Feature

KEY POINTS

- Use of the bridge bank or asset management vehicle resolution measures has the potential to result in significant prejudice to good debtors.
- If, by way of example, a bank headquartered in another EU member state is failing but the business of its UK branch is financially viable and the bank is made subject to resolution measures in the EU member state, UK resolution authorities could refuse to recognise the third-country resolution action and resolve the UK branch independently, giving consideration to the objective of avoiding disproportionate interference with borrowers' property rights.
- However, the UK government has made it clear that use of new powers to resolve UK branches independently of third-country resolution authorities is a matter of last resort so borrowers should look for ways to protect themselves contractually at the outset.

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The competing interests between bank and borrower when a bank in resolution sells debt

This article examines a recent Court of Appeal decision on the ability of (in this case) the special liquidator of a bank to market the bank's good loans for sale as part of a package containing distressed debt. The case highlights the potential competing interests between bank and borrower in such a situation, which equally may arise if a bank enters resolution under the UK's special resolution regime implementing the Bank Recovery and Resolution Directive.

The recent Court of Appeal decision in *Irish Bank Resolution Corporation Ltd v Camden Market Holdings Corp & Ors (In Special Liquidation)* [2017] EWCA Civ 7, [2017] All ER (D) 64 (Jan) raises an issue of potential importance for banks and borrowers where a bank enters resolution under national measures implementing the EU Bank Recovery and Resolution Directive (2014/59/EC) (BRRD) and the bank's assets are transferred to a bridge bank or asset management vehicle in order to be realised. In such circumstances, it is not only the bank's shareholders and creditors who may suffer from the application of resolution measures. Often, good borrowers with strong assets charged as security need to be able to sell those assets in the course of their businesses in order to redeem the loan (for example, property development companies). However in a resolution situation such borrowers may find themselves prey to the so-called "vulture fund" strategy whereby potential purchasers of the assets, rather than buying them at market value, would instead look to purchase the loans from the bridge bank or asset management vehicle as part of a package of distressed debt and then seek to enforce the security.

Unfortunately in recent years such circumstances are not at all unusual. Where a borrower has had a good and longstanding relationship with a bank, the last thing he would want is for his loan and security to be transferred to an entity with no interest in maintaining a long term relationship, but instead is focused on getting as much as possible from the borrower to recoup its investment. How can banks and borrowers protect against erosion of the value of the underlying security in these circumstances?

IRISH BANK RESOLUTION CORPORATION LTD v CAMDEN MARKET HOLDINGS CORP

A similar concern arose for the borrowers in the context of the special liquidation of the Irish Bank Resolution Corporation (IBRC). In 2009, the Irish government decided to bail out and nationalise Anglo Irish Bank. Over the next two years, the Irish government provided €34.7bn in public funding to Anglo Irish and Irish Nationwide Building Society (INBS). In 2011, Anglo Irish Bank and INBS were merged to form IBRC. In the early hours of 7 February 2013, the Irish Parliament passed the Irish Bank Resolution Corporation Act 2013, permitting the Irish Minister of Finance to make an order placing IBRC into special liquidation and to instruct it to sell off its loans.

The claimants, members of the Camden Market Group (the Group), had entered into a facility agreement with IBRC for some £195m to fund major development in London. It was intended that the proceeds of sale of the development would repay the loan. The claimants were concerned that marketing of their loan for sale by IBRC's special liquidator would jeopardise the Group's own marketing of the properties it was developing. It was accepted that the claimants' loan was not distressed and that the properties were good security for the loan. However the loan was being marketed by the special liquidator as part of a package containing distressed debt, which the Group claimed gave rise to the mistaken market perception that their debt was distressed. The claimants feared that potential purchasers would seek to acquire the loan from IBRC rather than buying the properties from the Group, and then adopt the "vulture fund" strategy of contriving a basis to enforce the security and so obtain the properties at less than market value.

The claimants contended that there was an implied term in the facilities agreement that IBRC would not do anything to hinder the Group's marketing of the properties by marketing the sale of the loans in competition with the Group's marketing.

