levels)<sup>100</sup>.

94 Source: FMLC report section 2.1.3 (vii).

95 A Treasury memorandum of 6 August 2003 prepared for the working group shows that on September 24th, by Executive Order (No. 113,24), the Governor exercised the power in section 29a of the Executive Law, with the following effects: filing fees (and some other filing and service requirements) for probate or other estate-related actions in respect of disaster victims were suspended; withdrawals from the accounts (and mutual funds) of missing persons (up to \$15,000) could be obtained by relatives on the presentation of an affidavit attesting to their family relationship; the revocation upon death of certain payment authorities could be prevented by the presentation of a similar affidavit; and that all New York licensed insurers would be required to accept an affidavit in lieu of a formal death certificate in order to expedite the payment of insurance benefits to victims' families.

96 Source: FMLC report section 2.1.3 (iv).

97 Suspending Redemptions: A Case-Study from 11 September 2001: Report of the Technical Committee of IOSCO, October 2002: <http://www.iosco.org/pubdocs/pdf/IOSCOPD135.pdf>

98 An office of the US Treasury.

99 In some instances, changes were considered, and rejected. We draw attention to MSRB (Municipal Securities Rulemaking Board) Notice 2003-37 (August 28, 2003) which says that, "In December 2002, the MSRB filed with the SEC a proposed rule change to provide a formal mechanism for the MSRB to halt trading in municipal securities in the event of a market emergency disabling critical systems or infrastructure. SEC staff had requested the MSRB to undertake rulemaking in this area to ensure that market crises could be appropriately addressed in a pre-established manner that would be known to market participants in advance. The SEC published the MSRB's proposed rule change for comment in January 2003. This proposal has engendered a thoughtful and energetic debate within the fixed income markets on the issue of trading halts during market crises and a wide variety of views have been expressed. The SEC has asked the MSRB to withdraw its proposed rule filing at this time, as the issue is further considered. The MSRB has today acted upon this request by sending a letter of withdrawal to the SEC."

100 See below.

(14) However there is a significant caveat to enter as regards the above. The severity of the 11 September attacks, the goodwill generated afterwards, as well as the size and dominance of the US markets was a very strong disincentive to parties which sought to benefit financially from the disaster. It cannot necessarily be taken for granted that similar goodwill would prevent profit taking resulting from an incident in London, should that be open to market participants. A similar caveat relates to the undesirability of financial uncertainty in relation to an institution affected by the crisis.

## 2 United Kingdom

115 A crucial point is that a major incident in a major financial centre is bound to have significant spill over effects. (Apart from the particular international connectivity of the London markets, this is an important reason for avoiding legal measures which might prompt possibly incompatible measures elsewhere.) Brief mention is made here of the 11 September spill over in the London insurance markets, and the corrective measures put in place.

116 Following the attacks, the provision of third party war and terrorism insurance for the aviation industry was severely restricted, preventing airlines and airports from operating. Without having to use emergency powers, the Government established a company called Troika to provide the necessary cover. The Government reinsured Troika's liabilities completely. Troika was established at short notice over one weekend. Troika successfully provided the cover required without a hitch. Through Troika, the Government raised the premia charged and encouraged a return to normal market conditions within a relatively short space of time. The scheme was withdrawn after 13 months.

## Part G: The Green Paper

117 As stated above, the key issue in the Green Paper is whether private sector efforts to deal with operational disruption can be assisted by legislative powers, and if so, what powers. The two powers mooted in the Green Paper (see paragraph E.13) are (1) a power to suspend certain financial obligations, so as to provide a legal breathing space, and (2) a power to direct financial 'infrastructure' (such as exchanges, clearing

houses, settlement systems and payment systems) providing a means of intervention (but only in formal markets and systems at the heart of the financial system), so as to assist the bodies concerned to resume early functions.

118 We are in no doubt that the Green Paper has made a valuable contribution to an informed analysis of the legal issues raised by major operational disruption in the context of the financial sector. Equally, it seems to us that it is essential in taking the proposals forward to identify precisely what the proposed powers could cover, and test them against the policy aims which the paper is seeking to achieve, and where necessary adapt them.

### 1 Power to suspend financial obligations

119 As a background comment, an attraction of English law as the law governing financial contracts has been the perceived insulation which it provides from action by other States suspending or abrogating financial obligations<sup>101</sup>. Experience in the US in such circumstances has been that difficult questions arise both as to the place of performance of the relevant obligation and the incidence of the obligation within international multi-branch corporations<sup>102</sup>. A major contemporary example of suspension is the temporary moratorium on overseas payments declared by the Government of the Russian Federation in August 1998 in connection with the collapse of the rouble against the US dollar, which in addition to the well-known failure of LTCM, caused significant litigation in the derivatives market.

120 The proposals are set out in chapter 6 of the Green Paper. In summary, the purpose of exercising the power to suspend would be to provide a breathing space where disruption made settlement of obligations difficult, without preventing parties who were able to fulfil their obligations from doing so.

121 The idea of a breathing space is sensible, and the question arises whether this can be achieved by the means suggested. If a 'direct' suspensory power is to be enacted, a precondition is to define in a satisfactory way the obligations that would be within the power to suspend. Unless that can be done, enacting a power would cause uncertainty, which would not be alleviated by making it clear, as the Green Paper does, that it would only be exercised in extreme circumstances.

<sup>101</sup> Eg *National Bank of Greece v Metliss* [1958] AC 509.

<sup>102</sup> Eg *Wells Fargo Asia Ltd v Citibank SA* 495 US 660 (1990).

