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Case No: FS-2017-000004

IN THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS
OF ENGLAND AND WALES
BUSINESS LIST (Ch D)

Financial Services and Regulatory

7 Rolls Building, Fetter Lane, London, EC4A 1NL
Date: 3rd May 2018

Before:

THE HONOURABLE MR JUSTICE HILDYARD

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IN THE MATTER OF LLOYDS BANK PLC
IN THE MATTER OF BANK OF SCOTLAND PLC
IN THE MATTER OF LLOYDS BANK CORPORATE MARKETS PLC
AND
IN THE MATTER OF THE FINANCIAL SERVICES AND MARKETS ACT 2000

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- -

Martin Moore QC and Mary Stokes (instructed by **Linklaters LLP**) for the Applicants
Rory Phillips QC and Robert Purves (instructed by **PRA & FCA**) for the Regulators
Javan Herberg QC (instructed by **Deloitte)** for the Skilled Person
Hearing dates: 27th & 28th March 2018

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Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

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MR JUSTICE HILDYARD :

Introduction and scope of this Judgment

1. This judgment concerns an application under Part VII of the Financial Services and Markets Act 2000 ("FSMA") by three companies in the Lloyds Bank group (the "Lloyds Group" or the "Group"), seeking an order sanctioning a ring-fencing transfer scheme ("the Lloyds RFTS" or "the Scheme") for the separation of its retail banking business from its (potentially riskier) wholesale and investment banking activities.

2. This separation, with ring-fencing, is mandated by statute, and in particular by a new Part 9B which was introduced into FSMA by section 4(1) of the Financial Services (Banking Reform) Act 2013 ("FSBRA").

3. FSBRA represents a multi-layered response to the financial crisis of 2008 and 2009. It is all part of a package designed to strengthen the UK's larger high-street banks and to provide additional protection to their retail and small business customers. Ring-fencing is an essential part of that response: it is mandatory and has to be effected by 1st January 2019.

4. Sir Geoffrey Vos CHC has described ring-fencing as "a statutory project on an unprecedented scale." As noted in the skeleton argument provided to me on behalf of the Prudential Regulation Authority ("PRA") and the Financial Conduct Authority ("FCA", and with the PRA together, "the Regulators"),

> "Implementation is a highly complex project of national importance. It will be relevant to millions of retail banking customers in the UK."

5. A ring-fencing transfer scheme or "RFTS" is a statutorily-mandated process for implementation of ring-fencing. The process is governed by provisions also newly introduced into Part VII of FSMA by FSBRA. Such a scheme, after detailed consideration by statutorily-designated persons, must ultimately be put before the Court for its sanction before it can be given effect.

6. The Lloyds RFTS is the second such scheme to come before the English Court for its sanction. The first was a scheme proposed by Barclays Bank plc ("BBPLC") and Woolwich Plan Managers Limited ("WPML"): this was sanctioned by Sir Geoffrey Vos CHC on 9 March 2018 in the circumstances and for reasons explained in his detailed judgment of that date [2018] EWHC 472 ("the *Barclays* Judgment"). Other applications, by HSBC and Santander, are pending in this Court. RBS's ring-fencing transfer scheme has already been sanctioned by the Court of Session in Scotland.

7. My earlier judgments in the context of the Lloyds RFTS concerned procedural issues, and also the Applicants' plan for notification of the proposals to interested persons ("the Communications Plan"), of which more later. This judgment concerns the final stage of a long process: the stage at which the Court must determine whether or not to sanction the Scheme and make ancillary orders to give it full effect.

8. Its purpose is to explain in greater detail my decision to sanction the Lloyds RFTS, which I announced on 12 April 2018 in advance of detailed reasons given the tight

timetable before the preferred effective date for implementation of the Lloyds RFTS. It amplifies the short statement of reasons I gave on that occasion.

9. In considering the detailed provisions governing the Lloyds RFTS and in reaching my decision, I have had the benefit both of the *Barclays* Judgment and detailed submissions both written and oral from Mr Martin Moore QC, leading Ms Mary Stokes, who appeared for the Applicants; from Mr Rory Phillips QC, leading Mr Robert Purves, who appeared for the Regulators; and from Mr Javan Herberg QC, who appeared for the "Skilled Person" approved by the PRA to report on the terms of the Lloyds RFTS (see below). I have also heard from a Mr Brown, a customer of a Jersey-incorporated bank in the Lloyds group, who has put forward more general observations. In addition I have considered various objections to the Lloyds RFTS put forward by customers affected.

Structure of this judgment

10. I address the matter under the following headings (which largely reflect the sequence of submissions made by Mr Moore on behalf of the Applicants):

[A] The ring-fencing regime introduced as Part 9B of FSMA;

[B] The implementation of ring-fencing by a ring-fencing scheme under Part VII of FSMA;

[C] Basic design of the Lloyds RFTS;

[D] Rationale for the design of the Lloyds RFTS;

[E] The Lloyds Group's parallel reorganisation;

[F] The principal features of the Scheme;

[G] Procedural history of the application and previous hearings;

[H] The Transferors' Communications Plan and its implementation;

[I] Amendments to the Scheme proposed before sanction;

[J] Jurisdictional pre-conditions and their satisfaction;

[K] The Court's role and discretion: the guidance in the *Barclays* Judgment;

[L] The Skilled Person's Report and conclusions on the Statutory Question;

[M] Objections and representations;

[N] Effective Date: preferred and contingency;

[O] Determination whether the Court should sanction the Scheme;

[P] Form of Order sought: sections 111, 112 and 112A of FSMA.

[A] *The ring-fencing regime: Part 9B of FSMA*

11. This new set of provisions requires UK financial institutions having "core deposits" with a combined value (averaged over three years) exceeding £25 billion to separate and ring-fence "core activities" from "excluded activities" (sections 142A and 142G of FSMA) by no later than 1st January 2019. The detail of the provisions is as follows.

12. Part 9B of FSMA prohibits a *"ring-fenced body",* i.e. a UK institution which carries on deposit-taking and any other designated *"core activities" (*"RFB") from carrying on *"excluded activities"* or contravening certain prohibitions**.**

13. A bank will only be designated a RFB if it has (or that bank together with the other UK banks within its group in aggregate have) over £25 billion in core deposits, averaged over a rolling three-year period. To date, the only activity that has been designated as a core activity is the regulated activity of accepting deposits, but only when carried on in specified circumstances. Under the Financial Services and Markets Act 2000 (Ring-fenced Bodies and Core Activities) Order 2014, as amended, a bank will only be deemed to be carrying out the core activity of accepting deposits if it accepts any deposit that is a *"core deposit".* A core deposit is defined, broadly, as a deposit taken from a retail customer or SME customers at a branch in the UK or elsewhere in the European Economic Area ("EEA").

14. *"Excluded activities"* are defined as the regulated activity of dealing in investments as principal and other activities specified by order. Dealing in commodities has also been specified by order as an Excluded Activity. A RFB must not conduct these Excluded Activities, except in certain exempted circumstances specified in the Financial Services and Markets Act 2000 (Excluded Activities and Prohibitions) Order 2014, as amended ("EAPO"). It is to be noted that Article 20 of the EAPO provides that a ring-fenced body must not (subject to certain exemptions) maintain or establish a branch in, or have a participating interest in any undertaking which is incorporated in, or formed under the law of, a non-EEA country. An amendment to this provision will be required before the UK leaves the European Union, because it would otherwise thereafter preclude UK branches or subsidiaries.

15. In addition, subject to certain exceptions, EAPO prohibits a RFB from various other activities, including having exposures to *relevant financial institutions* ("RFI")[1] and (as mentioned above) establishing or maintaining branches or having participating interests outside the EEA (the *"Prohibitions"*).

[B] *Ring-Fencing Transfer Schemes*

16. The statutory machinery for a RFTS is set out in sections 106B, 107, 109A. 110(3), (4) and (5), 111 and 112 of Part VII of FSMA, as amended by FSBRA.

17. Prior to FSBRA and the introduction of these provisions, Part VII of FSMA already provided for banking business transfer schemes and insurance business transfer schemes. However, although a RFTS has features analogous to schemes for the transfer of insurance and banking business, it is categorically distinct: in particular, it

[1] An institution of the type defined in article 2 of EAPO, including (and subject to exceptions) credit institutions (other than RFBs), investment firms, structured finance vehicles, global systemically important insurers, UCITS, managers of UCITS and alternative investment fund managers.

is in effect a compulsory means of achieving a statutory purpose, rather than an elective means of achieving a commercial objective.

18. Section 106B of FSMA provides as follows:-

> "(1) A scheme is a ring-fencing transfer scheme if it— (a) is one under which the whole or part of the business carried on— (i) by a UK authorised person, or (ii) by a qualifying body—is to be transferred to another body (the transferee), (b) is to be made for one or more of the purposes mentioned in subsection 3, and (c) is not an excluded scheme or an insurance business transfer scheme …
>
> (3) The purposes are (a) enabling a UK authorised person to carry on core activities as a ring-fenced body in compliance with the ring-fencing provisions; (b) enabling the transferee to carry on core activities as a ringfenced body in compliance with the ring-fencing provisions; (c) making provision in connection with the implementation of proposals that would involve a body corporate whose group includes the body corporate to whose business the scheme relates becoming a ring-fenced body while one or more other members of its group are not ring-fenced bodies; (d) making provision in connection with the implementation of proposals that would involve a body corporate whose group includes the transferee becoming a ring-fenced body while one or more other members of the transferee's group are not ring-fenced bodies …
>
> (5) For the purposes of subsection 1(a) it is immaterial whether or not the business to be transferred is carried on in the United Kingdom.
>
> (6) 'UK authorised person' has the same meaning as in section 105 …
>
> (8) 'The ring-fencing provisions' means ring-fencing rules and the duty imposed as a result of section 142G".

19. As to these definitions:

(1) A UK entity obtains 'authorisation' under FSMA 2000 by a successful application for 'a Part 4A permission' to carry on one or more 'regulated activities' by way of business in the UK. A person that has such a permission is an 'authorised person';

(2) 'The regulated activity of accepting deposits' (the principal regulated activity of a bank) is specified as a 'PRA-regulated activity'. An application for a permission that includes a PRA-regulated activity must be made to the PRA. A firm with permission to carry on a PRA-regulated activity is a 'PRA-authorised person';

(3) It follows that a UK-authorised bank (for example, Lloyds Bank plc) is both (a) an 'authorised person'; and (b) a 'PRA-authorised person';

(4) The result is that UK-authorised banks are dual-regulated: that is, they are subject to (a) prudential regulation by the PRA; and (b) conduct of business regulation by the FCA;

(5) Other authorised persons (for example most investment businesses) which do not carry out deposit-taking activity or any other PRA-regulated activity, apply to the FCA for authorisation and are solo-regulated by the FCA: that is subject to both (a) prudential regulation by the FCA; and (b) conduct of business regulation by the FCA.

20. In the present case:

(1) Each of the Transferors and the Transferee are PRA-authorised persons, dual-regulated by the FCA and the PRA, with permission to carry on deposit-taking activities, amongst other regulated activities;

(2) Lloyds Bank Corporate Markets plc (the Transferee) is newly authorised under FSMA 2000; and

(3) As is common for newly authorised banking entities, LBCM was authorised with 'mobilisation restrictions' imposed by the PRA, with the consent of the FCA. These are restrictions on LBCM's activities, pending the PRA's decision, with the consent of the FCA, that the bank is fully ready for operation. I return to an issue as to the lifting of these restrictions later.

21. Section 107 of FSMA provides as follows:-

> "(1) An application may be made to the court for an order sanctioning an insurance business transfer scheme or banking business transfer scheme, a reclaim fund business transfer schemes or a ring-fencing transfer scheme.
>
> (2) An application may be made by— (a) the transferor concerned (b) the transferee, or (c) both.
>
> (2A) An application relating to a ring-fencing transfer scheme may be made only with the consent of the PRA.
>
> (2B) In deciding whether to give consent the PRA must have regard to the scheme report prepared under section 109A in relation to the ring-fencing transfer scheme".

22. Section 109A of FSMA provides for a ring-fencing transfer scheme to be assessed by a suitably skilled person in a formal scheme report as follows:-

> "(1) An application under section 106B in respect of a ring-fencing transfer scheme must be accompanied by a report on the terms of the scheme ('a scheme report').

> (2) A scheme report may be made only by a person— (a) appearing to the PRA to have the skills necessary to enable the person to make a proper report, and (b) nominated or approved for the purpose by the PRA.
>
> (3) A scheme report must be made in a form approved by the PRA.
>
> (4) A scheme report must state— (a) whether persons other than the transferor concerned are likely to be adversely affected by the scheme, and (b) if so, whether the adverse effect is likely to be greater than is reasonably necessary in order to achieve whichever of the purposes mentioned in section 106B(3) is relevant.
>
> (5) The PRA must consult the FCA before— (a) nominating or approving a person under subsection 2(b), or (b) approving a form under subsection (3)".

23. In relation to ring-fencing transfer schemes, section 110 of FSMA provides that:-

> "(3) Subsections 4 and 5 apply when an application under section 107 relates to a ring-fencing transfer scheme.
>
> (4) The following are also entitled to be heard— (a) the PRA (b) where the transferee is an authorised person the FCA, and (c) any person ('P') (including an employee of the transferor concerned or of the transferee) who alleges that P would be adversely affected by the carrying out of the scheme.
>
> (5) P is not entitled to be heard by virtue of subsection 4(c) unless before the hearing P has— (a) filed … with the court a written statement of the representations that P wishes the court to consider, and (b) served copies of the statement on the PRA and the transferor concerned".

