

**COOPERATION GUIDANCE**  
**BETWEEN**  
**RECOGNISED BODIES**  
**AND**  
**INSOLVENCY PRACTITIONERS TO ASSIST**  
**MANAGEMENT OF MEMBER DEFAULTS BY**  
**RECOGNISED BODIES**  
**(Recognised Clearing House Version)**

*This document is not intended to provide legal advice or legal opinion. Nor is it intended to override or restrict in any way the rights or obligations of the parties under the legislation or regulations described herein. Any description of legislation or regulatory provision is intended for information only.*

**Objective**

1. Maintaining confidence in the financial system is critical to economic well-being. Recognising this, the regime in Part VII of the Companies Act 1989<sup>1</sup> is designed to safeguard the operation of financial markets.<sup>2</sup> This Guidance has been drawn up to facilitate a closer understanding of the regime and management of the respective responsibilities of recognised bodies (RBs) providing central counterparty services and insolvency practitioners (IPs) in a default situation.

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<sup>1</sup> and accompanying secondary legislation (namely the Financial Markets and Insolvency Regulations 1991 (“the 1991 Regulations”) and the Financial Services and Markets Act 2000 (Recognition Requirements for Investment Exchanges and Clearing Houses) Regulations 2001 (“the 2001 Recognition Requirements Regulations”).

<sup>2</sup> RBs may also be designated under the 1991 Regulations (which implement the Settlement Finality Directive). This determines and protects the point at which ‘transfer orders’ – including money transfers – within the system become irrevocable, and ensures that such transfers cannot be challenged by a liquidator in the event of a member’s insolvency.

2. The Guidance represents a set of non-binding procedures agreed between the RB and IP signatories. In drawing up the Guidance all parties recognise that insolvency legislation imposes duties and obligations on both RBs and IPs and that those duties and obligations may on occasion conflict – if only in competing for scarce resources and time. The Guidance is not intended to, and does not, absolve any party from fulfilling its contractual or statutory obligations or limit its discretion in determining how best to meet those obligations. Conflicts will be resolved constructively between the two sides, if necessary through prompt seeking of advice from the Courts. This Guidance is, however, intended to minimise the likelihood of such actions being necessary.

3. Operation of the Guidance rests with those bodies, although its content is supported by the FSA and the Bank of England.

## **Part VII**

*What does Part VII enable RBs to do?*

4. Part VII modifies insolvency law to protect the actions of recognised clearing houses and recognised investment exchanges (RBs)<sup>3</sup> in the event that one of their members defaults on the obligations it has entered into in the course of buying or selling financial instruments.

*What does this mean in practical terms?*

5. The protections given to RBs under Part VII enable each RB to protect the markets it serves against the repercussive effects of an individual insolvency or default of a member, and ultimately against systemic failure by choosing the course of action, within the constraints of its default rules, that presents the lowest risk to itself and the markets it serves, including closing out a defaulter's unsettled market contracts in accordance with its default rules. These may include, for example, provisions to close out positions through the execution of transactions on the open market or through auction, to settle positions early and to transfer positions to other members. They allow the RB to undertake offsetting transactions either individually or to hedge risk across the portfolio while the defaulter's positions are being resolved. The default rules contain provisions for the calculation of net sums owing between the RB and the defaulting member and permit the RB to realise collateral. The RB's rules may include offsetting profits and losses on different contracts and setting off assets provided as margin against net losses. The RB's preferences amongst the range of options will depend on the size and nature of the positions of the defaulter, the characteristics of the individual markets and the market conditions prevailing at the time.

6. Part VII is crafted so as to ensure that the operation of the default rules of RBs takes precedence over insolvency procedures. In practice this means that third parties, including administrators or other insolvency officer-holders, cannot interfere with or disrupt the operation of the default rules or prevent settlement of transactions held at an RB in the defaulter's name. Similarly, the moratorium on enforcement of security that is triggered by administration does not prevent an RB from enforcing the security it has from the defaulting member, eg using or selling collateral provided.

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<sup>3</sup> The term "recognised body" includes overseas exchanges and clearing houses recognised by the FSA.