122 The definition point is of course well recognised in the Green Paper, though no firm proposal as to definition is set out there. It envisages a power to suspend “financial system obligations”, in the sense of wholesale market obligations (paragraph 6.10), which we understand to mean contracts of a wholesale financial nature. However even by category, such contracts are obviously very varied and numerous. In terms of further explanation, the paper says<sup>105</sup> that, “Obligations within the maximum scope of the suspension power might include those associated with the following:

- Wholesale loans and deposits.
- Wholesale (high value) payments.
- Wholesale foreign exchange transactions.
- Derivatives contracts.
- Securities and money market paper. The obligations concerned might include both those arising from such assets — eg bond interest payments, payment of (declared) share dividends, corporate actions — and other obligations associated with them (eg settlement and collateralisation obligations).
- Transfer orders (effected via payment, settlement or similar systems).
- The bullion market”.

123 This is a useful list of some of the financial instruments and transactions which give rise to contractual obligations in the London context. But it does not set out to define the obligations which would be within the suspension power with a sufficient degree of clarity to enable its enactment, or to formulate an order should the power be provided. In fact, we doubt whether this is possible in the context of the modern markets, because the spread of contracts is so sizable. The definition issue is further addressed in the Green Paper under the heading “Specifying the obligations suspended”, where it asks the question how an order made under the power might specify such obligations. This is clearly a crucial question. The paper says that, “for example, the order could suspend obligations arising from contracts...

- of type X;
- of type X which were affected by the operational disruption;
- of type X involving companies A, B and C; and
- or even could suspend obligations arising from individually identified contracts (subject to

the obvious practical limitations of making such a list.”

124 This passage raises further issues as to, but does not resolve, the definition issue. We think that the paper is right to identify these problems, and one of the values of its analysis is to show how difficult it would be to provide a breathing space by a direct suspension of financial obligations. Powers exist to suspend trading in a particular stock or stocks, and to freeze assets belonging to named parties, and to declare bank holidays, and in some countries to impose emergency exchange control, and there are certainly other examples as well, but it is doubtful that by government order one could meaningfully suspend international financial obligations by reference to type of obligation. Picking up on the other points in the passage just cited, to limit the suspension to contracts affected by the operational disruption would only increase uncertainty, and whilst uncertainty would not necessarily arise if the order named contracting parties, or even individual contracts, we agree with the obvious practical limitations mentioned in the Green Paper in this regard.

125 As regards the scope of obligations potentially within the power, with the possible exception of Finland, we are not aware of powers in national authorities to suspend obligations under OTC derivatives. Such power does not exist in the United States (see above), and there seems good reason not to introduce it in the UK. There are also practical problems in this regard, including the fact that hedging techniques result in contracts being backed up against each other, so that market contracts are highly interconnected. Contracts are generally governed by standard ISDA (International Swap and Derivatives Association) terms, and subject to either English or New York law. Suspending obligations under some contracts but not others in a manner not contemplated by their terms would risk increasing the effects of disruption, rather than minimising them. An analogous point arises as regards foreign exchange cleared through the CLS settlement service, under which continuous linked settlement takes place through a London services company and a New York bank<sup>104</sup>.

126 A further definitional difficulty arises as regards the governing law and place of performance of the obligations concerned. The Green Paper discusses whether the proposed power should apply to all

<sup>105</sup>Box 6.2.

<sup>104</sup>See the CLS response to the Green Paper dated 17 April 2005.

contracts governed by a UK law, and concludes that suspensions “would better affect actions that took place in the UK, whether governed under UK or foreign law. It would be the location of the actions—not whether they were governed in contractual or proprietary terms under a UK or foreign law — that would matter. They would not therefore affect UK law transactions that did not involve persons or transactions in the UK” (paragraph 5.19). The solution proposed therefore is that, regardless of the law by which they were governed, obligations would fall within the proposed suspensory power if the place of performance of the obligation concerned was within the UK, but not otherwise.

127 It is correct as the Green Paper points out that a power which fastened on obligations that were governed by English law, regardless of their geographical connection to England, would be unacceptable, not least as deterring choice of English law. However, we think that the alternative approach conditioned on the place of performance also raises legal issues of very considerable difficulty. This can be illustrated by reference to the rules which apply through the European Union giving jurisdiction to the courts of the country of the place of performance of contractual obligations<sup>105</sup>. In the case of international financial contracts, it can be difficult to identify the country concerned, requiring an enquiry into the acts that comprise performance by each of the parties concerned, place of payment, location of branches, etc<sup>106</sup>. Whilst this generally causes no problems in the markets because of choice of jurisdiction clauses, it would cause real uncertainty in the context of a suspensory power. It is axiomatic that a direct power of suspension can only be assistance if it is immediately clear what obligations are covered by it.

128 Our conclusion in this respect is that powers of the kind envisaged here are not workable. This is the case regardless of whether the situation is such as to cause the proclamation of a state of emergency, in other words it is not a question dependent on having sufficiently wide legal powers. In any event, there are adverse implications in suspending financial obligations, which we think could make matters worse, not better, and lead to substantial uncertainty and litigation. However this should not be taken to contradict the main thrust of the comments in the Green Paper as to whether it would be useful to provide a breathing space.

If the Task Force comes to that conclusion, we think that another route is required. A possibility is to approach suspension by an indirect rather than a direct route, and one outcome in this regard is to adapt and take forward the Green Paper proposals by giving power to declare a bank holiday, or non-business day. If properly done, this may have the effect of producing a suspension of financial obligations, depending on contractual terms, and has the advantage of working within contracts, rather than suspending their provisions. There are however certain drawbacks, and we return to this issue below. A final point in this regard is that we feel that retail obligations as well as wholesale obligations should be taken into consideration. The wholesale and retail markets are interconnected, as regards for example funding of bank loans to retail customers.