24. Section 111 of FSMA provides as follows:-

> "(1) This section sets out the conditions which must be satisfied before the court may make an order under this section sanctioning an insurance business transfer scheme, a banking business transfer scheme or a reclaim fund business transfer scheme, or a ring-fencing transfer scheme.
>
> (2) The court must be satisfied that … (ab) in the case of a ring-fencing transfer scheme the appropriate certificates have been obtained (as to which see Parts 2B of [Schedule 12]); (b) the transferee has the authorisation required (if any) to enable the

> business, or part, which is to be transferred to be carried on in the place to which it is to be transferred (or will have it before the scheme takes effect).
>
> (3) The court must consider that, in all the circumstances of the case, it is appropriate to sanction the scheme."

25. Paragraph 9B of part 2B of schedule 12 of FSMA defines the *"appropriate certificates"* for the purposes of section 111(2)(ab) as follows:-

> "(1) For the purposes of section 111(2) the appropriate certificates, in relation to a ring-fencing transfer scheme, are—
>
> (a) a certificate given by the PRA certifying its approval of the application,
>
> (b) a certificate under paragraph 9C …".

26. Paragraph 9C of part 2B of schedule 12 of FSMA deals with the provision by a "relevant authority" of a *certificate as to financial resources* ("CFR") as follows:-

> "(1) A certificate under this paragraph is one given by the relevant authority and certifying that, taking the proposed transfer into account, the transferee possesses, or will possess before the scheme takes effect, adequate financial resources.
>
> (2) "Relevant authority" means—
>
> (a) if the transferee is a PRA-authorised person with a Part 4A permission or with permission under Schedule 4, the PRA;
>
> (b) if the transferee is an EEA firm falling within paragraph 5(a) or (b) of Schedule 3, its home state regulator;
>
> (c) if the transferee does not fall within paragraph (a) or (b) but is subject to regulation in a country or territory outside the United Kingdom, the authority responsible for the supervision of the transferee's business in the place in which the transferee has its head office;
>
> (d) in any other case, the FCA.
>
> (3) In sub-paragraph (2), any reference to a transferee of a particular description includes a reference to a transferee who will be of that description if the proposed ring-fencing transfer scheme takes effect."

27. Sections 112 and 112A give the Court wide powers, if it sanctions the scheme, to make ancillary orders to give it full effect. These provisions and the scope of the powers they confer are set out and considered in paragraphs [243] to [254] below.

28. The provisions of Part VII of FSMA attribute different functions to the Regulators, the *Skilled Person* (as I shall refer to the person appointed to report on the scheme in accordance with section 109A) and the Court.

29. Sections 107 and 109B of FSMA demonstrate the supervisory role of the PRA as lead regulator for the implementation of ring-fencing, particularly in four important respects. First, the consent of the PRA is a pre-condition of the making of an application for a ring-fencing transfer scheme and such consent is only to be given after the PRA has taken into account the report on the terms of the scheme required by section 109A. Secondly, that report on the scheme may be made only by a person appearing to the PRA to have the requisite skills and who has been nominated or approved by the PRA. Thirdly, the form of the *"Skilled Person's report"* (as I shall call the report required by section 109A of FSMA) must also be made in a form approved by the PRA. Fourthly, the PRA is required to review the Scheme and any amendments of, objections to, or other relevant information in respect of it before the sanction hearing to consider whether, and if so formally confirm that, the Scheme remains one which it considers to be suitable to be sanctioned by the Court. The PRA issued a Supervisory Statement in February 2017, updated in December 2017, explaining the PRA's objectives and expectations in relation to the legal structure of banking groups containing one or more RFBs, and other matters associated with the ring-fencing regime.

30. The FCA also has key responsibilities, especially in providing guidance as to the scope and content of scheme reports and supervising proper and sufficient notification of scheme proposals to customers. In nominating or approving a person as the Skilled Person for a particular scheme, and before approving the form of his or her report on the scheme, the PRA must consult the FCA in advance. The FCA has issued Guidance on its approach, dated March 2016.

31. The Skilled Person also has a central role, not least because it is on his or her report that the Court is likely to place most reliance in assessing the scheme, any adverse effects it may occasion, and whether they are avoidable. The Skilled Person's special remit is to address in the scheme report what has become known as "the Statutory Question", since (as can be seen above) section 109A(4) requires that the report must state "(a) whether persons other than the transferor concerned are likely to be adversely affected by the scheme, and (b) if so, whether the adverse effect is likely to be greater than reasonably necessary in order to achieve whichever of the purposes mentioned in section 106B(3) is relevant". Together with satisfaction of the jurisdictional requirements, and consideration of specific objections, that is a very important test of the scheme.

32. As noted above, section 110 of FSMA provides that any person who alleges that they would be adversely affected by a scheme is entitled to be heard at the sanction hearing. That informs the approach required to notification of a ring-fencing transfer scheme: any communications plan must be sufficient to ensure the vitality of this right.

33. The Court provides the forum for such objections, and it has the final say. The Court's involvement is not ministerial nor by way of a rubber-stamp. It is not compelled to follow the recommendation of the Regulators nor the advice of the Skilled Person. Its discretion is unfettered and genuine at each stage of the process in which it is involved. I return to this later, in discussing the guidance in the *Barclays* Judgment and in various interlocutory judgments preceding it.

[C] *Basic design of Lloyds RFTS; transferring and non-transferring business*

34. There are two basic approaches to structuring a ring-fencing transfer scheme for banking groups that are required to ring-fence their core activities under Part 9B of FSMA. Any entity within the banking group which carries on both core activities and Excluded Activities or business which would breach the Prohibitions (see paragraph [15] above] can either:

    (1) transfer the core activities to a ring-fenced body, leaving the transferor to conduct Excluded Activities and other business which would breach the Prohibitions; or

    (2) transfer the Excluded Activities and business which would breach the Prohibitions to another entity, leaving the transferor to carry on the core activities as a ring-fenced body.

35. Whereas Barclays chose the first, the Lloyds Group has chosen the second of these options. The choice of this second option means that most of the existing banking business and customers will remain with the Transferors (or entities within its sub-consolidation group).

36. In broad outline, the Scheme will transfer to the third Applicant, Lloyds Bank Corporate Markets plc ("LBCM" or "the Transferee") those parts of the businesses of the first two Applicants, Lloyds Bank plc and Bank of Scotland plc (together "the Transferors"), which are Excluded Activities or would breach the Prohibitions to the Transferee. Once the ring-fencing regime comes into effect on 1st January 2019, each of the Transferors will be a ring-fenced body and the Transferee will be a non-ring-fenced body. The Transferee is a newly-formed entity which is wholly and directly-owned by Lloyds Banking Group plc (the "Parent"), the parent company of the Group, and will not form part of the Transferors' sub-group.

37. In very broad terms, the business transferring pursuant to the Scheme comprises:

    (1) certain derivative transactions (mainly complex derivatives);

    (2) certain loan facilities which incorporate a complex derivative within the loan (e.g. an interest rate based on an index such as the RPI);

    (3) certain other transactions which directly or indirectly result in the Transferor having a prohibited exposure to a RFI, such as loan and liquidity facilities to which an RFI is a party.

38. The transferring business is carried on within the Commercial Banking division of the Group. The Commercial Banking division provides a wide range of commercial banking services and products to businesses ranging from small and medium sized enterprises with a turnover of between £1 million and £25 million to very large financial institutions, such as banks, insurance companies, pension administrators, etc. Customers in this division are divided into segments according to a variety of criteria, including turnover, the nature of the customer's business, the type of customer and the type of product: 'Small-and-medium- sized enterprises' ("SME"), 'Mid-Markets' ("MM"), 'Global Corporates' ("GC"), 'Financial Institutions' ("FI") and 'Client Asset Management' business ("CAM").

39. The number of customers whose products are being transferred and/or who have agreements with the Transferors which are being duplicated by the Scheme is estimated as likely to be approximately 3,200, representing about 1% of the total number of customer entities in the Commercial Banking division. The customers so affected are mainly from the GC and FI segments of the Commercial Banking customers.[2]

40. The other two principal areas or divisions of the Group's business are (1) Retail Banking and (2) Insurance and Wealth.

41. The Retail banking division provides current accounts, savings products, loans, mortgages and investments to personal customers and small business customers with an annual turnover of less than £1 million. Since 1st November 2017, the Retail banking division has been restructured into a number of separately managed sub-divisions. Some of the business which used to be within the Consumer Finance sub-division before November 2017 is now separately managed in two other sub-divisions, but for the sake of convenience (and further elaboration being unnecessary) the existing Consumer Finance sub-division and these other sub-divisions have been referred to in submissions and in this judgment are collectively referred to as "the Consumer Finance sub-division."

42. The Consumer Finance sub-division provides motor finance products, unsecured personal loans and commercial and consumer credit and charge cards. It also houses the 'International Mortgage Services', which is a closed book of mortgage loans which were extended to expatriate customers, and which is now in the process of being run-off. Some of the business in this division is carried on in the UK by various subsidiaries, including Black Horse Limited, Lex Autolease Limited, Cardnet Merchant Services Limited and MBNA Limited.

43. As its name indicates, the Insurance and Wealth division comprises two separate parts. The insurance business is carried out by separately authorised and regulated entities within the sub-group headed by Scottish Widows Group Limited and provides long-term savings, investment and protection products and general insurance. The Wealth division provides wealth management services to individuals with at least

[2] Though these estimates above do not account for: (i) multiple fund entities within a customer group that may, or do have the option to participate within lending facilities where the Group data recognises only a single entity as the principal borrower; and (ii) approximately 257 customers (across all divisions of the Group) whose products may be curtailed by the Group, as a result of the ring-fencing regime and the manner in which the Group has chosen to organise its business in the future to comply with that regime.

£250,000 in savings, investments or personal pensions or a sole annual income of at least £250,000.

44. In addition to the three principal divisions of the Group's business, the Group makes and holds investments outside the Group through Lloyds Development Capital (Holdings) Limited, its subsidiaries and certain other group companies.

45. The Group's business is operated primarily in the UK, but it also has operations in the United States, Europe, Singapore, the Crown Dependencies (Jersey, Guernsey and the Isle of Man) and Gibraltar, conducted through a combination of overseas branches and overseas subsidiaries. These include operations both within and outside the EEA.

46. As at 30th April 2017 the Group had approximately 2,000 branches in the UK, approximately 70,000 employees (full-time equivalent) and more than 38 million customers.

47. Some idea of the scale of the transfer relative to the business of the Transferors and the Group is given by the following figures. Following the transfer becoming effective, the aggregate size of the balance sheet of the Transferors (on a consolidated basis) is currently expected to be approximately £615 billion, in contrast to the (standalone) balance sheet of the Transferee, which is expected to be £54 billion at that date (i.e. 8.7% of the combined balance sheet size).

48. Currently the target date for the Scheme to become effective is 28th May 2018. However, as foreshadowed above and more fully explained later, it is possible that this date may need to be moved to a later date of 16th July 2018. That is the reason for seeking to introduce a provision for a contingency date, as explained in more detail later.

[D] *Rationale for the design of the Lloyds RFTS/Scheme*

49. The Group refers to its chosen model as the Wide RFB model. This connotes that as much business as possible is retained with the Transferors, subject to two principal exceptions in relation to FI and GC customers (see paragraph [38] above), and certain MM Customers, SME Customers and CAM Customers (*ibid.*) referred to in the evidence as 'Split Portfolio Customers'. The model for the non-ring-fenced bank (the "NRFB") is correspondingly narrow.

50. In brief, the high-level objective in designing the Scheme was presented as being to further the Group's goal to be "Best Bank for customers", and to do so by minimising customer impacts from ring-fencing to a relatively small cohort of customers. The Wide RFB was considered by the Group and its directors (unanimously, it was confirmed to me by Mr Moore) to be the best option to achieve these objectives for three reasons.

51. First, the Wide RFB model permits the Group to continue to offer customers a broad range of banking products and allows customers to retain their existing relationship with the Group, with the Transferors as the RFBs continuing to offer most the products customers have been accustomed to obtaining from the Transferors, with the Transferee (as the NRFB) offering those products which would involve undertaking Excluded Activities or that would breach Prohibitions. A single relationship manager

for customers within the Commercial Banking division is designed to facilitate the customers' relationship with both the Transferors and the Transferee.

52. Secondly, the Wide RFB minimises both the population of transferring customers and the scope of the transferring business. The expected numbers of customers whose products are transferring pursuant to the Scheme (or whose agreements with the Transferors are being duplicated with the Transferee) are set out above and are small. The customers affected are those in the Commercial Banking division, particularly FI and GC Customers, leaving retail customers unaffected.

53. The Wide RFB Model has allowed the scope of the transferring business (with some exceptions[3]) to be minimised by identifying the transferring business by reference to specified products (e.g. complex derivatives, loans to RFIs), rather than by reference to particular categories of customer, except where this was required by ring-fencing. This means that fewer customers within the Commercial Banking division will experience changes to their banking relationship than if the transferring business had been defined by reference to customer segments.

54. Thirdly, the Group identified that the credit rating of the NRFB was likely to be important for certain customers. The directors assessed the likely approach of the credit rating agencies for the different possible NRFB models accordingly. They concluded that a credit rating equivalent to that of the Transferors was not likely to be achieved in respect of the Transferee by adopting a narrow RFB model and a wide NRFB, that being a possible alternative to the Wide RFB model ultimately chosen.

55. The choice of the Wide RFB Model and its rationale are of considerable importance. Either model is capable of causing adverse effects, and although the choice was made in the exercise of their commercial judgement by the directors, that choice and rationale have been carefully scrutinised both by the Regulators and the Skilled Person: I shall return to that scrutiny later.

[E] *The parallel reorganisation in the Lloyds Group*

56. The Scheme is a key part of a more extensive reorganisation of the Group's existing business designed to achieve compliance with the ring-fencing regime.