The Court of Appeal, reversing the High Court's decision, allowed IBRC's appeal. It rejected the implied term contended for by the claimants on the basis that such a term was inconsistent with the express terms of the facilities agreement, which permitted IBRC, without requiring the Group's consent, to disclose information about the Group and/or the loan to any potential assignee or transferee of the loan, or any counterparty by way of subparticipation (applying what Lord Neuberger has called the "cardinal rule" that an implied term must not contradict any express term of the contract: *Marks & Spencer plc v BNP Paribas Securities Services Trust Co (Jersey) Ltd* [2015] UKSC 72, [2016] AC 742 at [28]). Summary judgment was entered for IBRC.

THE BANK RECOVERY AND RESOLUTION DIRECTIVE

The BRRD entered into force on 2 July 2014, enshrining an EU-wide change of approach to banking collapses which seeks to ensure that in future the shareholders and creditors of failed institutions are bailed in, rather than bailed out as happened with Anglo Irish Bank and INBS.

The BRRD was required to be implemented by member states by 1 January 2016. In the UK, it was implemented via the special resolution regime (SRR) in the Banking Act 2009 and subordinate legislation.

Among other measures, Pt I of the Banking Act 2009 allows all or part of the business of a bank entering resolution to be transferred to:

- A bridge bank controlled by the Bank of England (s 12 of the Banking Act 2009; Art 40 of the BRRD). The purpose of the bridge bank is to maintain access to the critical functions of the bank with a view to selling the bank or its business (s 12(1A)(c) of the Act); or
- An asset management vehicle (AMV) controlled by the Bank of England (s 12ZA of the Act; Art 42 of the BRRD), separating good from bad assets. Under s 12ZA(4) of the Act, an AMV must "manage the assets transferred to it with a view to maximising their value through eventual sale or orderly wind down".

Under s 12A of the Act (Art 43 of the BRRD), creditors may be bailed-in, including by way of a special bail-in provision under s 48B of the Act.

Whereas a bail-in of creditors under s 12A may leave a borrower with a performing loan relatively unaffected, use of the bridge bank and/or AMV resolution measures has the potential to result in significant prejudice to good debtors, for substantially the reasons feared by the Camden Market Group.

> Resolution authorities ought to have specific regard ... to the position of borrowers whose security may be adversely affected by a transfer to a bridge bank or AMV

KEY POINTS FOR BORROWERS AND CENTRAL BANKS

The borrowers in the *Camden Market* case were forced to rely on an alleged implied term that the bank's marketing efforts could not compete with their own, since the facilities agreement prevented IBRC transferring the loan by way of assignment or novation without the Group's consent, but did not prevent disposal by way of sub-participation, which was how the special liquidator chose to market the package of loans.

Borrowers may be able to obtain additional protection by ensuring that their finance documents contain more widely drawn provisions, requiring the bank to obtain prior consent for all disposals including by way of sub-participation. Whether the lender is prepared to agree such restrictions will depend on the negotiating power and policy of the lender. Lenders may want to preserve the ability to transfer loans and in practice one sees a wide variety of provisions ranging from a complete restriction on any transfer without the borrower's consent to an absolute right to transfer.

Furthermore, where the intention behind a financing agreement is that the loan is to be redeemed in whole or in part by the borrower realising the security (as is frequently the case for property lending), borrowers can seek to negotiate express restrictions as to the manner in which their loans can be marketed for disposal by the bank, particularly where there has been no event of default.

However borrowers should be aware that any term purporting to give rise to new rights or obligations upon a bank entering resolution or special liquidation, or to provide in those circumstances that a particular right of disposal lapses, may be ineffective. Section 48Z of the Banking Act 2009 provides that default event provisions are deemed generally not to be triggered by "crisis management measures" and/or "crisis prevention measures" including the exercise of stabilisation powers under Pt I of the Act, nor by any event directly linked with such measures. The general rule is subject to any exceptions expressly provided for by the Bank of England or HM Treasury on a case-by-case basis; however such exceptions will no doubt be made sparingly, if at all.