## 2 Power to direct financial infrastructure

129 Chapter 7 of the Green Paper proposes a power to direct financial infrastructure (such as exchanges, clearing houses, settlement systems and payment systems) providing a means of intervention (but only in formal markets and systems at the heart of the financial system). We refer to the report of the infrastructure working group in this regard, commenting only that:

- (1) The definitional problems identified in relation to the proposed power to suspend contractual obligations do not arise in the same way as regards infrastructure, in that the systems covered could presumably be identified clearly in advance.
- (2) A crucial issue is the degree of linkage that now exists between UK clearing and settlement systems and their European counterparts, raising questions at least in some cases as to whether unilateral directions by the authorities in any particular country are appropriate any longer.
- (3) This differentiates the position in the US and the UK, and needs to be kept in mind when making comparisons with the powers of the SEC to call suspensions of trading on national securities exchanges in the United States (the relevant powers are noted in paragraphs 109 and 111 above). The authorities in the US have no similar impediment to acting unilaterally.
- (4) We assume that the authorities here would not wish to direct a system to close if its management

<sup>105</sup> Article 5 Council Regulation on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (EC/44/2001). The Regulation re-enacts similar rules previously contained in the 1968 Brussels Convention.

<sup>106</sup> *Bank of Baroda v Vysya Bank Ltd* [1994] 2 Lloyd's Rep 87.

- wished it to remain open, and vice versa.
- (5) There might be tension produced as regards the exercise of the power between national considerations, and the wider interests of London as an international market.
  - (6) The direction power might not be necessary if a satisfactory route to suspension could be devised. There was in any case no support in this Working Group for the direction power.

## Part H: Gaps and options to fill them

130 11 September demonstrates that the overriding objective in a market emergency is to resume operations as quickly as possible. The central issue raised in the Green Paper is the extent to which the new legislative powers mooted there may assist or conversely impede a process which by its nature will require speed and innovative thinking, as well as the implementation of existing contingency plans, and co-ordination by the authorities.

131 The conclusion in this respect is a matter for the Task Force, and we limit ourselves at this point to a discussion of possible gaps in the coverage of the law as it applies in this country, and the available options for filling them. However we have reached some conclusions relevant to the overall discussion, and we explain what they are in the options sections below.

### 1 Gaps analysis

132 An important issue is whether gaps have been identified in the law as it applies in the UK as compared with the US, or indeed otherwise, as is discussed in the Green Paper at paragraphs 3.21–3.24. In this respect our analysis has focused on whether the powers available to the US authorities on September 11 were materially different from those currently available to the UK authorities. Our comments are as follows:

- (1) The powers in the Executive to proclaim an emergency are comparable in the US and the UK. The consequential powers to issue regulations are at least as wide in the UK as the US, particularly if the proposed Civil Contingencies Bill is enacted. In any case, as explained above, emergency powers were used only to a limited extent as regards the financial sector in connection with September 11. We have not noted anything in the laws of other countries which suggests a gap in this regard.

- (2) As noted in the Green Paper at paragraph 3.21, and as explained above in Part C, the power to declare a bank holiday is wider in the US than in the UK in a number of respects:
  - (a) it can be declared on a same day basis, whereas in the UK it is unclear whether a bank holiday could be called for the day of the proclamation (see the Green Paper paragraph A7, and the FMLC report section 6.14.3);
  - (b) it does not require a proclamation by the head of state, since state governors have power to do so;
  - (c) powers are expressly given in emergency situations;
  - (d) upon a proclamation, banks may close their places of business in the holiday area, but are not required to do so; and
  - (e) what is implicit in UK law is more explicit in New York law, namely that if a contract requires the payment of money on a holiday, such payment may be made on the next succeeding business day, unless the contract expressly or impliedly indicates a different intent.
- (3) The other gap identified in the Green Paper is a power to call suspensions of trading. We have discussed the SEC's powers in this regard in paragraphs 109 to 111 above, and attach in annex 6B a copy of section 12k of the Securities Exchange Act of 1934 along with a relevant definition. The SEC's powers to order trading suspensions are subject to significant restrictions in that they only apply to national securities exchanges, do not apply to exempted securities, and do not take effect unless the SEC notifies the President of its decision and the President notifies the SEC that the President does not disapprove of such decision. The suspensory power proposed in the Green Paper is much wider, extending for example to the OTC derivatives market, which would go well beyond the US legislation, and cannot therefore be considered as filling a gap.
- (4) A possible further gap relates to the temporary relief that we understand was granted by the Securities and Exchange Commission from certain regulatory requirements to allow market participants to focus on resuming operations following 11 September. Temporary relief is potentially important, and we think that this aspect of the matter deserves further consideration. According to the FMLC report section 2.1.3 (iv), the SEC relaxations included temporarily waiving some capital regulation requirements, and relaxing

rules that restrict buy-backs of quoted shares. The FSA has powers to waive capital regulation requirements, so that no gap is evident in this respect. So far as share acquisition is concerned, under UK law, companies are subject to the restrictions in Pt V, Ch VI Companies Act 1985 against providing financial assistance for the acquisition of their own shares. There is no power in the FSA to relieve companies of these restrictions on a temporary basis<sup>107</sup>. As regards the more specific relief that might come in terms of market support in disrupted conditions by the purchase by the issuing company of its shares, we set out in Annex 6C a note written by Robin Potts QC. He concludes that it is not necessary to suspend or relax the provisions as to buy-backs in an emergency situation.

- (5) Though this is not technically a gap, we note that the emergency provisions in the part of the FSA Handbook containing General Provisions are capable of providing valuable relief from the consequences of contravention of rules in circumstances of operational disruption. But the provisions as regards giving notice to the FSA seem too formal for use in a major emergency and could usefully be reviewed. See paragraph 99 above.