57. This reorganisation of the legal entities within the Lloyds Group (which does not form part of the Scheme) is already in progress. It involves:

    (1) transferring the insurance sub-group (Scottish Widows Group Limited and its subsidiaries) from Lloyds Bank plc to the Parent;

    (2) transferring various companies and certain other strategic and minority investments that are currently held directly or indirectly by the Transferors (or

[3] All derivatives products, including Permitted Derivatives, with FI Customers or GC Customers will be transferred to the Transferee in order (a) to ensure that the Transferors comply with the limits placed by EAPO on the volume of derivative transactions that each Transferor may enter into with its account holders, calculated by reference to the aggregate relevant risk requirements attributable to such derivative transactions; (b) to maintain netting sets for those customers: (c) to allow headroom to enable Transferors to offer simple derivatives to their customers on an ongoing basis; and (d) to treat all similar customers as consistently as possible.

other entities in the Group) to a new intermediate holding company, LBG Equity Investments Limited, which is a direct wholly-owned subsidiary of the Parent, to form the equity investments sub-group; and

(3) transferring various entities incorporated outside the EEA, which carry on banking business and which are currently held directly or indirectly by the Transferors, to the Transferee, to form the non-ring-fenced bank sub-group.

58. In addition to the legal entities reorganisation, and again separately from the Scheme, the non-EEA banking business that is currently conducted by the Transferors from their non-EEA branches[4] will be transferred to the Transferee, which will establish its own branches in these non-EEA jurisdictions.

59. The reorganisation is expected to be complete in the fourth quarter of 2018 to ensure that the Group is compliant with the ring-fencing regime before it becomes effective on 1st January 2019.

[F] *The Scheme in more detail*

60. I take the following explanation of the Scheme (with only very minor amendments) from the Applicants' Skeleton Argument. As there explained, this follows the example of the Summary of the Scheme provided to customers in outlining the main features of the Scheme by topic (in the same order as the Summary), rather than following the precise structure of the Scheme itself. References below are to paragraphs in the Scheme and to the Schedules to the Scheme.

The Transferring Business

61. Paragraph 4.1 of the Scheme provides for the transfer of the *Transferring Business* at the *Effective Time* from the Transferors to the Transferee. The *Transferring Business* is defined in Schedule 1 to the Scheme both by reference to the precise manner in which it is identified and by a description of the nature of the transferring business:

(1) The manner in which it is identified is by: (a) a USB drive which lists the identification number of trades, transactions and contracts at a cut-off date of 16 March 2018; and (b) a data base, which will be compiled by the Transferors, listing the identification numbers of trades, transactions and contracts booked or entered into after the cut-off date for the USB drive, provided in each case they have not been terminated or novated or transferred by the relevant Transferor prior to the Relevant Date (as defined in paragraph [101]. The USB drive and the data base are identified in Schedule 2 to the Scheme. The USB drive is to be held by Linklaters, the Transferors' solicitors, to the order of the Court. This is in my experience unusual; but I do not think it objectionable and it is certainly logistically rational and sensible.

(2) The nature of the Transferring Business is defined as including, to the extent governed by the laws of England and Wales, Scotland or Northern Ireland:

[4] Lloyds Bank plc has branches in the following non-EEA jurisdictions: Jersey, Singapore and New York, all of which provide Commercial Banking services. Bank of Scotland plc has a branch in New York, providing Commercial Banking services and one in the Isle of Man, providing Retail and Commercial Banking services.

(a) certain long-dated derivatives with a maturity date on or after 1st January 2021;

(b) certain short-dated derivatives with a maturity date before 1st January 2021;

(c) *RFI Loan Facilities*, being in broad terms loan and liquidity facilities (and certain sub-participations entered into in connection with such facilities), which at the Effective Date remain outstanding (including those that are undrawn) and which involve an exposure to an RFI, but excluding *Permitted RFI Exposures*;

(d) *Trade Finance Transactions* which have a maturity date that falls on or after 1st January 2019 and in relation to which at least one of the Transferors is the beneficiary of a counter-indemnity issued by an RFI or which otherwise creates a prohibited exposure to an RFI, but excluding Permitted RFI Exposures;

(e) *RPI Loan Facilities* (not falling within (c) above), being in broad terms loan facilities which have an interest rate linked to the retail price index, such that the relevant Transferor would be prohibited from holding the loan under the ring-fencing regime, and which have a contractual maturity date that falls on or after 1st January 2021, but excluding *Permitted RFI Exposures*.

62. The provisions of the Scheme in relation to the transfer of derivatives are quite complex. They treat long and short-dated derivatives differently and draw a distinction being between Permitted Derivatives and other derivatives. They also treat derivatives held by different customer segments differently and provide some optionality to customers as to whether short-dated derivatives transfer under the Scheme or not. The precise scope of the derivatives transferring under the Scheme and the rationale for the various distinctions (especially as regards optionality) is explained in the evidence in support of the Lloyds RFTS. In broad summary, the objective has been to seek to permit the transfer of permitted derivatives to the extent necessary to enable customers to continue netting arrangements (the removal of which would be an adverse effect).

63. The Transferring Business does not include *Excluded Large Exposure Transactions*. This permits the Transferors to determine that business which would otherwise transfer under the Scheme will not do so in order to avoid a breach by the Transferee of its large exposures limits.

64. The Transferring Business also includes:

(1) *Transferring Ancillary RFI Exposures,* being broadly any receivables due under certain closed-out derivatives agreements to a Transferor and which involve an exposure to an RFI;

(2) the *Business Assets*, being broadly other assets relating to the transferring transactions and contracts, including, among other things, associated agreements entered into by the Transferors with customers, rights and benefits

of the Transferors under *Transferring Guarantees / Security*, rights and claims of the Transferors, data, receivables and pipeline business;

(3) the *Assumed Liabilities*, being broadly the liabilities of the Transferors relating to the transferring transactions and contracts, to the extent that those liabilities arise on or after the Effective Date (excluding the *Excluded Liabilities*).

65. Paragraph 5.2 of the Scheme provides for the transfer to the Transferee on the Effective Date of the *Transferring Assets* and the *Transferring Liabilities*. This is a "belt-and-braces" provision, adopted from like provisions in frequent use in other forms schemes under Part VII, encompassing the transfer of the *Business Assets* and the *Assumed Liabilities*, which form part of the Transferring Business.

66. Paragraph 5.5 provides for assets and liabilities transferring under the Scheme to transfer to the Transferee subject to all *Encumbrances* and with the benefit of any *Rights of Security* that affect them.

The effect of the Scheme

67. There are provisions throughout the Scheme designed to ensure the efficacy of the transfer of the Transferring Business to the Transferee. As appears later, these are to be given effect by orders made under sections 112 and 112A of FSMA. Thus, for example:

(1) Paragraph 5.9 contains the usual provision that the transfer takes effect notwithstanding any provision to the contrary in any contract or arrangement with any customer or other person and as if there were no requirement upon either of the Transferors of any other person to obtain the consent of any other person or comply with any other contractual provision which could have the effect of restricting or prohibiting the transfer.

(2) Paragraph 12 provides that the transfer and other matters effected by the Scheme shall not give rise to other consequences, such as invalidating or discharging any contract; or requiring compliance by a Transferor and/ or the Transferee with a number of possible contractual provisions, which might otherwise be triggered by the transfer; or allow any party to terminate any contract, if that party would not otherwise have been entitled to terminate it.

68. However, paragraph 5.10 provides that the Scheme shall not operate to prevent any Customer exercising or enforcing any *Preserved Rights*. These are defined in Schedule 1 and include certain rights triggered as a result of the transfers effected by the Scheme. These include, for example, rights of a customer to terminate a Master Agreement as a result of the Transferee's credit rating being lower than the minimum credit rating specified in the Master Agreement; rights of a customer to request transfers of collateral from the Transferee by reason of the Transferee's lower credit rating and rights to terminate a Master Agreement by reason of an "Additional Termination Event" as a result of the Transferee not meeting certain regulatory requirements specified in the Master Agreement.

69. Paragraph 7.5 disapplies set-off rights which would infringe the rules made pursuant to the ring-fencing legislation prohibiting RFBs, like the Transferors, from having "netting" arrangements which allow set-off between the RFBs and certain other members of their group, including the NRFB.

Treatment of security

70. *Rights in Security* in relation to the Transferring Business transfer to the Transferee under the Scheme: paragraphs 5.5 and 7.3. Rights in Security is defined broadly and includes guarantees and security held by a Transferor as a guarantee or security for payment or discharge of any liability owed to it in relation to the Transferring Business. (The definition excludes *ISDA Credit Support Annexes*, under which collateral is held, such collateral being dealt with separately in the Scheme.)

71. Provision is made in paragraph 8 of the Scheme for guarantees and other security to be shared between the relevant Transferor and the Transferee where, broadly speaking, a guarantee or security relates both to a product which is transferring to the Transferee and another which remains with the Transferor. It does so by providing for a security trust to be created, whereby the relevant Transferor as security trustee holds the security or guarantee on trust for itself and the Transferee according to their respective interests in the relevant obligations guaranteed or secured by the guarantee/ security.

72. The Transferor and Transferee will also enter into an Inter-Creditor Agreement governing the relationship between them with regard to shared guarantees and security. A summary of its terms is available on the Group's microsite and the principles of the shared security are helpfully and clearly set out in a slide exhibited to the first witness statement of Mark George Culmer ("Mr Culmer"), a director of both the Transferors).

73. If the security trust (see paragraph [71]) is not fully recognised by any relevant law, the affected guarantee or security and any related assets and liabilities will be treated as *Residual Assets* and *Residual Liabilities* (see below).

Duplication of Master Agreements and ancillary documents

74. The Scheme duplicates certain Master Agreements in force between the relevant Transferor and its customers (paragraph 9.2). Master Agreement is defined as any ISDA Master Agreement, Treasury Master Agreement, Global Master Repurchase Agreement and/or Global Master Securities Lending Agreement.

75. 'Duplication' in this context means that with effect from the *Effective Time*:

    (1) the existing Master Agreement remains in force between the relevant Transferor and the customer and continues to govern transactions under it which do not form part of the Transferring Business; and

    (2) a new Master Agreement on identical terms will come into effect between the Transferee and the customer. Any derivative transactions forming part of the Transferring Business will cease to be governed by and form part of the

existing Master Agreement and instead be governed by and form part of the duplicated Master Agreement (paragraphs 9.1 and 4.2).

76. Paragraph 9.1 of the Scheme sets out which Master Agreements will be duplicated. They are identified on the USB drive described in Schedule 2 and thereafter will be listed within the Group's database, also described in Schedule 2. They include Master Agreements that relate to the derivative transactions which form part of the Transferring Business. They also include other Master Agreements that have no outstanding transactions under them or relate to assets and liabilities which do not form part of the Transferring Business ("Empty Master Agreements").

77. The rationale for the duplication of Empty Master Agreements is to allow customers to enter into new derivatives, securities lending or repo transactions with the Transferee from the *Effective Date*, without the customers having the burden of preparing a new Master Agreement with the Transferee for the purpose of entering into such transactions. The Empty Master Agreements which will be duplicated are essentially Master Agreements entered into with customers whom the Transferors consider are likely to want to enter into the relevant sort of transaction with the Transferee after the Effective Date or where there is a derivative credit limit made available by the Group in respect of such Master Agreement.

78. An *ISDA Credit Support Annex* (governing how collateral is posted by the parties to the underlying ISDA Master Agreement to reduce the credit risk of the party who is "in the money" in respect of derivative transactions governed by the ISDA Master Agreement) which has been entered into in relation to an *ISDA Master Agreement* will be duplicated (as the definition of *ISDA Master Agreement* includes such an *ISDA Credit Support Annex* and see also paragraph 9.5).

79. The Scheme also duplicates other agreements associated with certain *Master Agreements;* certain *Omnibus Guarantee and Set-off Agreements* and *Reservation of Rights Letters* (paragraph 10); and terms of business that are in effect between a customer and a Transferor immediately prior to the Effective Time which relate to any part of the Transferring Business (paragraph 11).

Treatment of Collateral

80. Paragraph 9.5 of the Scheme makes provision for collateral held pursuant to an *ISDA Credit Support Annex*, where the derivative transactions which are relevant for the purposes of calculating the collateral required (the "Exposure") transfer to the Transferee at the *Effective Time*.

81. Paragraphs 9.5.1 and 9.5.2 of the Scheme deal with the situation where collateral is held by the Transferor. If all the derivative transactions which are taken into account for calculating the Exposure transfer to the Transferee at the *Effective Time*, then all the collateral, will be transferred to the Transferee and be deemed to be held by the Transferee under the duplicated *ISDA Credit Support Annex*. If some, but not all, such derivative transactions transfer to the Transferee at the Effective Time, a *pro rata* share of the collateral held by the Transferor immediately prior to the Effective Date will be transferred to the Transferee and deemed to be held by the Transferee under the duplicated *ISDA Credit Support Annex*.

82. There are similar provisions in paragraphs 9.5.3 and 9.5.4 of the Scheme to deal with the situation where collateral is held by a counterparty rather than a Transferor. Here the Scheme deems the relevant collateral to have been posted with the counterparty by the Transferee under the terms of the duplicated ISDA Credit Support Annex.

Residual Assets and Liabilities

83. As foreshadowed above in the context of the security trust (see paragraphs [71] to [73] above), it is possible that the provisions of the Scheme may not be given effect in foreign jurisdictions, especially insofar as they relate to foreign assets and liabilities. The same potential problems have arisen in the context of other forms of Part VII Transfer Schemes (with longer histories). The Scheme borrows from that experience and adopts provisions in respect of such eventualities. In brief, *Residual Assets* and *Residual Liabilities* are defined in Schedule 1 as assets/ liabilities which would be within the scope of the Transferring Business but which the Court does not have jurisdiction to transfer; or the Court determines not to transfer; or which the Transferors and the Transferee agree would be more conveniently transferred after the Effective Date.