*Why have RBs been granted these protections?*

7. RBs that provide central counterparty services manage the risk that clearing member counterparties to market trades will become unable to fulfil their obligations when they become due. The rules of the exchange and/or the clearing house specify that, by novation or an equivalent formality, the central counterparty becomes contractual intermediary for all positions – typically by the RB becoming buyer from the seller and seller to the buyer, so that performance of the contract is guaranteed, subject of course to the viability of the central counterparty itself. The ability of the RB to operate its default rules effectively is central to its ability to manage the risks that it assumes. To the extent that it was unable to enforce its default rules promptly, the benefits and economic efficiency of its role in the market could be compromised, potentially undermining the stability and confidence of the broader market. Prompt communication between RB, the defaulting firm and the IP will be essential if that outcome is to be avoided.

8. These protections therefore safeguard the integrity of financial markets, and public confidence in them, by minimising the disruption caused by the default of the member of a clearing house or the member of an exchange. They are designed to try and ensure that the market is immunised against repercussive effects from an individual insolvency or default, and ultimately against systemic failure.

### **Legal obligations of IPs**

9. Insolvency law imposes a duty on the administrator to perform his functions with the objective of:

- rescuing the company as a going concern, or
- achieving a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being in administration), or
- realising property in order to make a distribution to one or more secured or preferential creditors.

10. The administrator must perform his functions with a view to achieving the first of these objectives unless he thinks either:

- that it is not reasonably practicable to achieve that objective, or
- that the second objective would achieve a better result for the company's creditors as a whole.

11. The administrator may perform his functions with a view to achieving the third objective only if:

- he thinks that it is not reasonably practicable to achieve either of the first two objectives, and
- he does not unnecessarily harm the interests of the creditors of the company as a whole.

12. An administrator has very broad powers, including powers to carry on the company's business and realise its assets. The administrator displaces the company's board of directors from its management function and has the power to remove or appoint directors.<sup>4</sup>

13. Where the insolvent company is a UK bank or building society,<sup>5</sup> it is likely to become subject to a special insolvency order made under the Banking Act 2009. In such situations, the Banking Act modifies the normal legal duties of the IP by imposing a primary objective on him:

- to work with the FSCS to ensure that all FSCS insured depositors are paid out or have their accounts transferred<sup>6</sup>; or
- where part of the business has been transferred under the statutory powers in the Banking Act, to ensure that the transferee is provided with such services and facilities as it requires, in the opinion of the Bank of England, to enable it to operate the transferred business effectively<sup>7</sup>.

14. This Guidance is designed to facilitate cooperation between RBs and IPs within the framework set out in Part VII. It does not alter the IP's broader powers and objectives. Where the IP's objectives may conflict with those of the RB, all parties acknowledge that no action should be taken by an IP which conflicts with its obligations under Part VII. Equally, it is acknowledged that close co-operation between RBs and IP will help both in the performance of their duties and may ultimately be beneficial to creditors.

15. Particular concerns arise where the defaulting clearing member's records of its own or its clients' positions and related collateral are difficult to access, confused or inaccurate. Where that is so, communication and co-operation will be crucial in reaching a speedy outcome acceptable to both the RB and the IP. The following section addresses those issues.

#### Practical arrangements for RBs and IPs<sup>8</sup>

### **Communication**

16. RBs and IPs should establish and share a single permanent point of contact (with nominated delegates/alternates) ex ante in order to facilitate immediate coordination in the event of a default and administration.

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<sup>4</sup> In the case of the BAP, the Banking Act imposes an obligation on the IP to obtain the consent of the Bank of England before carrying out a range of his powers under the Insolvency Act 1986.

<sup>5</sup> The specific requirement is that the firm be incorporated in the United Kingdom and hold a Part IV permission to carry on the regulated activity of accepting deposits (Banking Act 2009, s.2).

<sup>6</sup> Banking Act 2009, s.99(2) in relation to a liquidation of the whole company under the Banking Insolvency Procedure (BIP).