## 2 Options

133 In the light of the above gaps analysis, there would appear to be a number of available options.

134 The first option is to leave aside any changes to the law for the time being, continuing to focus on contingency planning work, and coordination between the responsible authorities. The gaps analysis does not appear to have revealed any substantial gap to be filled in this respect (though we have identified above some matters that would benefit from further attention). This is essentially the course that we understand is being taken in the United States. The inter-agency White Paper of 8 April 2003 records that in general commentators prefer the agencies to retain a 'sound practices' format, rather than adopt a regulatory approach that could be susceptible to a 'one size fits all' application. We are not aware of any major reforms to US law in this regard, and have identified above one instance in which changes were proposed, and rejected<sup>108</sup>.

135 The second option is to include special provision as regards the financial sector in the Civil Contingencies Bill in accordance with the suggestions set out in the Green Paper, in other words to adopt the proposals. (The Bill is stated in the Green Paper to be the appropriate legislative vehicle for the proposals.) In this regard:

- (1) We do not think that a suspensory power in the form proposed is a viable option, because we do not think that it is workable in that form. In any event, there are adverse implications inherent in a direct suspension of financial obligations, which in the form proposed could make matters worse, not better, and lead to substantial uncertainty and litigation.
- (2) It is important to state that this conclusion applies regardless of whether the situation is such as to cause the proclamation of a state of emergency. In other words, it is not a conclusion dependent on the adequacy of legal powers (the powers in the Civil Contingencies Bill being essentially wide enough to do most things, in common with emergency legislation internationally).
- (3) There was no support in this Working Group for the proposed direction power, or for any concept of retrospective powers. But we think that this is primarily a matter for the infrastructure group.

136 The third option is to adapt and take forward the Green Paper proposals by approaching the suspension issue by creating a breathing space by the indirect bank holiday route rather than the direct route.

- (1) This approach could avoid the practical difficulties identified above in relation to the direct suspension power, and if properly structured could have the advantage that it would work within contractual provisions, and not purport to override them.
- (2) There may be benefit therefore in considering updating the Banking and Financial Dealings Act 1971 to permit an "emergency bank holiday" to be declared, which would be restricted to facilitating banks to close on the day or days in question in the same way as a conventional bank holiday, would be permissive and not mandatory, perhaps limited to a specified affected area, would not require to be implemented by royal proclamation, would not be restricted to circumstances in which

<sup>107</sup>The Secretary of State has certain powers by s.179 to modify the restrictions.

<sup>108</sup>See the Municipal Securities Rulemaking Board Notice 2003-37 of August 28, 2003, footnoted above.

- there had been a proclamation of an emergency under the Emergency Powers Act 1920 or the Civil Contingencies Bill, would be subject to the terms of the contract, would not entail the other economic consequences of a bank holiday eg in relation to wage costs, and would generally reflect the position as it obtains in the State of New York.
- (3) There is the further consideration that whilst the declaration of such a bank holiday perhaps on a very localised basis would send a signal that major operational disruption had occurred, as compared to some alternative approaches it would not entail the creation of any new legal concepts (such as “emergency non-business day” or the like), in other words it would essentially be a modernisation of existing powers.
- (4) On the other hand, it is important to be clear that, as some of our members put it, the declaration of a bank holiday (particularly without the modifications mentioned above) is something of a blunt instrument, and in any case is subject to the limitation that it would depend for its suspending effect on whether a particular contractual provision conditioned performance on whether London banks were open for business that day. Nor in the limited form mentioned would it have the effect of requiring London payment systems or exchanges to close<sup>109</sup> (see the FMLC report sections 6.4.3), though depending on the operational circumstances one or more might decide to do so<sup>110</sup>.
- (5) Another of our members specialising in payment systems drew attention to the intra-day timing issue, which raises the more general point that it might not be desirable to declare a bank holiday for an entire day if the disruption occurred towards the end of the business day.
- (6) Before reaching a definite conclusion, the Task Force might wish to (1) explore further any possible downside risk (the FMLC report sections 4.4.2 raises the possibility of an unscheduled bank holiday resulting in acceleration of some contractual obligations, which is clearly not what is intended, but may be relatively easy to deal with by appropriate contractual drafting), (2) obtain a formal opinion on the position under New York law, and (3) explore how an amendment to the 1971 Act empowering the declaration of an emergency bank holiday might actually be drafted, since this may have the effect of flushing out practical difficulties prior to making a recommendation.

137 There appears to be little support for the retention of the powers presently contained in section 2 of the 1971 Act (see the comments in paragraphs A9–A11 of the Green Paper).

138 Any steps taken will need to recognise that the lead given in the London markets is likely to be followed elsewhere, and will require careful explanation so as to avoid inconsistent measures in other jurisdictions.

<sup>109</sup> Except for CREST, which might need to reconsider its rules in this regard, so that the decision whether to remain open or closed was taken on operational grounds.

<sup>110</sup> See also the FMLC report section 6.4 on the background of special bank holidays.

## ANNEX 6A

# Statutory and rule based powers available to the FSA in the event of major operational disruption to the Financial System<sup>III</sup>

### Introduction

1 The FSA has a range of powers that might be of use in the event of a major operational disruption to the financial system. It has powers in respect of

- authorised persons (paras 3–20);
- companies whose securities are admitted to the Official List (para 21–27);
- recognised bodies (para 28–33); and
- the market at Lloyds (para 34).

This note sets out those powers that would likely to be of most use in such a circumstance, but also notes their limitations.