84. Paragraph 6.1 of the Scheme provides for the relevant Transferor to hold Residual Assets on trust for the Transferee and to retain any related Residual Liability, with some exceptions. The provisions are based on those often used for very similar reasons in insurance business transfer schemes.

85. Paragraph 5.3 provides that Residual Assets and Residual Liabilities will transfer to the Transferee on a *Subsequent Transfer Date,* this being the date when, in summary, such transfer becomes possible, or in the case of Residual Assets and Residual Liabilities held back by agreement between the Transferors and the Transferee, the time and date that they agree that the transfer shall take effect.

86. If any Residual Assets and Residual Liabilities have not transferred to the Transferee by 23.59 on 30th December 2018, that Residual Liability or Residual Asset will transfer on that date at that time, to the extent that the Court has jurisdiction to make the transfer. This is to ensure that as far as possible all business that would cause a breach of EAPO has been transferred before the deadline of 1st January 2019.

87. The Transferors and Transferees have agreed that the following assets and liabilities would be more conveniently transferred after the Effective Date and thus will be deemed to constitute Residual Assets and Residual Liabilities, which either transfer on a Subsequent Transfer Date or cease to exist before 1st January 2019:

    (1) certain liquidity facilities with customers that are RFIs, which support the credit ratings of the debt securities issued by the RFI, where upon the transfer of the facility to the Transferee, the customer or other transaction parties (acting on its behalf) may be obliged to make a standby drawing as a result of the Transferee's credit rating falling below a contractually stipulated level, and the interest and other fees payable on the sum drawn-down are greater than the commitment fee payable whilst the facility remains undrawn;

    (2) certain swaps entered into with the Transferors to hedge securitisation structures, where the swap would otherwise transfer under the Scheme on the

Effective Date, but the securitisation structure includes certain documents governed by laws of a foreign jurisdiction (i.e. any laws other than those of England and Wales, Scotland and Northern Ireland);

(3) certain derivatives with a maturity date which falls between 28th May 2018 (being the targeted Effective Date) and 11th June 2018;

(4) certain Business Assets in relation to which the counterparty has granted security governed by the law of a foreign jurisdiction where the security cannot be transferred simultaneously with the Business Assets.

Undertakings

88. The Transferors and Transferee give various undertakings, which are set out in Part D of the Scheme.

89. In particular, paragraph 20 provides that each Transferor undertakes, for the period of 7 months following the Relevant Date to reimburse customers certain fees or disbursements incurred by customers as a result of the Scheme, defined as *Reimbursed Amounts*, within 30 days from the receipt by the relevant Transferor of evidence to the reasonable satisfaction of the relevant Transferor of the fees or disbursements having been incurred. They include such things as agency change fees, registration fees and trade booking fees. In broad terms, they are costs which are required to be incurred to make the transfer under the Scheme effective and/or to meet the requirements of the ring-fencing legislation.

Changes to agreements and mandates

90. On and with effect from the Relevant Date, paragraph 14 of the Scheme requires any reference to any Transferor or "Bank" in relation to the Transferring Business or duplicated agreements to be construed as a reference to the Transferee and requires similar such adjustments to the meaning of other terms to ensure the efficacy of the transfer.

91. There is a similar provision in paragraph 7.2 in relation to any instruction, direction, mandate, standing order, power of attorney or authority given to, or by, any Transferor in relation to the Transferring Business. They are to have effect as if given to, or as the case may be, by the Transferee.

Conduct of Proceedings

92. Under paragraph 13 of the Scheme any legal proceedings which have been issued or threatened in connection with the Transferring Business by or against any Transferor shall be continued by or against the Transferee and the Transferee shall be entitled to all defences, claims, counterclaims, defences to counterclaims and rights of set-off. This is another example of a provision to be given effect by order made under section 112 of FSMA.

Confidentiality, Data Protection, Access to Records, Marketing Preferences and Subject Access Requests

93. Paragraph 15 of the Scheme contains various provisions to allow the sharing of customer confidential information, and personal data, between the relevant Transferor and the Transferee (and *vice versa*) to give effect to the purposes of the Scheme, including to administer, manage and enforce retained products or transferred products. Among other things, this will support the operation of the "shared services" model adopted by the Group for ring-fencing purposes, pursuant to which the Transferors will provide (on arm's length terms) the majority of services required by the Transferee to conduct the Transferring Business following its transfer. Pursuant to the Scheme, the Transferee will owe the same duties of confidentiality as the Transferor owed immediately before the Relevant Date.

94. Paragraph 16 provides that marketing preferences given by a customer to any Transferor are deemed to apply to both the Transferor and the Transferee from the Relevant Date.

95. Paragraph 17 permits the Transferee (if so agreed with the relevant Transferor) to respond to any subject access request made to a Transferor if the Transferor has not responded before the Relevant Date.

Modification

96. Paragraph 27 of the Scheme contains modification provisions. Paragraph 27.1 permits the Transferors and the Transferee to make modifications to the Scheme if they all consent and the Court approves the same.

97. Some amendments have been proposed to the Scheme; they are explained below.

Effective Date

98. Paragraph 26 provides that the Scheme shall become effective in respect of the Transferring Business and the Duplicated Agreements at the *Effective Time*, which is defined in Schedule 1 to be 00.01 on the *Effective Date*.

99. The Effective Date is in turn defined in Schedule 1 and is (a) 28th May 2018; or (b) such date as is agreed between the Transferor and the Transferees between the date of order sanctioning the Scheme and 30th June 2018; or (c) such other date as the Transferors and Transferee acting together, shall determine, and as the Court may allow.

100. This provision may have to be relied upon in this case: for although the target date for the transfer to become effective is 28th May 2018, there is a risk that this will not be practicable, and with that possibility in mind the Applicants are seeking the approval of the Court of a date of 16th July 2018, as a contingency Effective Date, if it transpires that it is indeed not practicable for the transfer to take place on 28th May 2018.

101. The concept of *Relevant Date* is also employed by the Scheme. It means in respect of a *Transferring Asset* or an *Assumed Liability* or an *Excluded Liability* or a *Duplicated Agreement*, the *Effective Date*; whereas in relation to a *Residual Asset* or a *Residual Liability* and some duplicated documents it means the applicable *Subsequent Transfer*

Date (Schedule 1). This too reflects existing practice in the context of other forms of Part VII Scheme.

Another feature of the ring-fencing arrangements curtailed products

102. In addition to identifying the main elements of the Scheme itself, one further matter was drawn particularly to my attention: that is the curtailment of certain products. This is not a feature of the Scheme itself, but rather results from the ring-fencing regime and the manner in which the Group has chosen to organise its business in the future to comply with that regime. There are approximately 257 customers (across all divisions of the Group) who have products that may be curtailed by the Group.

103. It was explained to me that a key aim of the Group in designing its ring-fence model was to continue to offer the same broad range of products to customers wherever possible. However, there are certain products currently offered by the Transferors which the Group will not make available to customers that are RFIs after 31st December 2018: these include basic facilities such as overdraft facilities, credit and charge cards, loans linked to the Bank of England base rate or fixed rate loans and products relating to asset financing or invoice financing. The reason for ceasing to make these products available is that the Transferors will not be permitted to offer these products to RFIs as this would create a prohibited exposure; and the Transferee is not proposing, for practical operational and commercial reasons, to offer these products.

104. In addition, any customer with a loan agreement which gives the customer a right to elect to have the interest rate linked to the RPI, and whose loan agreement is not transferring to the Transferee pursuant to the Scheme, will no longer be permitted to make that election in respect of new loans. Again, the reason for this is that the Transferors will not be permitted to make such a loan once they become RFBs.

A detail concerning two derivatives

105. Lastly in the context of this description of the Scheme and its effects, I note a detail concerning long-dated derivative transactions (both callable swaps with a maturity date on or after 1st January 2021) that have been entered into with one of the Transferors and certain customers which (under the terms of the Scheme) are within the scope of the Transferring Business, unless the transactions are Permitted Derivatives: see (c) in the definition of Transferring Business in the Scheme. However, the Transferors have determined to treat both transactions as Permitted Derivatives, so that they do not transfer to the Transferee under the Scheme. This is permissible because, although both call options will exist at the Effective Date (if on 28th May 2018 as currently expected), they will lapse if not exercised by Lloyds Bank plc before their expiry dates. The transactions will then be Permitted Derivatives that can be held by the bank on 1st January 2019. Alternatively, if the bank were to exercise the options, the transactions would then terminate. There is therefore no risk that the bank will be in breach of EAPO on 1st January 2019, when the ring-fencing regime comes into effect. Moreover, treating these derivatives as Permitted Derivatives gives effect to the purpose behind excepting from transfer Permitted Derivatives held by SME and CRE-PG customers, which is for this sort of derivative to remain with the relevant Transferor, as there is no regulatory imperative to transfer it to the Transferee.

[G] *Procedural chronology*

106. This hearing to consider whether the Lloyds RFTS should be sanctioned is the culmination of a long process in which the Court has been involved at various stages.

107. Indeed, and exceptionally, the Court was involved even before any application in respect of the Lloyds RFTS (or any ring-fencing scheme) had been filed: this was to obtain the Court's directions for an orderly progress and to give the Applicants comfort, in the context of a novel jurisdiction, as to how to proceed. The sequence was, in summary, as follows.

108. The PRA, after the required consultation with the FCA, approved the appointment of Mr Michael Lloyd ("Mr Lloyd" or "the Skilled Person") as the Skilled Person in respect of the Lloyds RFTS by letter dated 20th December 2016.

109. On 26th May 2017, and thus prior to the filing of the present application, Sir Geoffrey Vos CHC and Snowden J gave prospective general guidance to Barclays, HSBC, Lloyds and Santander on their ring-fencing transfer schemes, in relation to (i) their proposed communications programmes and (ii) the timetable of hearings for their sanction applications (*Re Barclays Bank plc and others* [2017] EWHC 1482 (Ch)).

110. On 25th September 2017, and in light of the prospective guidance that had been given as explained above, I provisionally approved certain key elements of the Applicants' proposed Communications Plan, as described and on the basis summarised in my judgment in the matter [2017] EWHC 3125 (Ch).

111. Having consulted with the FCA, the PRA approved the form of the Scheme Report by letter dated 15th November 2017.

112. Thereafter, having again consulted with the FCA and taken the Scheme Report (or a final draft) into account, the PRA, by letter dated 22nd November 2017, consented to the making of the present application.

113. On 4th December 2017, at the first hearing for directions after the actual issue of the application, I made further directions in respect of the proposed Communications Plan and also in respect of the form of guidance to be given to persons wishing to make representations about the Scheme. That guidance followed closely what the Chancellor had directed at a hearing of the Barclays Scheme on 10th November 2017 ([2017] EWHC 2894 (Ch)). The reference for my judgment dated 4th December 2017 is [2017] EWHC 3498 (Ch).

114. A Case Management Conference took place on 9 March 2018, at which I gave final procedural directions for this hearing ("the sanction hearing").

115. By letter dated 15th March 2018, the PRA, with the consent of the FCA, informed the Chairman of the Transferee of its final decision to grant the Transferee its application requesting variations to its permission under Part 4A of FSMA and, in particular, the lifting of 'mobilisation restrictions' which (as is common in the case of newly authorised banking entities) imposed restrictions on the scope of its activities, so as to be fully ready to commence operations as a bank from the effective date of that decision (being 24 May 2018). That lifting of restrictions has subsequently been made

subject to caveat to cater for the possibility that the effective date of the Scheme may have to be postponed. Arrangements for that contingency are further explained below.

116. On 16th March 2018, the PRA issued (a) a certificate of approval, having consulted with the FCA, to confirm to the Court that the PRA is still of the opinion, having considered (i) objections to the Scheme, (ii) any other relevant information, including proposed amendments to the Scheme, and (iii) the Supplementary Report (in final draft), that the Scheme is suitable to be sanctioned by the Court; and (b) a Certificate as to Financial Resources ("CFR") in respect of the Transferee in accordance with section 111(2)(ab) and paragraph 9C(1) of Schedule 12 Part 2B of FSMA.

117. The certificates and decision letter referred to above were exhibited to a third witness statement made by Mr Culmer on 19th March 2018. Mr Culmer's witness statements (filed on 24th November 2017 in the case of his first and 5th March 2018 in the case of his second) are clear and comprehensive in their description of the background, objectives and rationale for decisions in respect of the Lloyds RFTS, and I am grateful for the care with which they have been prepared. Mr Culmer's third witness statement, in particular, explains certain difficulties which have arisen which may necessitate a potential change to the Effective Date, and also certain amendments to the Scheme itself. The same statement also updates the Court as to the implementation of the communication plan, and the state of play with respect to representations, objections and expressed concerns relating to the Scheme. Again, I shall return to those matters later.

118. Also on 19th March 2018, Mr Lloyd (as the Skilled Person) formally issued his supplementary report ("the Supplementary Report") containing his updated assessment of the matters he is required to address in answering the Statutory Question. In his Supplementary Report, Mr Lloyd considers, amongst other things, whether his view as expressed in the Scheme Report had changed in light of further information, other relevant events subsequent to his finalisation of the Scheme Report, and written statements filed by persons interested pursuant to section 110(5) of FSMA.

119. After the exchange of skeleton arguments on behalf of the Applicants, the Regulator and the Skilled Person, the sanction hearing took place on 27th and 28th March 2018.

[H] *The Communications Plan and its implementation*

120. As previously noted, section 110(4) of FSMA confers an entitlement to be heard on "any person ("P") (including an employee of the transferor concerned or of the transferee) who alleges that P would be adversely affected by the carrying out of the scheme, subject to the provisions of section 110(5) (requiring the filing of written representations before the hearing). Accordingly, the Communications Plan involved both public or general communications and individual notifications to customers and other stakeholders referred to as Other Relevant Persons.