<sup>7</sup> Banking Act 2009, s.138(1) in relation to the Bank Administration Procedure (BAP).

<sup>8</sup> Annex A provides current contact details, these should be reviewed quarterly

17. Each RB at which the defaulting institution holds positions, collateral and/or settlement obligations should make contact with the IP as soon as it becomes aware that an IP has been appointed. By the same token, when an IP is appointed it should make contact with the relevant RBs as soon as it becomes aware that a defaulting institution is a member of an RB. If it is possible to make contact before the formal appointment of the IP, then this should be considered and, if appropriate, undertaken.

18. After this contact is made, the IP and RB should identify and exchange contact details of named individuals at junior and senior level responsible for managing the relationship and resolving quickly any issues that arise. These named individuals should be familiar with the needs and constraints of the other party. The IP and the RB will co-operate with each other in the identification and sharing of contact details between their respective organisations and relevant personnel of the institution in administration.

### **Information**

19. Part VII places a duty on those who have control over the assets and records of the defaulting institution to give RBs such assistance as they may require to carry out their default procedures. Should it request it, the RB should be given read-only working access as soon as practicable, ideally on the same day that procedures are initiated, to the relevant records of the defaulting institution. IPs and RBs will endeavour to work together ex-ante to specify what typically constitutes such relevant records, but will discuss any information requests that are specific to a given institution or event should such need arise. These would include: trading records (house and client); position records (house and client); records of collateral placed with the clearing house; client contact details. In particular, the RB requires sufficient information to enable it to identify individual client positions held within omnibus accounts (either segregated or non-segregated) to facilitate the RB's transfer or hedging strategies in respect of these positions. Where practical, the IP and the RB will agree information requirements for both parties.

20. The RB acknowledges that by meeting the RB's need for the information defined in paragraph 19 within a very tight timeframe, the IP will not have been able to verify, and so cannot guarantee or accept any responsibility for the completeness and accuracy of such information. IPs and RBs will work together ex-ante to develop pro-forma documentation, including a hold-harmless basis, to be used to reflect the unverified nature of this information and such a document will be used whenever practical. The IP will work with the RB and use reasonable endeavours to ensure over time a set of information that is as current, accurate and complete as practicable.

21. The RB commits to use such information supplied only where needed for the purposes of the management of the default, which may include providing such information to third parties participating in/assisting with the management of the default. In this context, the RB notes its obligation to remain in compliance with REC 2.5.14. with regard to such information provided. The RB will also ensure that the third party that is recipient to such information acknowledges in a legally adequate fashion the unverified nature of such information.

22. To the extent that the records are available in a standard electronic format, the RB will be given access in that form. Such records will be provided in an electronic format. The RB shall not be entitled to access the defaulting institution's systems for the purposes of manipulating the information within those systems.

23. Subject to non-interference with the IP's obligations and duties under insolvency legislation, the RB should be given access to staff from the defaulting institution as soon as practicable and the IP will support the RB's attempts to contact them. These will include staff who are familiar with the data, those who can assist the RB in contacting clients and front office staff to assist the RB when necessary in the execution of trades to hedge and/or liquidate the defaulting institution's positions. The IP and RB will co-operate to ensure that, as far as is practicable the staff from the defaulting institution are given clear, consistent and coherent instructions by the IP.

### **Priority**

24. Subject to being able to satisfy its own obligations and duties, the IP will support the RB in accessing data and staff in a timely way in order to enable the RB to fulfil its remit of minimising the disruption caused to financial markets by the default of a member of the RB.

25. As far as is practicable, the IP will support the RB in carrying out its default procedures. For example, where an RB has exercised its rights under its default procedures to close out the positions of a defaulting participant, it may subsequently need to issue instructions to a Central Securities Depository to cancel any pre-existing settlement instructions in respect of deliveries due from the defaulting participant to the RB. Some CSDs require any such cancellation instruction to be matched by a corresponding instruction from the IP<sup>9</sup>. In such circumstances so far as is practicable, the IP will support the RB by promptly issuing such matching cancellation instructions to the relevant CSD. While recognising that the RB's default processes are time critical and may offer limited discretion, the RB will endeavour to meet the IP's need for information on the default management actions it intends to take. In this regard, RBs could work with IPs ex ante to ensure a greater level of understanding of the options available to RBs.