2 The FSA's exercise of these powers is circumscribed by procedures determined by the Financial Services and Markets Act (FSMA) and by a proper consideration of the FSA's statutory objectives<sup>112</sup> and principles of good regulation<sup>113</sup>. Largely, the powers available to the FSA and the procedures associated with them are designed for dealing with day to day supervisory issues that arise at firm level. They are not designed to deal with the immediate fallout from major operational disruption to the financial system.

### Authorised persons

#### Rule making

3 FSMA provides the FSA with a number of rule making powers in respect of authorised persons. However, these powers are unlikely to be a use in the event of major operational disruption. The FSA may only make such rules applying to authorised persons with respect to the carrying on of both regulated and unregulated activities as appears to be necessary or expedient for the purpose of protecting the interests of

consumers (“general rules”)<sup>114</sup>. Although “Consumers” is a term broadly defined it is not unlimited; it may be that a desired step would fall outside the scope of consumer interests.

4 In any event, it is difficult to envisage circumstances in which use of this rule making power would be necessary or useful. Rules bite on authorised persons; they do not bite upon third parties in contractual relationships with authorised persons. Therefore rules could operate to ban an authorised person from completing a contract or from entering into new contracts. They cannot operate to relieve an authorised person of any pre existing contractual obligations to a third party; they cannot, for example, provide a contractual breathing space through the suspension of contractual obligations of an authorised person affected by disruption.

5 Separately, a number of specific rule making powers are available to the FSA. These might be relevant in the event of operational disruption to the financial system, but operate with the limitations described above. These include the power to:

- make client money rules;
- impose rule based restrictions on managers of authorised unit trust schemes;
- impose rule based restrictions on authorised persons effecting or carrying out insurance contracts;
- make price stabilising rules; and
- make rules relating to the disclosure and use of information held by an authorised person<sup>115</sup>.

6 Should it be necessary, rules may be made without consultation and take immediate effect if the

<sup>III</sup> Annex written by Mr Robert Purves of the FSA.

<sup>112</sup> FSMA s2(2).

<sup>113</sup> FSMA s2(3).

<sup>114</sup> FSMA s138.

<sup>115</sup> FSMA ss139, 140, 141, 144, 147.

delay that would otherwise result would be prejudicial to the interests of consumers<sup>116</sup>. However, rule making is a legislative function reserved to the FSA's Board. In those circumstances in which a rule change might assist in the proper management of significant financial disruption, it may be that it is not achievable in an appropriate time frame.

### Waiver

7 The FSA may waive or modify general and certain other specific rules that would otherwise apply to an authorised person<sup>117</sup>. The FSA may direct that all or any of the rules do not apply to the authorised person or only apply with such modifications as may be specified. In any event, before exercising this power, the FSA must be satisfied that:

- compliance with the rule would be unduly burdensome or would not achieve the purpose of the rule; and
- the waiver or modification would not result in undue risk to persons whose interests the rules are intended to protect.

Unless satisfied that it is inappropriate or unnecessary so to do, the FSA must publish the waiver or modification.

8 The power to waive or modify a rule requires the consent or application of the authorised person. Should the FSA decide that it would be appropriate to waive or modify rules for a sector or the market as a whole, it cannot act unilaterally. This is not to say that the FSA cannot create a climate in which applications would be forthcoming. For example, in January 2003 the FSA made it clear that it was monitoring closely the position of life insurance companies in the light of sharp falls in the equity markets. The FSA wrote to the CEOs of life insurance companies in the context of the obligation to maintain a minimum margin over solvency ("RMM") informing them that it was open to such firms to apply to the FSA to waive or modify particular rules which form part of the RMM calculation.

### Force majeure

9 Should an authorised person find itself unable to comply with a particular FSA rule, the Emergency

provisions in GEN (the part of the Handbook containing General Provisions) operate to provide relief.

- Under these rules, if an unavoidable emergency arises, the person will not be in contravention of that rule for as long as the emergency continues if;
- the emergency is one that is outside the control of the authorised person; and
- the emergency makes it impractical for that person to comply with a particular rule.

An authorised person in this position must keep the FSA informed and of the steps it is taking or proposing to take to deal with it.

### Guidance

10 The FSA may give both individual and general advice to authorised persons as to the operation of the rules or on any other matter on which it appears desirable to give information or advice<sup>118</sup>. The giving of general guidance is usually circumscribed by a process of consultation, but this may be dispensed with and guidance given immediately if complying with the relevant provisions would be prejudicial to the interests of consumers.

11 This is a power that the FSA used in June 2002 to address certain problems facing the life insurance industry caused by existing guidance on the stress testing of portfolios; the so called resilience test. By issuing revised guidance, the FSA was able to take account of existing market conditions and alleviate problems identified with the resilience test in anticipation of revised rules.

### Variation of permission

12 The FSA may vary an authorised person's part IV permission to carry on one or more regulated activities<sup>119</sup>. Whether at its own initiative or otherwise, the FSA may:

- add a regulated activity;
- vary the description of a regulated activity;

<sup>116</sup> FSMA s155.

<sup>117</sup> FSMA s148.

<sup>118</sup> FSMA s157.

<sup>119</sup> FSMA ss44, 45.

- vary the permission by including in it such requirements as the FSA considers appropriate, including a requirement to take or refrain from taking specific action; or an “assets requirements”;
- cancel or vary a requirement; or
- cancel a Part IV permission.

13 This power is not designed to be used on a market or sector wide basis; rather it is a power to be exercised firm by firm. As with the power to waive or modify rules it is anticipated that in the event of a crisis, action under this power would be undertaken at the request or with the cooperation of individual firms.