121. Plainly adequate notification is necessary if the entitlement is to have meaning and vitality; but equally plain are the difficulties (and expense) of fashioning an appropriate and sufficient communications plan. Indeed, it was largely by reference to these difficulties, and to obtain comfort as to the course proposed, that initial pre-application guidance was sought and obtained from the Court in general terms in May

2017, with increasing definition thereafter being sought in the subsequent scheme-specific applications chronicled above.

122. For the purposes of the Communications Plan in this case, Lloyds customers were divided into three categories: (1) Category 1 Customers, being those with either a product transferring or an agreement being duplicated by the Scheme or with a product that will be curtailed; (2) Category 2 Customers, being those in the Retail (including Consumer Finance) or the Commercial Banking division, with whom the Transferors have a contractual relationship or with whom they engage on a regular basis, but who do not fall within Category 1; and (3) Category 3 Customers, being customers who do not fall within Category 1 and who either do not have a contractual relationship with either Transferor or, if they do, have an engagement in respect of a product which is not a banking product and is limited to a payment service, or whose engagement is governed by foreign law and is not to be transferred under the Scheme but under a foreign law novation or statutory scheme.

123. Pursuant to the Communication Plan, Category 1 Customers and Category 2 Customers were to receive individual notification (though of differing sorts), in contrast with Category 3 Customers, where the Court did not require such notification. As regards Other Relevant Persons, some were to be sent individual notification and others not.

124. Public communications were stipulated and regulated by other parts of the Communication Plan.

125. The Communication Plan was approved at the Directions Hearing and is summarised at Schedule 1 to the order made at the Directions Hearing. The basis of approval is set out in my Judgment in relation to that hearing. In such circumstances, I do not think it necessary to repeat the basis on which I was satisfied with its architecture, as added to or amended to meet exigencies.

126. Inevitably, there were some glitches and mistakes in its full implementation; some other minor deviations involving, for example, some small changes made (by way of improvement) to the draft communications; and some slight slippage in the dates communications were made or made available. But I am satisfied, as have been the Regulators and the Skilled Person, that the deviations are not such as to undermine the integrity or overall effectiveness of the Communications Plan, and that any mistakes have been rectified (where necessary by individual contact).

127. In summary, therefore, I am satisfied that the Communications Plan as implemented, including the developing consciousness of the proposals engendered by more amorphous publication in notices and the media, has publicised the Scheme and explained it sufficiently to ensure that any persons who might wish to allege that they were adversely affected by it could do so, and that in consequence sufficient notice has been given of the Scheme for the purposes for which such notification is required.

128. I would add that at each of the hearings before me, both pre- and post- application, I have required to be satisfied, and have been so, that there was adequate notification of the event and its purpose to enable anyone interested to attend.

[I] ***Amendments to the Scheme prior to sanction***

129. As previously mentioned, the Court's approval is sought pursuant to paragraph 27.1 of the Scheme to various amendments to which the Transferors and the Transferee have consented. Most of the amendments are minor and are designed to rectify various small omissions and drafting errors or infelicities. Those of a more substantive nature are described below.

130. It is perhaps appropriate to record at the outset that the Regulators have been notified of these amendments and have raised no objections; and that the Skilled Person has also considered the amendments and has taken the view that no adverse effect arises as a result of them. I record them for comprehensiveness, noting that they seem to me to demonstrate, not any real difficulty, but rather the continuing care and attention devoted to the development of the Scheme at every stage.

131. First, the Scheme already duplicates Existing Early Termination Notices and Existing Reservation of Rights Letters in existence at the Effective Time, with effect from that time (paragraph 9.4 and 10.5 respectively). A new paragraph 9.4.2 has been inserted, providing for the duplication with effect from the Subsequent Transfer Date of Existing Early Termination Notices which relate to Residual Assets or Residual Liabilities and which are validly delivered at any time between the Effective Time and the Subsequent Transfer Date for the relevant Residual Asset or Residual Liability. A similar provision has been inserted at paragraph 10.7 in respect of Existing Reservation of Rights Letters which relate to any Residual Asset and which are delivered between the Effective Date and the Subsequent Transfer Date. These amendments are designed to fill a lacuna, which was overlooked, and will make the regime in relation to the duplication of Existing Early Termination Notices and Existing Reservation of Rights letters comprehensive, whether they relate to business transferring at the Effective Time or later, at the Subsequent Transfer Date.

132. Secondly, amendments have been made to correct an oversight in the drafting of the provisions in the Scheme which deal with splitting posted collateral as a result of the duplication of ISDA Credit Support Annexes, where some but not all the derivative transactions which are taken into account for calculating the Exposure transfer to the Transferee at the Effective Time (paragraphs 9.5.2 and 9.5.4). It was considered that these provisions would not work as intended where some of the relevant derivatives under an ISDA Credit Support Annex transfer and some are held back as Residual Assets/ Residual Liabilities to transfer on a Subsequent Transfer Date. Amendments are therefore proposed to the definitions of *Maximum Counterparty Delivery Amount*, *Maximum Transferee Delivery Amount* and *Relevant Proportion* in paragraph 9.5.5, to ensure that when calculating the proportion of posted collateral allocated to the Transferor or Transferee or deemed held by each of them for the counterparty at the Effective Time (on the Effective Date), the derivative transactions which are not transferring at the Effective Time but on a Subsequent Transfer Date are excluded from the relevant part of that calculation.

133. Thirdly, there are amendments to paragraph 14 of the Scheme, which deals with how references in respect of the Transferring Business or in any Duplicated Agreement are to be construed from the Relevant Date. These have particular reference to certain ISDA Credit Support Annexes entered into between a Transferor and a social housing association provide that the "Exposure" of the Transferor to the counterparty is reduced by the net value of properties which the counterparty has charged to the Transferor as security for the counterparty's liabilities. The "Exposure" governs the

amount of collateral the counterparty is required to post with the Transferor. Amendments are required in order to ensure that when the existing ISDA Credit Support Annex with the Transferor is duplicated under the Scheme, no duplication results in an inadvertent double counting of the deduction nor any difficulty in relation to the provisions for the release of security. (In addition, other technical changes are proposed so that the Scheme accommodates the variety of defined terms used in the various ISDA Credit Support Annexes.)

134. Fourthly, what was termed a "wrong pockets" provision is inserted at paragraph 25. This provides that, if at any time after the Effective Date, but before 1st January 2019, either Transferor has trades, transactions or contracts which would result in the Transferor engaging in an activity that is subject to a Prohibition or an Excluded Activity under the ring-fencing regime, these shall transfer to the Transferee. The provisions of the Scheme will apply to any assets and liabilities, Master Agreements and security associated with the transferring asset. The agreement of the Transferor and Transferee and notice to the relevant customer is needed first. All business which would result in the Transferors engaging in an activity that is subject to a Prohibition or Excluded Activity should be transferred under the Scheme either on the Effective Date or, at the latest, by 1st January 2019. Paragraph 25 is designed to ensure that should an error be made in this regard, the Transferors can ensure that they are compliant with the ring-fencing regime by the deadline of 1st January 2019.

135. Fifthly, an amendment is proposed to the definition of *Transferring Business* to exclude from transfer any trades, transactions or contracts which are governed by the laws of England and Wales, Scotland or Northern Ireland, but which are booked to a *Non-EEA Branch* of a Transferor (the definition of this term also being added to Schedule 1 of the Scheme.) There are fewer than 25 such trades etc. The Transferors intend to transfer them to the Transferee by novation, together with the other business booked to those branches. The novations will only be effected when the Transferee has obtained the requisite licences to operate branches in the non-EEA member states.

136. One further, sixth, issue was identified immediately before the commencement of the hearing, which will necessitate another small amendment to the Scheme. It has emerged that certain derivatives held by GC customers and one CRE-PG customer have been categorised as long-dated derivatives, on the basis of their scheduled termination/settlement dates, whereas on further analysis the derivatives in question have mandatory early termination dates that fall before 1st January 2021 and are therefore properly categorised as short-dated derivatives. The customers in question should have, but have not, been told that these short-dated derivatives would remain with the relevant Transferor, subject to the customer's option under the grandfathering provisions to elect for these, and other short-dated derivatives they may hold, to transfer to the Transferee. Provision has been introduced to cater for this. Again, neither the Regulators nor the Skilled Person consider this to raise any adverse effect or substantial difficulty.

[J] *Satisfaction of jurisdictional requirements*

137. I have set out above (see paragraphs [16] to [33]) the relevant provisions of Part VII of FSMA which provide the jurisdiction and delineate the statutory process for a ring-fencing transfer scheme. These establish statutory pre-conditions which must be satisfied before a Court can sanction such a scheme.

138. I am satisfied that in the case of this application these pre-conditions have been fulfilled. More particularly, and for the record, the evidence demonstrated satisfactorily as follows.

139. As to section 106B of FSMA:

(1) The Scheme satisfies the definition of a ring-fencing transfer scheme within the meaning of section 106B of FSMA. Part of the business carried on by each of Lloyds Bank plc and Bank of Scotland plc is to be transferred to Lloyds Bank Corporate Markets plc, the Transferee. Both Lloyds Bank plc and the Bank of Scotland plc are UK authorised persons within the meaning of section 105 of FSMA, i.e. bodies incorporated in the UK with Part 4A permissions to carry on one or more regulated activities.

(2) The Scheme is for purposes set out in s. 106B(3)(a) and (c) FSMA in that:

(a) the transfer is for the purpose of enabling the Transferors to carry on core activities as ring-fenced bodies in compliance with the ring-fencing provisions: s. 106B(3)(a); and

(b) in addition, the Scheme is made for the purpose of making provision in connection with the implementation of proposals that involve the Transferors (as body corporates of the Group) becoming ring-fenced bodies, while the Transferee (as another member of the Group) is not a ring-fenced body: s. 106(3)(c).

(3) the Scheme is not an "excluded scheme" (within the meaning given to that term in s. 106B(4)); nor is it an insurance business transfer scheme, so that s.106B(1)(c) does not apply.

140. As to section 107 of FSMA, the application for sanction of the Lloyds RFTS:

(1) is made by both the Transferors and the Transferee in accordance with section 107(2)(c);

(2) was made with the consent of the PRA, which in giving its consent had regard to the Scheme Report in accordance with s.107(2A) and (2B);

(3) is properly made to the High Court in accordance with s. 107(3)(b) and (4), Lloyds Bank plc and the Transferee being registered in England and Wales and Bank of Scotland plc in Scotland.

141. As to section 109A of FSMA and the requirements concerning a scheme report by a skilled person (analogous to the report required to be made by an Independent Expert in the case of an insurance business transfer scheme):

(1) The appointment of Mr Lloyd as the Skilled Person was approved by the PRA after consulting with the FCA. Mr Lloyd has been a partner in the Banking and Capital Markets practice of Deloitte LLP since 1996. He is a fellow of the Institute of Chartered Accountants of England and Wales ("ICAEW") and a Fellow of the Association of Corporate Treasurers. Amongst other things, he is

involved in the ICAEW's role in providing recommendations to policymakers in the UK and internationally on accounting and regulatory matters in relation to financial services' firms, including banks, both as a member of the ICAEW's Financial Services Faculty Board and the Chair of the ICAEW's banking committee.

(2) Mr Lloyd has the requisite independence for the role, as reinforced by (i) the PRA's approval of both his nomination as the Skilled Person and the form of the Scheme Report; (ii) Mr Lloyd's own recognition for the need for his independence from the Group; and (iii) the fact that Mr Lloyd is required to give his opinion on the Statutory Question and has prepared the Scheme Report in accordance with the PRA Statement of Policy and FCA Finalised Guidance on the implementation of RFTSs.

(3) The Scheme Report provided by Mr Lloyd is in a form approved by the PRA, after consulting with the FCA, in accordance with section 109A(3) of FSMA, as shown by a letter from the PRA dated 15th November 2017. Mr Lloyd has produced, in addition to a detailed and comprehensive Scheme Report (24th November 2017), a Summary Report summarising the Scheme Report and a Supplementary Report (19th March 2018) considering developments relevant to the Scheme since his Scheme Report was issued, including any objections received in respect of the Scheme. I discuss these most important documents, and Mr Lloyd's assessment of the Lloyds RFTS, later.

142. As to the particular pre-conditions specified in section 111 of FSMA:

(1) The "appropriate certificates" have been obtained by the Applicants. The PRA has certified its approval of the Applicants' application for sanction. Further, the PRA has given the Transferee a CFR. Counsel for the Regulators took me to the copies of these certificates in the evidence. The PRA is the "relevant authority" to give the certificate, as the Transferee will be a PRA-authorised person with a Part 4A permission if the proposed Scheme takes effect, as to which see below.

(2) With respect to the pre-condition in section 111(2)(b) that the Transferee has the authorisation required, or will have it before the scheme takes effect, to enable the business which is to be transferred to be carried on in the place to which it is to be transferred, the evidence shows that on 25th July 2017 the Transferee was authorised by the PRA under Part 4A FSMA as a credit institution, having permission to carry on certain regulated activities. That permission was subject to restrictions. On 21st December 2017 the Transferee applied to vary its permission by removing the restrictions. On 15th March 2018 the PRA (with the consent of the FCA) made its decision to grant that application to take effect on 24th May 2018 (4 days prior to the target Effective Date of 28th May 2018). The requirements in connection with its mobilisation to be met by the Transferee in advance of the PRA (with the consent of the FCA) removing restrictions on the Transferee's permissions are, and are expected to remain, within the control of the Transferee or the Group and the Transferee intends to make arrangements to fulfil them before the Effective Date. The PRA has informed the Transferee that, if the Effective Date is not 28th May 2018 (as to which see paragraph [193] below), a further decision of the PRA (with the consent of the FCA) will be required before the Transferee will have the necessary full authorisation to carry on regulated

activities. The PRA has stated that the further decision will be "*to defer the date that the variation of the Transferee's permission to lift mobilisation restrictions takes effect*". I return to this later when addressing the Applicant's desired provision for a later date of 16th July 2018 as a contingency Effective Date.