### **Record keeping**

26. RBs should ensure that they maintain comprehensive records of all the actions taken in the process of managing a default and make all relevant information available to the IP in a timely fashion to enable the IP to conduct the administration of the defaulting institution. The RB would generally expect to be able to provide such information within a three month period from the completion of its default management process.

### **Role of the authorities**

27. The tripartite authorities (FSA, Bank of England and HMT) welcome this Guidance. They acknowledge that they may wish to facilitate RBs and IPs in the resolution of problems and are willing to assist this process.

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9 Noting that a minor amendments will be made to the Uncertified Securities Regulations 2001 so to allow the operator of a settlement system (such as CREST) in the event of the default of a member of the system to be able to delete instructions and remove the trade entirely from the system so that it will not settle

## Issues identified for future work

28. The parties to this Guidance have identified a number of issues arising from the default of a member of a CCP which merit further consideration. These include, but are not limited to:

- issues arising from the personal liability of the IP, which might be mitigated in order for example to facilitate the release of information to the RB were some means to be found of absolving the IP from personal liability;
- on a related point, steps which might be taken to permit/speed up the transfer of client positions, and also the assets provided to the clearing member in support of those positions (subject to such asset transfer being permitted by the relevant provisions of UK law and regulatory provisions<sup>10</sup>);
- potential amendments to Part VII (but note that wider questions on the role, responsibility and powers of IPs are being taken forward separately – the Guidance will be amended as needed to reflect these in due course);
- adequacy of record-keeping by clearing members, including maintenance of records in standard electronic format accessible by RBs; and
- procedures of clearing members, for example relating to RBs' powers under their rules to transfer client positions without consent, and to do with segregation and margining of client positions.

29. The parties undertake to work with the appropriate authorities to take these issues forward by means of a regular standing forum on which both IPs, RBs and their members are represented.

30. The Guidance will be updated as needed to reflect changes to legislation, regulation or market practice.

31. The parties will each provide a named contact to liaise with regard to the potential changes to this Guidance as described in this section.

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<sup>10</sup> HM Treasury are currently developing a new special administration regime for investment firms which will have the prompt return of client assets as one of its objectives.

## **Annex A: Nominated Contacts**

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**Annex B: Part VII of the Companies Act 1989 (as updated).**

Please see the following link:

<http://www.legislation.gov.uk/ukpga/1989/40/part/VII>

## Annex C: Membership list of Recognised Bodies

### EuroCCP Ltd

General Clearing Participants	Individual Clearing Participants
ABN AMRO Clearing Bank N.V.	Barclays Capital Securities Limited
Bank of America Merrill Lynch	Credit Agricole Cheuvreux S.A.
BNP Paribas Securities Services	Credit Suisse Securities (Europe) Limited
Citibank International plc	Deutsche Bank AG, London Branch
Citigroup Global Markets Limited	Instinet Europe Limited
Deutsche Bank AG, Frankfurt Branch	Morgan Stanley & Co. International PLC
Goldman Sachs International	Morgan Stanley Securities Limited
J.P. Morgan	Nomura International Plc
KAS BANK N.V.	Numis Securities Limited
MF Global UK Limited	Royal Bank of Canada Europe Limited (Onboarding end 1st Quarter)
Parel S.A.	The Royal Bank of Scotland N.V. London Branch
Pershing Securities Limited	UBS Limited
Santander Investment, S.A.	
Skandinaviska Enskilda Banken AB	
Timber Hill (Europe) AG	