14 Unlike the power to waive or modify rules, action may be taken by the FSA either on the application of the authorised person or on the FSA's own initiative. However, the FSA may only exercise its power to vary a permission at its own initiative if it appears to the FSA that:

- the authorised person is failing or is likely to fail to satisfy the threshold conditions;
- the authorised person has failed during a period of at least twelve months to carry on a regulated activity for which it has a part IV permission; or
- it is desirable to exercise the power in order to protect the interests of consumers<sup>120</sup>.

15 It is impossible to say that the relevant test will always be satisfied in the event of significant financial disruption. As with the power to make rules, the power to vary a Part IV permission cannot operate to relieve an authorised person of any pre existing obligations. It can operate to ban an authorised person from effecting or performing contracts, but it will not bind a third party or clearly affect third party rights against the authorised person. In considering the use of this power for example to provide a breathing space for people to clarify their positions, the FSA would need to balance the risk of increased legal uncertainty with any benefits that might flow.

16 A further element of legal uncertainty will need to be considered in the exercise of these powers, namely

the impact of any intervention on any rights and obligations that fall to be considered other than under English law. Broadly, the regulatory system operates by reference to rights and obligations under English law and within the jurisdiction of the English courts. Not all contractual arrangements of authorised persons will do so.

### Asset requirements

17 If the FSA varies a part IV permission by imposing an asset requirement on an authorised person certain contractual effects will flow<sup>121</sup>. An asset requirement is a requirement:

- prohibiting or restricting the disposal of or other dealing with assets; or
- that all or any of the authorised person's assets or the assets of any consumers held by the authorised person must be transferred to or held by a trustee.

18 One example of an asset requirement that might be imposed is a requirement on a firm not to transfer assets out of the jurisdiction. In such a case, if the firm's bank has notice of the requirement, it will not be in breach of contract with the firm if it refuses to transfer any sum in the reasonably held belief that compliance would be incompatible with the requirement.

19 The FSA must give an authorised person written notice of a variation at its own initiative, but it can take effect immediately if the FSA reasonably considers that it is necessary for it so to do<sup>122</sup>. The authorised person may make written representations and has the right to refer the matter to the Tribunal. Any variation is enforceable by injunction on the application of the FSA to the court<sup>123</sup>.

### Additional firm based powers

20 The FSA has a number of specific powers that relate to an authorised person's financial wellbeing that may be of use in the event of a major operational disruption impacting on a particular authorised person, although the FSA does not consider that these are likely to be of significance in the immediate aftermath of significant financial disruption. The FSA may petition the court for:

<sup>120</sup> FSMA ss45(5), 43.

<sup>121</sup> FSMA s48.

<sup>122</sup> FSMA s53.

<sup>123</sup> FSMA s380.

- an administration order in respect of an authorised person or an appointed representative, in the event of that person being in default of an obligation to pay a sum due and payable under an agreement the making or performance of which constitutes or is part of a regulated activity<sup>124</sup>; or
- the winding up of an authorised person or appointed representative if (i) that person is in default of an obligation to pay a sum due and payable under an agreement the making or performance of which constitutes or is part of a regulated activity or (ii) the court is of the opinion that it is just and equitable that the person should be wound up<sup>125</sup>.

### Listed companies

21 The FSA as competent authority for listing in the UK under FSMA Part VI has both statutory and rule based powers that may be exercised over companies whose securities are admitted to the Official List (“listed companies”).

### Rule making

22 The FSA has scope to make, repeal or amend Listing Rules<sup>126</sup>. This is broad power, but it is not likely that the Listing Rules themselves will be central to the proper management of a financial disruption. Nonetheless should it be necessary so to do, the FSA may make listing rules and those rules may take immediate effect on listed companies if delay that would otherwise result from following the usual consultative process would be prejudicial to the interests of consumers<sup>127</sup>.

### Waiver

23 Under Listing Rule 1.11 the FSA has the power to waive or modify Listing Rules in such cases and in such circumstances as it considers appropriate<sup>128</sup>. This is a power that may be used in respect of an individual listed company, a particular sector or even the market as a whole. It may be used unilaterally by the FSA, as its use does not depend upon the consent or request of a listed company. These powers could be used for example

to modify the usual arrangements for information dissemination by listed companies if the usual outlets have been disrupted.

### Information

24 The FSA may under Listing Rule 1.5 require an issuer to publish such information as the FSA considers appropriate for the purpose of protecting investors and maintaining the smooth operation of the market. This may be of some use to limit or prevent information asymmetries between market participants.

### Guidance

25 At all times, the FSA may give both general and individual guidance to listed companies as to the operation of the listing rules or on any other matter on which it appears desirable to give information or advice<sup>129</sup>.

### Suspension of listing

26 Under Listing Rule 1.15 the FSA may suspend the listing of any security where:

- the smooth operation of the market is or may be temporarily jeopardised; or
- where protection of investors so requires.

It may do so at any time and in such circumstances as it thinks fit<sup>130</sup>. This step may be taken without the consent of the listed company concerned and it may take immediate effect. However, of itself, this action does not stop on market trading taking place in the security concerned; this step is taken under the rules of the exchange on which the security is traded. OTC trading can continue unaffected by the suspension. Should the FSA unilaterally suspend the listing of a security, the listed company has the right to refer the matter to the Tribunal<sup>131</sup>.

### Discontinuance of listing

27 The FSA may discontinue the listing of a security if satisfied that there are special circumstances

<sup>124</sup> FSMA s359.

<sup>125</sup> FSMA s369.

<sup>126</sup> FSMA s138.

<sup>127</sup> FSMA s155.

<sup>128</sup> FSMA s101(2).

<sup>129</sup> FSMA s157.

<sup>130</sup> FSMA s77(2).

<sup>131</sup> FSMA s78.

that preclude normal regular dealings<sup>132</sup>. Any discontinuance may take place with immediate effect and the listed company has the right to refer the matter to the Tribunal<sup>133</sup>. However, it is likely that effective use of the power to suspend the listing of a security would render the use of this power unnecessary in the event of a major operational disruption.