143. That leaves section 111(3) of FSMA which stipulates that an order sanctioning a ring-fenced transfer scheme under Part VII may only be made if the court considers that "in all the circumstances of the case" such sanction is appropriate. That brings me to the principles upon which the Court is to approach the exercise of its discretion: see the next section.

[K] *Court's role and discretion: guidance in the Barclays judgment*

144. This is only the second ring-fencing transfer scheme to come before this Court for its sanction; but the principles have been explored in the first such scheme, in the Chancellor's *Barclays* judgment.

145. As the Chancellor accepted, and as emphasised by Mr Moore, both the similarities with other forms of scheme under Part VII of FSMA and certain obvious differences are important guides. As Mr Moore put it in his skeleton argument:

> "Having chosen to apply the Court's s 111 jurisdiction to ring-fencing transfer schemes, the appropriate inference is that Parliament intended that the Courts would at least have regard to the approach to the exercise of their discretion as had been previously been adopted under s 111(3)…
>
> However, it is only a starting point and an RFTS is categorically different to any other species of transfer under Part VII…"

146. The most obvious and perhaps important difference (and one which, on behalf of the Regulators, Mr Phillips QC especially emphasised) is that a ring-fencing transfer scheme is a step in a compulsory process by which a banking group brings itself into compliance with the ring-fencing regime introduced as an essential part of the UK Government's response to the financial crisis of 2008-2009 and the very considerable difficulties it brought. This fact, that a ring-fencing transfer scheme is a compulsory process, and the further imperative that ring-fencing must be achieved by 1st January 2019, make such a scheme categorically distinct from the transfers of business (for example transfers of banking and insurance business) otherwise dealt with under Part VII of FSMA.

147. The differences are reflected also in the particular requirement in the newly-introduced sections inserted into Part VII by FSBRA not only for input by way of approved report by a skilled person (whose position and role are otherwise similar to those of an independent expert reporting on a transfer of insurance business), but also that such skilled person should address a specific (two-part) Statutory Question, which is cast in terms that recognise that the compulsory regime may cause adverse

effects, and requires assessment as to whether such effects are greater than reasonably necessary.

148. In light of the analogy (but not equivalence) with other Part VII schemes, in the *Barclays* judgment the Chancellor quoted at length (at paragraph [39]) from the authoritative statement of the approach (under predecessor legislation in the Insurance Companies Act 1982) by Hoffmann J (as he then was) in *Re London Life Association Ltd* (21st February 1989) which was not reported but which has proved the bedrock of subsequent decisions, including *Re Axa Equity & Law Life Assurance Society plc and Axa Sun Life plc* [2001] 1 All ER (Comm) 1010 (see especially pages 1011-1012), and on the slightly different context of transfers of banking business under Part VII, *Re Alliance & Leicester plc* [2010] EWHC 2858 (Ch).

149. Turning to the differences between ring-fencing transfer schemes and other schemes under Part VII of FSMA, the Chancellor emphasised the importance of setting such schemes, and the necessity for them, in context as part of the bank regulatory reforms introduced to seek to strengthen the banks in the interests of customers and tax payers as well as the UK economy at large in the wake of the financial crisis of 2008 to 2009.

150. The Chancellor itemised in paragraph [96] of the *Barclays* judgment the principal reforms, and he referred also to a useful summary of them (and their intent) in a speech given on 29th September 2017 by Sir John Cunliffe, the Deputy Governor of the Bank of England for Financial Stability. The Chancellor highlighted five particular measures in addition to the ring-fencing requirement, all of which are applicable to the Lloyds Group as they were to Barclays, as follows:

> "(A) substantially increased "going concern" capital and liquidity requirements with detailed rules improving the quality of capital issued and increasing the amount of liquid assets held;
>
> (B) new rules with respect to "minimum requirements for own funds and eligible liabilities" ("MREL"), which require … [affected banks] to issue an amount of equity and subordinated debt equal to circa 30 per cent. of risk weighted assets ("RWAs") in order to effect a recapitalisation via "bail-in" of the relevant entity in a stress [situation] …
>
> (C) broad resolution powers of the Bank of England that (coupled with stabilisation enacted through MREL conversion) enable it to take remedial action to the benefit of critical stakeholders … ;
>
> (D) operational continuity requirements, whereby banks are required to identify and ensure that critical services that support critical economic functions supporting the wider economy can continue operating during a stress [situation]; and
>
> (E) senior manager requirements, whereby senior individuals within banks are individually accountable to the PRA and FCA for the ongoing operation of the bank, including recovery and

> resolution planning for their respective entities. This regime includes a criminal offence punishable by up to seven years in prison if, broadly, a senior manager is found to be culpable for a bank failure".

151. At paragraph [97] of the *Barclays* judgment, the Chancellor summarised the following features of the important context:

> "It is important, therefore, to consider also the Scheme against the background of the purpose of ring-fencing, which was described in the PRA's paper "the Ring-Fencing Regime for UK Banks" of 10th February 2017 as being "to isolate retail banking services from the risks of global wholesale and investment banking, to ensure the continuity of deposit taking services, to ensure greater resilience against future financial crises and to remove risks from banks to the public finances."

152. He also noted the importance of bearing in mind the fact that such schemes are compulsory, and there is an imminent deadline for their implementation, and observed (in paragraph [99]) that

> "It is noteworthy that Part VII of FSMA does not provide for the approach that the court should adopt to a negative answer to the statutory question. In these circumstances (though the matter was not argued before me), it seems to me that it would not be *incumbent* on the court to refuse to sanction a ring-fencing scheme even if it or the Skilled Person reached the view that a material adverse effect was likely to be greater than was reasonably necessary in order to achieve the statutory purposes."

153. The Chancellor then provided the following overall guidance (in paragraph [100]):

> "It seems to me, therefore, taking into account the authorities and the submissions that I have mentioned, that in exercising its discretion, the court must keep in mind, in addition to the contextual and other matters I have already mentioned, the following main factors:-
>
> (1) The court's discretion is unfettered and genuine and is not to be exercised by way of a rubber stamp.
>
> (2) The design of a ring-fencing transfer scheme is a matter for the board of the bank concerned. There may be many possible approaches to the design of a statutorily-compliant

ring-fencing transfer scheme that will affect stakeholders differently. The choice is for the directors of the bank concerned, acting properly in accordance with their duty under section 172(1) of the Companies Act 2006 (which is to act in the way they consider, in good faith, would be most likely to promote the success of the company having regard to matters including those specified in that subsection).

(3) The adverse effects of a ring-fencing transfer scheme must be viewed through the lens of the statutory question, so that the court must consider, with the aid of the Skilled Person, first whether persons other than the transferor are likely to be adversely affected by the scheme, and, if so, whether the adverse effect is likely to be greater than is reasonably necessary in order to achieve the statutory purposes. In considering whether persons are likely to be adversely affected by the scheme, regard need only be had to those adverse effects that are (i) possibilities that cannot sensibly be ignored having regard to the nature and gravity of the feared harm in the particular case, (ii) a consequence of the scheme, and (iii) material in the sense that there is the prospect of real or significant, as opposed to fanciful or insignificant, risk to the position of the stakeholder concerned.

(4) Even if the statutory question is answered negatively, it will not automatically follow that a proposed scheme will be rejected. The court's approach will depend on all the circumstances, including the balance between the chosen design of the scheme, the benefits that will be achieved by the scheme, and the nature of the adverse effects identified, all viewed through the lens of the approach inherent in the statutory question itself.

(5) The court will give weight to the views expressed to it by the Skilled Person and by the Regulators, and will fairly evaluate the weight to be given to views expressed to it in statements of representations made by stakeholders.

154. My only reservation or gloss is one which emerges from the particular circumstances of the Lloyds RFTS and relates to point (2) above in the Chancellor's summary.

155. I accept that the court will give considerable latitude to commercial decisions of a board which has appeared properly to address the correct question and acted in accordance with its duties under statute and common law. I accept, more particularly, that where there are different designs of scheme, none of which leaves people materially adversely affected, or no more so than is reasonably necessary to achieve

the ring-fencing purpose, the choice is for the promoters (and thus the directors) to make.

156. However, I would wish to emphasise that when the second part of the Statutory Question is being addressed, the question is not whether any adverse effect is greater than is reasonably necessary given the constraints of the particular scheme design, but whether that adverse effect is such as to be greater than reasonably necessary in order to achieve the statutory purpose. If the adverse effect appears material, and it appears likely that another scheme design would have avoided the adverse effect, that may call in question the scheme design chosen; and the court would not be required to accept the directors' choice (albeit that it would then also have to consider potential adverse effects of other designs). In other words, the greater the adverse effect, the more justified the scrutiny of the scheme design, and the less may be the readiness of the Court to accept the commercial judgment of the directors.

157. As I have said, this point emerges in this case because (as will become apparent from the next section of this judgment) the Skilled Person has had to grapple with the second part of the Statutory Question in a number of instances; whereas I think the issue arose once, if at all in the *Barclays* scheme. Perhaps the more general message may be that there are no hard and fast rules, but only guidelines: each case turns, and must be assessed, according to the circumstances of that particular case.

[L] ***The Skilled Person's Report and conclusions on the Statutory Question***

158. Crucial in assisting the Court's scrutiny of a scheme such as this is the assessment of the Skilled Person in his/her independent report(s). The Skilled Person is typically involved through most of the iterative process of developing and testing the proposed scheme, and brings both experience and expertise to bear on matters of a complexity which would be beyond reasonably informed scrutiny by a court without his/her assistance. I should wish to acknowledge at the outset my admiration of the way in which in this case Mr Lloyd, as the Skilled Person, has presented the issues, his meticulous approach in addressing the Statutory Question, and his careful and balanced treatment of the Scheme's potential adverse effects and their materiality. In this section of this judgment, I provide a brief summary or overview of his reports, which is based on that provided in the Applicants' Skeleton Argument, and follows the structure of the Scheme Report; but I have carefully assessed them all.

159. The basic structure of the Scheme Report is first, to confirm the Skilled Person's expertise and independence and explain the scope of his report (Section 1); second, to set out the Skilled Person's conclusion on the Statutory Question at its substantive beginning (in Section 2); thirdly, to provide an overview of the Lloyds RFTS and its statutory context and its purpose (in Section 3); fourthly, to elaborate on his role as Skilled Person and explain (a) the groupings of persons affected by the Scheme and (b) his approach to various key concepts in the legislation (in Section 4); and in subsequent Sections (Sections 5 to 17) to set out the details and rationale for his conclusion (i) on the Statutory Question and (ii) as to the Communications Plan and other incidents of the Scheme.

160. I shall return later to Mr Lloyd's overall conclusion to the Statutory Question, noting for the present only that it is favourable to the Lloyds RFTS. It is helpful in understanding his report to start at Section 4, and the explanation of the groups of

persons from whose point of view he has assessed the effect of the Lloyds RFTS and his interpretation of and approach to key phrases and concepts which inform his assessments and ultimate conclusions.

161. In paragraph 4.4, Mr Lloyd explains that in assessing the likely effects of the Scheme he has sought to identify relevant cohorts of potentially affected persons with similar characteristics, or products or relationships, given the impossibility of considering the individual circumstances of each person, and accordingly has considered separately

(1) "Transferring Customers": i.e. current customers with products transferring from either of the Transferors to the Transferee or with agreements being duplicated under the Scheme (considered in Section 6 of the Scheme Report);

(2) "Non-Transferring Customers": i.e. current customers of the Transferors with products that are not transferring under the Scheme; these are made up of all customers of the Retail Banking division (Section 7) and Consumer Finance sub-division (Section 8), and a portion of customers of the Commercial Banking division (Section 6);

(3) "Other Relevant Persons" who may be directly or indirectly affected by the Scheme (Section 9).

162. Also in Section 4 of his report, Mr Lloyd explains his interpretation of and approach to the following phrases and concepts in the Statutory Question:

(1) in assessing whether persons other than the transferor are *"likely to be adversely affected by"* the proposed Scheme, he has had to take a view as to the degree of likelihood of an adverse effect required to meet the test. He has adopted, having consulted multiple sources of possible guidance as to how to interpret the word "likely", including the dictionary, accounting standards and the medical profession, a conservative approach in including not merely those impacts or events where a person is "*more likely than not"* to be adversely affected.

(2) In other words, for practical purposes, Mr Lloyd can be taken to have applied a conservative standard in fulfilling his task as the Skilled Person. I note that this is consistent with the guidance given in the *Barclays* judgment, where (at [100(iii)]), the Chancellor indicated that

> "in considering whether persons are likely to be adversely affected by the scheme, regard need only be had to those adverse effects that are (i) possibilities that cannot sensibly be ignored having regard to the nature and gravity of the feared harm in the particular case".

However, it should be noted (paragraph 4.13 of the Scheme Report) that in the event Mr Lloyd did not identify any effects of the Scheme where making an assessment of "likely" was a critical factor in itself in enabling him to reach a conclusion on "adverse effect".

163. Mr Lloyd has given consideration, in the context of identifying potential adverse effects, to what degree of materiality, if any, is required. He has noted that materiality

must be assessed as dependent on the circumstances of those affected (or groups affected), and that it can depend on the nature or magnitude, or both, of the items to which the information relates. For practical purposes, Mr Lloyd has taken the antithesis of a "*material"* adverse effect to be one which is "*immaterial"*: paragraph 4.25. He has therefore again adopted a conservative approach. This is consistent with:

(1) paragraph 5.10 of the PRA's Statement of Policy dated March 2016 and entitled 'The implementation of ring-fencing: the PRA's approach to ring-fencing transfer schemes', which states, *"Given the breadth of the Statutory Question, the Skilled Person may wish to consider only material adverse effects"* and

(2) the Court's guidance in the *Barclays* judgment, where (at [100(iii)]) the Court noted that regard only need be had to those adverse effects that are

> "material in the sense that there is the prospect of real or significant, as opposed to fanciful or insignificant, risk to the position of the stakeholder concerned".