LCH.Clearent Group Limited

Abbey National Treasury Services Plc	KAS Bank N.V
ABN AMRO Bank N.V.	KBC Bank NV
ABN AMRO Clearing Bank N.V.	KBC Clearing NV
ADM Investor Services International Limited	Koch Metals Trading Limited
Advantage Futures LLC	Landesbank Baden-Württemberg
Amalgamated Metal Trading Limited	Landesbank Hessen-Thuringen Girozentrale
AXA Bank Europe SA	LMAX Ltd
Bache Commodities Limited	Louis Dreyfus Commodities Suisse SA
Banco Bilbao Vizcaya Argentaria, S.A.	M D Barnard & Co. Ltd
Banca IMI S.p.A	Macquarie Bank Limited
Banco Santander S.A	Marex Financial Ltd
Bank of America NA	Marfin Egnatia Bank S.A.
Bank of Scotland plc	Mars Chocolate UK Limited
Barclays Bank plc	Merrill Lynch International
Barclays Capital Securities Ltd	Merrill Lynch International Bank Limited
BGC Brokers LP	Metdist Trading Limited
BHF Bank AG	MF Global UK Limited
BNP Paribas	Mitsubishi UFJ Securities International plc
BNP Paribas Commodity Futures Limited	Mitsui Bussan Commodities Limited
BNP Paribas Securities Services	Mizuho Capital Markets Corporation
Bocimar International NV	Mizuho International plc
CACEIS Bank Deutschland GmbH	Mizuho Securities USA Inc
Cadbury International Limited	Morgan Stanley & Co International plc
Caja de Ahorros y Monte de Piedad de Madrid	Morgan Stanley Capital Services, Inc
Caja de Ahorros y Pensiones de Barcelona	Morgan Stanley Securities Limited
Cantor Fitzgerald Europe	National Australia Bank Limited
Carnegie ASA	Natixis
Citibank International plc	Natixis Commodity Markets Limited
Citibank NA	Newedge Group
Citigroup Global Markets Limited	Nomura Global Financial Products Inc
Commerzbank AG	Nomura International plc
Confederacion Espanola de Cajas de Ahorros	Nordea Bank Finland plc
Credit Agricole Cheuvreux	NRW.Bank
Credit Agricole Corporate and Investment Bank	Parel SA
Credit Suisse International	Pareto Securities AS
Credit Suisse Securities (Europe) Limited	Penson Financial Services Limited
Daiwa Capital Markets Europe Limited	Penson Futures
Danske Bank A/S	Pershing Limited
Deutsche Bank AG	Phibro Limited
Deutsche Postbank AG	R.J. O'Brien & Associates, LLC
Dexia Bank Belgium	Rabobank International
DZ Bank AG, Deutsche Zentral-Genossenschaftsbank	Rand Financial Services, Inc
E D & F Man Commodity Advisers Limited	Rosenthal Collins Group LLC
	Royal Bank of Canada
	Royal Bank of Canada Europe Limited
	Scotiabank Europe plc
	SEB Futures/Skandinaviska Enskilda Banken AB.

<p>Energy Clearing Services  Evolution Securities Limited  Fortis Bank NV/SA  G H Financials Limited  GETCO Europe Limited  Goldman Sachs Bank USA  Goldman Sachs International  HSBC Bank plc  HSBC France  HSBC Bank USA, N.A.  Hunter Douglas NV  Hydro Aluminium AS  ICAP Securities Ltd  iDealing.com Ltd  ING Bank NV  Instinet Europe Limited  Interactive Brokers (UK) Limited  Intesa Sanpaolo S.p.A  Investec Bank plc  Jefferies International Limited  J.P. Morgan Markets Limited  JPMorgan Chase Bank NA  JPMorgan Securities Limited  Jump Trading, LLC</p>	<p>Societe Generale  Standard Bank plc  Standard Chartered Bank  State Street Bank GmbH  State Street Bank and Trust Company  Sucden Financial Limited  The Hongkong and Shanghai Banking Corporation Limited  The Lords Commissioners of Her Majesty's Treasury acting through the UK Debt Management Office  The Royal Bank of Scotland N.V.  The Royal Bank of Scotland plc  Toyota Tsusho Metals Limited  Triland Metals Limited  TRX Futures Limited  UBS AG  UBS Limited  UniCredit Bank AG  VTB Capital plc  WestLB AG  Mercari PTY Ltd</p>
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