## Recognised bodies

### Power of direction

28 The FSA has powers of direction over parts of the financial markets infrastructure, but this only extends to those bodies that are “recognised bodies” under FSMA (“RBs”). As such, the FSA may direct an RB if that RB has failed or is likely to fail to satisfy the recognition requirements or has failed to comply with other obligations imposed by or under FSMA<sup>134</sup>. The recognition requirements are made by regulation and can be neither waived nor amended by the FSA<sup>135</sup>. The term “recognised body” encompasses all those entities that are either recognised investment exchanges (“RIEs”) or recognised clearing houses (“RCHs”). The FSA may direct an RB to take specified steps for the purpose of securing compliance with the recognition requirements or with any obligation of the kind in question. Under this provision the FSA could for example:

- direct an RIE to halt trading in one stock or the market as a whole;
- direct an RIE to extend settlement periods; or
- direct an RCH to suspend settlement operations.

29 However, the legal effect of these steps on individual unsettled contracts is uncertain and such interventions can have no impact on existing contractual obligations between parties to OTC transactions or operate to prevent parties from entering into such contracts.

30 FSMA prescribes a procedure to be followed in the giving of a direction, involving the giving of written notice and provision for the making of representations<sup>136</sup>. However, the FSA may give a

direction without notice, to take immediate effect, if it considers it essential so to do. A direction is enforceable by injunction on the application of the FSA to the Court.

31 Under the Companies Act 1989<sup>137</sup>, the FSA may direct action to be taken or not taken under an RB’s default rules. Under this provision, the FSA can for example direct an RB that a particular firm is placed in default or direct that a firm be not so placed in default. However, unlike the general FSMA power of direction, the FSA is obliged to consult with the RB in advance of any default direction; in the light of the consultation, the FSA may only direct the RB to take action if failure to do so would involve undue risk to investors; it may only direct an RB not to take action if the taking of action would be premature or otherwise undesirable in the interests of investors or other market participants. A direction is enforceable by injunction on application of the FSA to the Court.

32 Finally, the Uncertificated Securities Regulations 2001 (“USRs”) provides the FSA with the power to direct CRESTCo as the Operator of a relevant system to take certain steps for the purpose of securing compliance with USR schedule 1 or with any obligation imposed by or under the USRs<sup>138</sup>. This is a power delegated from HMT by order to the FSA<sup>139</sup>. As with the FSA’s general FSMA power described above, the USRs prescribe a process to be followed in the event of a giving of a direction, but this need not be followed if the FSA considers it essential so to do. A direction is enforceable by injunction on application of the FSA to the Court.

33 The FSA’s powers of direction are wholly untested, as they have never been used against an RB.

## Lloyds

34 The FSA has a very broad power to direct Lloyds. These powers are subject to a prescribed process, involving public consultation. This process may be dispensed with if delay would be prejudicial to the interests of consumers. These powers of direction are more extensive than those available to the FSA in respect of the insurance sector outside Lloyds.

<sup>132</sup> FSMA s77(1).

<sup>133</sup> FSMA s78.

<sup>134</sup> FSMA s296.

<sup>135</sup> FSMA 2000 (Recognition Requirements for Investment Exchanges and Clearing Houses) Regulations 2001.

<sup>136</sup> FSMA s298.

<sup>137</sup> CA’89 s166.

<sup>138</sup> USR reg 8.

<sup>139</sup> USR reg 11.

## General

35 The FSA has a number of injunctive powers that may also be relevant in the event of a major operational disruption to the financial system. The FSA may seek an injunction if there is a likelihood of:

- contravention of a relevant requirement<sup>140</sup>; this is unlikely to be of use to mitigate the effects of significant market disruption; and
- market abuse<sup>141</sup>; the court may make an order restraining market abuse or requiring the abuser to take such steps as the court may direct to remedy the abuse. This would be a useful tool if any person sought to take improper advantage of financial disruption but would not necessarily help to manage the disruption itself.

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<sup>140</sup> FSMA s380.

<sup>141</sup> FSMA s381.

## ANNEX 6B

### Powers of the US securities and exchange commission

Section 12k of the Securities Exchange Act of 1934 as amended provides that:

#### Trading suspensions; emergency authority

##### 1 Trading suspensions

If in its opinion the public interest and the protection of investors so require, the Commission is authorised by order —

- A. summarily to suspend trading in any security (other than an exempted security) for a period not exceeding ten business days; and
- B. summarily to suspend all trading on any national securities exchange or otherwise, in securities other than exempted securities, for a period not exceeding 90 calendar days.

The action described in subparagraph (B) shall not take effect unless the Commission notifies the President of its decision and the President notifies the Commission that the President does not disapprove of such decision. If the actions described in subparagraph (A) or (B) involve a security futures product, the Commission shall consult with and consider the views of the Commodity Futures Trading Commission.

##### 2 Emergency orders

A. The Commission, in an emergency, may by order summarily take such action to alter, supplement, suspend, or impose requirements or restrictions with respect to any matter or action subject to regulation by the Commission or a self-regulatory organisation under this title, as the Commission determines is necessary in the public interest and for the protection of investors —

- i to maintain or restore fair and orderly securities markets (other than markets in exempted securities); or
- ii to ensure prompt, accurate, and safe clearance and settlement of transactions in securities (other than exempted securities).

B. An order of the Commission under this paragraph (2) shall continue in effect for the period

specified by the Commission, and may be extended, except that in no event shall the Commission's action continue in effect for more than ten business days, including extensions. If the actions described in subparagraph (A) involve a security futures product, the Commission shall consult with and consider the views of the Commodity Futures Trading Commission. In exercising its authority under this paragraph, the Commission shall not be required to comply with the provisions of section 553 of Title 5 or with the provisions of section 19(c) of this title.