164. Consistently with this approach, for each adverse effect addressed in the Scheme Report, Mr Lloyd has classified the effect as being material or immaterial. Where he has judged that the adverse effect is not material, for example relative to changes that a stakeholder may experience in dealing with a new counterparty during the normal course of business, he has concluded that they are not likely to be materially adversely affected by the Scheme (for example, see paras 6.184 and 6.199 of the Scheme Report in relation to the Operational and Transitional adverse effects that a Commercial Banking customer may experience). Where Mr Lloyd considered that an adverse effect may be material to an individual stakeholder, he has then moved on to consider part (b) of the Statutory Question. Further:

(1) in assessing materiality, Mr Lloyd has considered the potential adverse effect 'net' of any mitigants that the Group has applied or the affected persons could reasonably be expected to apply themselves: Scheme Report, paragraph 4.25.

(2) He has also had regard to the fact that (as noted) materiality can depend upon the context of the individual customer. In many cases, it is not possible to know the precise impact upon an individual (or, practically, to investigate it given the potential numbers of those affected) and hence he has, where appropriate, made an assumption of materiality, and hence of an adverse effect, and moved on to consider Part B of the Statutory Question.

165. With particular reference to part (b) of the Statutory Question, and the question of whether an adverse effect is "*greater than is reasonably necessary"* in order to achieve the relevant ring-fencing purpose, Mr Lloyd has (in essence) first considered the Group's overall approach, strategy and solution to achieving ring-fencing, including an assessment of the governance process applied by the Group to select the selected solution, and the alternative structures which were available to the Group and

his understanding of the rationale for not selecting those alternative structures. This is "the design stage" (and see further below).

166. In the subsequent sections of the Scheme Report, Mr Lloyd has considered whether *particular* adverse effects which he identifies are "material" and if so, whether they are "greater than is reasonably necessary". This has been analysed on an individual basis, by reference to those options which might have been available to the Group, within the confines of the overall scheme design, to avoid that adverse effect.

167. In my view, Mr Lloyd's underlying approach to the concepts above identified is reasonable, consistent with the guidance given by the Regulators and by the Court in the *Barclays* judgment, and indeed correct.

168. In Section 5, Mr Lloyd carefully considers what (borrowing once more from the *Barclays* judgment) I have termed the "design stage", and which the Skilled Person describes as the various "high-level structures" considered by what he refers to as "the Group" (see below). This "design stage" is the stage of consideration at which, as the Court held in the *Barclays* judgment (at [100(ii)]), that

> "the design of a ring-fencing transfer scheme is a matter for the board of the bank concerned. There may be many possible approaches to the design of a statutorily-compliant ring-fencing transfer scheme that will affect stakeholders differently. The choice is for the directors of the bank concerned, acting properly in accordance with their duties under section 172(1) of the Companies Act 2006 (which is to act in the way they consider, in good faith, would be most likely to promote the success of the company having regard to matters including those specified in that subsection)".

169. Mr Lloyd identifies the three design structures evaluated by the Group, being:

(1) A wide RFB and narrow NRFB model, under which as many products and services would be kept inside the RFB as is permissible under the ring-fencing legislation;

(2) A RFBs-only Group model, under which any products, business or services not permissibly conducted within a RFB would be exited, unwound or allowed to run-off, possibly in conjunction with a partnership arrangement with another bank or institution to enable customers to have access through that partner to such products and services;

(3) A narrow RFB and wide NRFB model, under which all transactions with large Global Corporates with turnovers exceeding £500 million ("GCs"), services to Financial Institutions ("FIs") and other wholesale lending business would be conducted in a NRFB.

170. Mr Lloyd confirms that these were the only available high-level designs to meet the ring-fencing regime requirements; and that the selection of the narrow NRFB model

was "supportable", "logical" (in terms of achieving a key objective of the Group, that of limiting customer disruption) and the choice "most closely aligned to its areas of strategic focus of becoming the "Best Bank for Customers", and of "delivering sustainable growth". After a careful assessment, especially, of (a) the means of achieving the chosen structure, (b) its implications for the various customer groups, and (c) the likely resulting credit ratings for the RFB and the (new) NRFB, Mr Lloyd states his overall opinion in this context that:

> "…the choice of ring-fencing structure, by maintaining adverse effects to a relatively small cohort of customers…is reasonable in nature, such that the identified adverse effects arising as a direct result solely of the high-level design of the ring-fencing programme, and the Scheme, will not be greater than reasonably necessary in order to achieve the relevant ring-fencing purpose, as set out in Section 106B(3)(a) of the FSMA."

171. In the subsequent sections of the Scheme Report, Mr Lloyd analyses in detail the potential effects of the Scheme on Transferring Customers (Section 6), Non-Transferring Customers (Sections 7 and 8 and, for a portion of customers of the Commercial Banking division, Section 6); and Other Relevant Persons (Section 9). He then turns to consider whether there may be an adverse effect on any stakeholders by reference to a series of aspects of the Scheme arrangements and their potential consequences, in particular on the capital, liquidity and funding positions of the Group (Section 10); governance arrangements (Section 11); operational continuity and recovery and resolution planning (Sections 12 and 13); information technology considerations and payment implications (Section 14); tax implications (Section 15); pension schemes (Section 16); and communication plans (Section 17).

172. Sections 7 and 8 can be taken together. Mr Lloyd concludes that Retail Banking and Consumer Finance customers are not likely to be adversely affected by the Scheme. He reaches the same conclusion in section 6 in respect of Commercial Banking customers who will not have any products transferred under the Scheme, representing more than 98% of total customer entities in this division.

173. The primary content of Section 6 is a consideration of the Scheme from the point of view of the persons most obviously and directly affected, namely customers of the Commercial Banking division with products transferring to the Transferee or agreements being duplicated. I return to that in paragraph [176] below. In sections 6, 7, 8, Mr Lloyd also considers the effect of product curtailment on customers. He is clear that the adverse effects he identifies in this regard are not as a result of the Scheme, but rather the result of a commercial decision taken by the Group as a consequence of complying with the ring-fencing regime. He explains the products that will not be offered by the Transferee and will not be available to RFIs from the Transferors, and the manner in which the Group is proposing to deal with its RFI customers who are thus affected.

174. Likewise, in sections 6, 7 and 8, Mr Lloyd draws attention to the fact that the wider group restructuring, which affects various non-EEA entities and branches, may result

in change for customers. Again, he is clear that any such change will not be as a result of the Scheme, but as a consequence of complying with the ring-fencing regime.

175. In section 9, Mr Lloyd considers how the Scheme will affect Other Relevant Persons. That category is drawn very widely, encompassing any group who Mr Lloyd, as a result of his own independent analysis, believed could be affected by the Scheme (paragraph 9.9). He concludes that in relation to all the cohorts identified, there is not likely to be any or any material adverse effects- operational, transitional or financial with two exceptions, those being:

(1) certain possible financial effects of the Scheme on the NRFB sub-group, which he concludes are a consequence of the design decisions taken by the Group in order to comply with the ring-fencing regime and that, as a result, he is satisfied that the adverse effects will not be greater than is reasonably necessary to achieve the relevant ring-fencing purpose, as set out in s. 106B(3)(a) FSMA.

(2) Possible adverse effects on certain persons, who are not customers, but are connected with customers, may be adversely affected: these include, for example, securitisation noteholders and other secured creditors of an SPV which has entered into a liquidity facility with a Transferor or persons who have granted security or a guarantee to a Transferor. The potential adverse effects for these persons are further considered in section 6: in summary, Mr Lloyd is satisfied that as regards these persons the adverse effect is not greater than is reasonably necessary to achieve the relevant ring-fencing purpose, as set out in section 106B(3)(a) of FSMA.

176. Returning to the principal focus of section 6 of the Scheme Report, Mr Lloyd's analysis and assessment of the adverse effect of the Scheme on customers in the Commercial Banking division whose products are transferring to the Transferee and/or have agreements that will be duplicated by the Scheme, is as careful and comprehensive as it is important and clear. The effects are material and complex; and a summary is necessarily imperfect and incomplete. However, with that caveat, the following indicates the gist of Mr Lloyd's approach and assessments.

177. He divides the possible adverse effects into four types: (a) financial (including potential financial costs and other financial adverse effects); (b) product (adverse changes to the product offering to existing customers); (c) operational (due to the need to establish a new banking relationship with the Transferee or a split banking proposition across the Transferors and the Transferee); and (d) transitional (being adverse effects prompted by the need to establish a new banking relationship with the Transferee).

178. The easiest to deal with are the last two categories ((c) and (d) above): that is, those in relation to possible operational and transitional effects. He considers that Lloyds customers are not likely to be materially adversely affected by the Scheme in this regard. He is also satisfied that the Group is doing everything reasonably possible to mitigate the operational and transitional issues identified and none of those issues is material relative to changes a customer may experience in dealing with any new counterparty.

179. By contrast, Mr Lloyd identifies various adverse financial and product effects (categories (a) and (b) above) as a result of the Scheme. He starts by isolating seven main causes of potential adverse effects in the case of Commercial Banking customers. The most significant of these are summarised below (the summary being based largely on that provided in the Applicants' Skeleton Argument), together with the specific areas of potential adverse effect associated with each of these causes.

(1) The first main cause of potential adverse effect is that the Transferee is expected to have a weaker credit rating than either of the Transferors before the Scheme. This may have an impact on the fair value of products moved from the Transferors to the Transferee. It may also have an adverse impact on the regulatory capital levels of customers, such as banks, insurance and asset management entities, which are required to hold minimum capital levels. Further, credit rating clauses in derivatives, liquidity facility agreements and in contracts between a customer of the Group and that customer's own clients, may be triggered by the weaker credit rating of the Transferee, with adverse effects for customers.

(2) The second main cause of potential adverse effect is that the Scheme results in some Commercial Banking customers having a split banking relationship with some financial products in the Transferors and some in the Transferee. Possible adverse financial effects are a loss of set-off rights, the breaking of derivative netting sets, and a reduction in the availability of credit lines. There are also possible adverse product effects as a result of split banking, in relation to so-called "linked products" (for example, a deposit to secure a loan or a derivative transaction, resulting in more favourable pricing for the customer) where such linkage may cease to be possible, because the linked products are in different banks after the Scheme takes effect.

(3) The third main cause is the relatively smaller size of the Transferee compared with the Transferors. This has a potential adverse impact in respect of the large exposures regulatory rules, these being rules which are designed to limit the maximum loss a bank could face in the event of a sudden counterparty failure to a level that does not endanger the bank's solvency. The Scheme is likely to result in the exposure of some Commercial Banking customers exceeding the Transferee's large exposures limits, so that steps will have to be taken to reduce the exposure. This may impact adversely on the customer.

(4) The fourth is the Transferee's funding strategy. The Transferee will be primarily financed by Lloyds Banking Group plc, its parent company, rather than raising the majority of its funding from public markets. Customers will not be able to hedge or monitor their credit exposure to the Transferee by buying or monitoring the price of credit default swaps ("CDS") on the Transferee, as this is only possible if there is an active CDS market on the Transferee, which generally requires the bank to have issued actively traded public bonds. This contrasts with the

position in respect of Lloyds Bank plc, where customers who want to manage or monitor their credit risk exposures may do so, as there is an active CDS market on a number of its public issued debt securities. There is no such market against Bank of Scotland plc, so any potential adverse effect is limited to customers who have products transferring from Lloyds Bank plc.

(5) The fifth is the future business model of the Transferee. It will offer a narrower range of products and services than the Group did before the Scheme and will be potentially more susceptible to stress situations. This may impact in the future on interest-rates set by the Transferee, the pricing of products and the availability of credit lines for customers.

(6) The sixth is the transfer of products, which may trigger events which lead to adverse results. For example, the transfer of derivatives might result in the crystallisation of taxable gains or lead to increased margin requirements for US customers or the discontinuation of hedge accounting.

(7) The seventh is the effect of commercial decisions to make some curtailments in the products it offers post-Scheme, which will affect RFI customers.

180. Mr Lloyd examines in detail each of these possible causes of adverse effect and concludes that the Scheme is indeed likely to result in a number of adverse effects to customers whose products are transferring under it, though his analysis is often nuanced depending on the circumstances of different customers. I have read and re-read his assessment, and especially paragraphs 6.18 to 6.199 of the Scheme Report; and it seems to me that his identification and assessment of likely adverse effects is as comprehensive as can reasonably be achieved.

181. I should add, given my view (see paragraph [156] above) that the Skilled Person must, when he identifies a net material adverse effect which is an unavoidable likely consequence of the Scheme design, keep under review whether that effect is so serious as to call in question the design, that I have also been satisfied that Mr Lloyd has indeed done just that, especially taking Sections 5 and 6 of the Scheme Report together. (Thus, for example, where the cause of the adverse effect is the lower credit rating of the Transferee, Mr Lloyd refers to the fact that he is satisfied that the approach taken by the Group in designing the Transferee was reasonable and that there were no reasonable alternative Scheme structures that would have achieved the Group's design principles for ring-fencing and resulted in a better credit profile of the Transferee relative to the Transferors.)

182. Sections 10 to 16 of the Scheme Report assess how the following areas are affected by the Scheme:

(1) Section 10: capital, liquidity and funding;
(2) Section 11: governance arrangements and risk management;
(3) Section 12: operational continuity arrangements;
(4) Section 13: recovery and resolution planning;
(5) Section 14: information technology and payment implications;

(6) Section 15: taxation implications;
(7) Section 16: pension arrangements.