The difficulties highlighted in the *Camden Market* case are also a further important consideration for resolution authorities when deciding whether to exercise their resolution powers and, if so, which resolution tools should be used. Resolution authorities ought to have specific regard not only to the position of creditors and shareholders but also to the position of borrowers whose security may be adversely affected by a transfer to a bridge bank or AMV. Such consideration is likely to be required in any event as part of the duty of resolution authorities to have regard to special resolution objective 7: namely "to avoid interfering with property rights in contravention of a Convention right (within the meaning of the Human Rights Act 1998)" (see s 4(9) of the Banking Act 2009; each of the seven special resolution

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objectives must be balanced as appropriate having regard to the circumstances). HM Treasury, the PRA, the FCA and the Bank of England must ensure that any resolution measure interfering with borrowers' Art 1 Protocol 1 property rights is proportionate to the legitimate aim of bank stabilisation and strikes an appropriate balance between the rights of debtors, creditors, shareholders and the wider public.

Such issues might well arise for consideration where the UK resolution authorities are considering exercising their new powers to resolve the UK branch of a third-country institution that has been made subject to resolution action in the other member state independently of the third-country resolution authority. Section 89JA of the Banking Act 2009 was inserted by the Bank Recovery and Resolution Order 2016 with effect from 16 December 2016. It allows the UK resolution authorities to exercise certain of the special resolution measures against the UK branch of a third-country bank independently: namely the powers to transfer some or all of the business of the branch to a private sector purchaser, bridge bank or AMV, or to bail-in the liabilities of the branch in connection with such a transfer. The powers available against UK branches do not include the standalone bail-in power or a power to put branches in temporary public ownership.

The general conditions for exercising resolution powers against UK branches under s 7 of the Act (as modified by s 89JA) are as follows:

- The third-country institution is failing or likely to fail.
- It is not reasonably likely that action will be taken to prevent the third-country institution failing.
- The third-country institution is or is in the near future unlikely to be able to or willing to meet its liabilities arising from the business of the UK branch as they fall due, and no third-country resolution action or normal insolvency proceedings have been initiated or are likely to be initiated in the near future.
- The making of a property transfer instrument is necessary having regard to the public interest in the advancement of one or more of the special resolution objectives.
- Either:
  - the Bank of England has refused, or proposes to refuse, to recognise third-country resolution action that has been taken, in accordance with s 89H(4); or
  - third-country resolution action has not been, and is not likely to be, taken in relation to the third-country institution. Pursuant to s 89H(4), the Bank of England may refuse to recognise third-country resolution action where both the Bank and HM Treasury are satisfied that:
    - recognition would have an adverse effect on financial stability in the UK or another EEA state;
    - taking action against the UK branch of the third-country institution is necessary to achieve one of the special resolution objectives;
    - under the third-country resolution action, creditors in different EEA states would not receive equal treatment;
    - recognition and taking action in support of third-country resolution action would have material fiscal implications for the UK; or
    - recognition would breach s 6 of the Human Rights Act 1998 or a provision of EU law.

The public interest condition (Condition 4) must always be met for resolution action to be taken independently against a UK branch. In addition, either Condition 3, or Condition 5(a), or Conditions 1, 2 and 5 must also be met.

It is easy to imagine circumstances in which a bank headquartered in another EU member state is failing because of significant distressed debts and is therefore made subject to resolution measures in that country, but the business of the UK branch of the bank is financially viable and has good quality assets. If resolution measures taken by the third-country resolution authority would result in distressed loans in the third country being packaged for sale with the non-distressed loans in the UK, to the significant detriment of UK debtors, this would be a relevant consideration for the UK resolution authorities when deciding whether to refuse to recognise the third-country resolution action and instead resolve the UK branch independently.

However, the government has made clear that it considers use of the new powers to resolve UK branches independently of third-country resolution authorities to be wholly exceptional and a matter of last resort. Significant cooperation between resolution authorities at the EU level means that use of these powers is relatively unlikely. The government has stated that they are to be regarded very much as a back-stop if international cooperation fails.

Borrowers should therefore look for ways to protect themselves contractually at the outset against the dilemma faced by the borrowers in the *Camden Market* case. ■

Further Reading:

- Lessons on the cross-border recognition of bank resolution decisions involving foreign law elements [2015] 10 JIBFL 632.
- The EU Bank Recovery and Resolution Directive: moving towards full implementation [2015] 3 JIBFL 162.
- LexisNexis Loan Ranger blog: Implementation of the Bank Recovery and Resolution Directive.