##### 3 Termination of emergency actions by President

The President may direct that action taken by the Commission under paragraph (1)(B) or paragraph (2) of this subsection shall not continue in effect.

##### 4 Compliance with orders

No member of a national securities exchange, broker, or dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security in contravention of an order of the Commission under this subsection unless such order has been stayed, modified, or set aside as provided in paragraph (5) of this subsection or has ceased to be effective upon direction of the President as provided in paragraph (3).

##### 5 Limitations on review of orders

An order of the Commission pursuant to this subsection shall be subject to review only as provided in section 25(a). Review shall be based on an examination of all the information before the Commission at the time such order was issued. The reviewing court shall not enter a stay, writ of mandamus, or similar relief unless the court finds, after notice and hearing before a panel of the court, that the Commission's action is arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.

##### 6 "Emergency" defined

For purposes of this subsection, the term "emergency" means a major market disturbance characterised by or

constituting —

- A. sudden and excessive fluctuations of securities prices generally, or a substantial threat thereof, that threaten fair and orderly markets; or
- B. a substantial disruption of the safe or efficient operation of the national system for clearance and settlement of securities, or a substantial threat thereof.

*Section 3a12 (definitions and application) of the Securities Exchange Act of 1934 as amended (definitions and application) defines exempted security as follows:*

- A. The term “exempted security” or “exempted securities” includes —
  - i government securities, as defined in paragraph (42) of this subsection;
  - ii municipal securities, as defined in paragraph (29) of this subsection;
  - iii any interest or participation in any common trust fund or similar fund that is excluded from the definition of the term “investment company” under section 3(c)(3);
  - iv any interest or participation in a single trust fund, or a collective trust fund maintained by a bank, or any security arising out of a contract issued by an insurance company, which interest, participation, or security is issued in connection with a qualified plan as defined in subparagraph (C) of this paragraph;
  - v any security issued by or any interest or participation in any pooled income fund, collective trust fund, collective investment fund, or similar fund that is excluded from the definition of an investment company under section 3(c)(10)(B);
  - vi solely for purposes of sections 12, 13, 14, and, 16, any security issued by or any interest or participation in any church plan, company, or account that is excluded from the definition of an investment company under section 3(c)(14); and
  - vii such other securities (which may include, among others, unregistered securities, the market in which

is predominantly intrastate) as the Commission may, by such rules and regulations as it deems consistent with the public interest and the protection of investors, either unconditionally or upon specified terms and conditions or for stated periods, exempt from the operation of any one or more provisions of this title which by their terms do not apply to an “exempted security” or to “exempted securities”.

- B.
  - i Notwithstanding subparagraph (A)(i) of this paragraph, government securities shall not be deemed to be “exempted securities” for the purposes of section 17A.
  - ii Notwithstanding subparagraph (A)(ii) of this paragraph, municipal securities shall not be deemed to be “exempted securities” for the purposes of sections 15 and 17A.
- C. For purposes of subparagraph (A)(iv) of this paragraph, the term “qualified plan” means (i) a stock bonus, pension, or profit-sharing plan which meets the requirements for qualification under section 401 of Title 26, (ii) an annuity plan which meets the requirements for the deduction of the employer’s contribution under section 404(a)(2) of Title 26, or (iii) a governmental plan as defined in section 414(d) of Title 26 which has been established by an employer for the exclusive benefit of its employees or their beneficiaries for the purpose of distributing to such employees or their beneficiaries the corpus and income of the funds accumulated under such plan, if under such plan it is impossible, prior to the satisfaction of all liabilities with respect to such employees and their beneficiaries, for any part of the corpus or income to be used for, or diverted to, purposes other than the exclusive benefit of such employees or their beneficiaries, other than any plan described in clause (i), (ii), or (iii) of this subparagraph which (I) covers employees some or all of whom are employees within the meaning of section 401(c) of Title 26, or (II) is a plan funded by an annuity contract described in section 403(b) of Title 26.

## ANNEX 6C

### Share buy-backs

From: Robin Potts QC

To: Bill Blair QC

26 September 2003

1. I address below the issue raised in paragraph 132(4) of the Working Group report, namely:

“whether the powers of the FSA to give temporary relief from certain regulatory requirements in an emergency should be extended now to enable it to temporarily relieve firms of restrictions on the buy-back of their shares.”

2. In practical terms, the issue relates to buy-back of shares by English listed companies.

3. Buy-backs of shares are governed by Chapter VII of the Companies Act 1985 and, specifically, by Sections 159 to 170.

4. Buy-backs are either effected “off market” or “on market”.

5. “On market purchases” are defined by Section 163 and are generally defined as being purchases made on a recognised investment exchange. Under the Rules

of the London Stock Exchange (Rules 3000, 3041.2 and 3045) transactions are on market if one or both the parties to the transaction is a member firm whether as agent or principal. Normally buy-backs are made by a member firm as agent for the company or by it as principal with a view to selling on to the company.

6. Section 166 does not require each transaction by market purchase to be separately authorised by the shareholders of the company in general meeting. It suffices if the general meeting has conferred general authority to make buy-backs.

7. The majority of listed companies take such a general authority each year, ie they will have a pre-existing authority before the emergency appears and thus they can utilise that power.

8. All such buy-backs, generally, have to be made out of distributable profits (Section 160(1) and Section 162(2)). I see no reason why that limitation should not continue in a situation of an emergency.

9. In summary, I do not think it is necessary to suspend or relax the provisions as to buy-backs in an emergency situation.