183. The analysis is focussed in each case on whether changes to the arrangements as a result of the Scheme could lead to an adverse effect on customers and Other Relevant Persons. Once again, there is a useful summary in the Applicants' skeleton argument, which is reflected below.

184. In Section 10, Mr Lloyd summarises the regulatory regime, outlining the capital and liquidity requirements and the stress testing exercises in which banks are required to participate. He then explains how he approached his task of considering the effect of the Scheme on the capital and liquidity of the relevant entities and the information which he reviewed in doing so. He focusses on reviewing the effect of the Scheme on the Group on a consolidated/ domestic liquidity sub-group basis, on the RFB sub-group and on the Transferee. The impact of the Scheme is assessed by comparing each of these post- Scheme groupings with the position of the Group pre-Scheme, and assessing in particular (a) business model viability; (b) capital (pre- and post-scheme, in respect of the Group, and the RFB Sub-group and the Transferee post-scheme); (c) liquidity (as regards the same groupings as in the case of capital); and (d) pension obligation risk (pre- and post-scheme).

185. Of especial note are Mr Lloyd's conclusions with regard to the Transferee. These include the assessment that the Transferee has lower ratios for total capital in both base case and stress case scenarios than the Group pre-Scheme, and that, as regards liquidity, the Transferee has a different and potentially relatively riskier profile than the Group pre-Scheme, partially mitigated by a variety of factors. Nevertheless, although the Transferee is a relatively riskier entity than the Group pre-Scheme, Mr Lloyd considers that the potential adverse effects are not material. This is due to the mitigating factors that (a) regulatory capital minimum requirements are projected to be met, (b) following a stressed situation, the Transferee is still forecast to meet regulatory liquidity requirements and (c) that the stakeholders of the Transferee are likely to be sophisticated, have a greater understanding of risk and have access to multiple banks.

186. The conclusion Mr Lloyd reaches in sections 11 to 16 is that the Scheme will either have no adverse effect or no material adverse effect in relation to the various matters there identified. There is one exception in relation to the tax implications of the Scheme. One possible adverse tax effect is identified, and Mr Lloyd qualifies his view that there should otherwise be no adverse tax effect, on the grounds that he cannot be certain about his conclusion without knowing the particular arrangements and circumstances of customers, which might affect their tax position.

187. Section 17 concerns Mr Lloyd's assessment of the Communications Plan. That has now been implemented as described in Part [H] above. As already recorded, the Skilled Person, having reviewed the plan and its implementation, expresses the view that the:

> "plan, and the actual and draft or template communications I have seen to date, are clear, fair and not misleading."

Scheme Report: overall conclusion

188. I can thus return to the Skilled Person's overall conclusion as stated in Section 2 of the Scheme Report: that he is satisfied that either (a) the Scheme is not likely to adversely affect any persons other than the Transferors or (b) where the Scheme is likely to have an adverse effect, that the effect is no greater than reasonably necessary to achieve the relevant ring-fencing purpose set out in section 106B(3)(a).

Supplementary Report by the Skilled Person

189. Mr Lloyd has prepared a Supplementary Report (19 March 2018) in which he considers developments relevant to the Scheme since his Scheme Report.

190. There is no express statutory provision regulating such a report and its notification. However, such a report (i) has become common practice in the case of other Part VII schemes (ii) has obvious utility and indeed in reality is necessary given the passage of time inevitable after the filing of the Scheme Report before the sanctios hearing (iii) was prepared in accordance with PRA Policy Statement 10/16 and the FCA's Finalised Guidance 16/1 (both issued in March 2016) and (iv) has been reviewed by the Regulators.

191. The Supplementary Report, dated 19th March 2018, was made available on the Group website set up to provide information about the Lloyds RFTS ("the Microsite") on 19th March 2018. That means that the Supplementary Scheme Report will have only been available on the Microsite for 8 days before the sanction hearing. That is a relatively short time period; however, there is a balance between (a) having the most up to date assessment practicable and (b) sufficient notification. The Regulators have confirmed that they are satisfied that the Supplementary Report was published as soon as it was final; and that, having regard to the fact that its principal conclusions do not alter but rather confirm the conclusions set out in the Scheme Report, it was notified in sufficient time before the sanction hearing.

192. Mr Lloyd's Supplementary Report displays the same rigour and attention to detail as his main Scheme Report. As to its material content of the Supplementary Report, he considers in particular: (a) modifications to the Scheme adopted or proposed since the Scheme Report; (b) updates in relation to the Communications Plan; (c) filed objections made in accordance with s. 110(5) FSMA and other non-filed concerns; (d) updates on customers and other relevant persons affected; and (e) updates as regards (i) capital, liquidity and funding positions of the Group, (ii) Group governance arrangements, (iii) operational continuity arrangements, (iv) recovery and resolution planning, (v) information technology and payment considerations, (vi) tax implications, and (vii) pension arrangements. His assessment may be summarised as follows.

193. Having considered, in section 3 of his Supplementary Report, the modifications to the Scheme since its presentation, which include technical changes with regard to derivative documentation, a provision for 'wrong pocket transactions' (being, in essence, trades, transactions or contracts incorrectly not captured within the definition of Transferred Business), more extensive provisions for the transfer of certain assets and liabilities ("Residual Assets" and "Residual Liabilities"), together with any related security, on a later transfer date (though before the deadline of 1st January

2019), and the introduction of a provision for a "Contingency Date" of 16th July 2018 in case the targeted Effective Date of 28th May 2018 cannot be met, Mr Lloyd concludes that none will cause any material adverse effect or cause him to modify his overall answers to the Statutory Question.

194. In section 4, Mr Lloyd addresses the question whether the Group could do anything to improve the credit rating of the Transferee, in particular by injecting additional capital into the Transferee, this being a question the Court asked at the Directions Hearing, and which customers have also asked, and which is obviously one of the main causes of potential adverse effects of the Scheme for customers in the Commercial Banking division with products transferring to the Transferee (see also paragraphs [197] to [198] below).

195. Mr Lloyd expands on his initial assessment in the Scheme Report in that regard. He concludes that a capital increase in the Transferee would be unlikely to improve its credit ratings (within the realm of what is reasonable in a commercially viable and realistic business model for the Transferee); and that no other steps (such as holding more liquid assets in the Transferee, broadening the business model through transferring more business, or raising more stable and cheaper funding) could realistically be undertaken by the Group in sufficient magnitude to improve materially the Transferee's credit rating relative to those of the Transferors.

196. In section 5 of the Supplementary Report, Mr Lloyd reconsiders the communications sent to customers and others, the more general notification of the Scheme, and noted deviations from the Communications Plan. He also considers (the only two) filed objections (that is, written statements of representation filed with the Court as required by section 110(5) of FSMA) from non-transferring customers, and 'Non-Filed objections' (being a reference to concerns and objections raised in some other way, and numbering 13 from non-transferring customers at the date of the Supplementary Report). Noting that he is not aware of any customer who has made or might intend to make an objection as a result of deviations from the Communications Plan, and that deviations are "unsurprising given the large volume of communication necessary", Mr Lloyd concludes that none of the deviations represent a material adverse effect or prejudice or dilute meaningful enjoyment and deployment of the right to object. As to objections, filed and non-filed, and with the exception of a significant non-filed concern from a customer in the Commercial Banking division in relation to the transfer under the Scheme of a liquidity facility agreement, which is considered in detail in section 8 of the Supplementary Report, Mr Lloyd states that he is satisfied that none of the issues raised in the filed objections or the non-filed concerns from non-transferring customers, or the related correspondence, has led him to revise his conclusions on the Scheme.

197. Section 6 of the Supplementary Report relates to commercial banking customers (and updates the numbers involved, put at 3,140 in total (as at 31st December 2017), pointing out that it is estimated by the Group that some 99% of Commercial Banking customers will not have any products transferred under the Scheme). Mr Lloyd also focuses particularly on one notable non-filed concern, in connection with Liquidity Facilities for Securitisations, which was referred to at the Directions Hearing. Under the terms and conditions of the relevant securitisations the liquidity facilities must be drawn, at an increased interest cost, if the facility provider's credit rating is below a requisite level, as indeed is expected. Whilst the specific customer's concern has been

resolved, Mr Lloyd assesses all the arguments which were presented in the non-filed concern, to consider whether they had implications for others. These concerns could be grouped into two key themes: (1) whether a different Scheme structure could have resulted in a better credit rating for LBCM, thereby eliminating any adverse effect that the customer would suffer; and (2) whether there were specific mitigants that could be applied.

198. For reasons summarised in section 4 of the Supplementary Report (see also paragraph [195] above), Mr Lloyd considers the first theoretical mitigant to be unavailable, because any feasible capital increase in the Transferee was unlikely to improve its credit ratings (within the realm of what is reasonable in a commercially viable and realistic business model for the Transferee).

199. Two mitigants that would help to reduce the adverse effect and these have been agreed with the customer in question, enabling the non-filed concern to be resolved. These mitigants have also been offered to all other customers in similar circumstances that are potentially exposed to the same adverse effects. At paragraph 6.13, Mr Lloyd summarises two mitigants proposed by the Group in relation to the Liquidity Facilities as follows:

> (1) Delay to the legal transfer of the liquidity facilities for securitisations that are exposed to potential higher cost implications arising from the ratings trigger being exercised, from the Effective Date to later in the year, using the expanded Retained Assets/Liabilities mechanisms described above; and
>
> (2) Changing the contractual terms with the customer to suppress any margin "step-up" for liquidity facilities, if drawn due to the impact of the Scheme and where the margin changes due to the facility being drawn (this mitigant being proposed as a change to the contractual terms with the customer rather than a change to the Scheme itself).

200. Mr Lloyd concludes that the further mitigants specific to these liquidity facilities will reduce any adverse effect by delaying the transfer to as late as practically possible. Outside the Scheme design itself, the Group has offered to suppress the margin step-up for the customers most impacted, whereby the Group could potentially profit from a drawdown due to the Scheme. In Mr Lloyd's assessment, customers may still suffer a material adverse effect, but that flows from a requirement of the Ring-fencing regime that these liquidity facilities are transferred, and is therefore an inherent consequence of the Scheme, and not greater than reasonably necessary in order to achieve the relevant ring-fencing purpose, as set out in section 106B(3)(a) of the FSMA.

201. In section 6 of the Supplementary Report, Mr Lloyd concludes that non-transferring commercial banking customers 'will not experience any adverse effect as a result of the Scheme'.

202. In sections 7, 8 and 9 of the Supplementary Report, Mr Lloyd updates his assessment of the effect of the Scheme on Retail Banking customers, Consumer Finance customers and other relevant persons respectively. It is not necessary to relate his assessment in detail; it suffices to record that he concludes that he can identify no

'likely adverse effects of the Scheme on Retail Banking customers'; that Consumer Finance customers "are not likely to be adversely affected by the Scheme"; and that there is no change to his conclusions as to the effect of the Scheme on any of the categories of 'other relevant person' identified in the Scheme Report.

203. Finally, in sections 10, 11 and 12 of the Supplementary Report, Mr Lloyd concludes that he would expect no material adverse effect to arise from the anticipated changes to (a) the capital and liquidity position of the affected entities; (b) governance and risk management arrangements; (c) operational continuity arrangements; (d) recovery and resolution planning; (e) information technology and payment arrangements; (f) the tax position of the affected entities; or (g) pension arrangements, taking account of the additional security arrangements agreed with the relevant pension fund trustees.

Conclusion as to the Skilled Person's assessments

204. In short, I am satisfied that Mr Lloyd's approach and conclusions in fulfilling his task and obligations as the Skilled Person are solidly based and clearly explained. I see no reason not to accept his conclusion that although there are net adverse effects, none is greater than reasonably necessary in order to achieve the relevant ring-fencing purpose as set out in section 106B(3)(a) of FSMA.

[M] *Objections and representations*

205. As is apparent from earlier references, only two written statements of representation have been filed with the Court. In addition, there have been 13 non-filed concerns (including the one discussed at some length in paragraphs [197] to [200] above). All such representations and concerns have been provided to and considered by the Regulators and the Skilled Person as well as the Applicants.

Non-Filed concerns

206. The non-filed concerns have been collated and analysed in a 'Non-Filed Concerns Report' exhibited to Mr Culmer's third witness statement. I was taken through this analysis at the hearing. I do not think it is necessary to do more than record that (a) concerns of more general impact and importance (for example, those relating to the Applicants' comparative credit ratings) have already been addressed above; and (b) none of the concerns is one which has not already been considered by the Skilled Person and assessed by him as not causing him to depart from his conclusions.

Filed objections

207. Of the filed objections, one came from Mr R.A. Brown ("Mr Brown") and the other from Mr James Richard Pooley Rowe ("Mr Rowe"). Mr Brown also appeared at the sanction hearing (as he had at the sanction hearing for the Barclays ring-fencing scheme). Mr Rowe did not, but he made clear that he wished the court to consider fully his objections nevertheless and sought reassurance (which I gave and repeat) that they not be "void or diminished" by his non-attendance.

Mr Brown's concerns and objections

208. Mr Brown is a Jersey resident and is a customer of Lloyds Bank International Limited ("LBIL"), a Jersey bank incorporated in Jersey, subject to the regulatory regime of the Jersey Financial Services Commission. LBIL provides, amongst other things, retail and commercial banking services to residents in the Crown Dependencies (Jersey, Guernsey and the Isle of Man). He is not a customer of the Jersey branch of Lloyds Bank plc or any of the Applicants.

209. As a non-UK bank, LBIL is not itself within the scope of the ring-fencing regime and will not become either an RFB or a NRFB. Currently LBIL is an indirect subsidiary of Lloyds Bank plc. However, RFBs are not permitted to have a participating interest in any undertaking which is incorporated in a country or territory which is not an EEA-member state: and Jersey is not an EEA member state. Therefore, in order to comply with the ring-fencing legislation, LBIL will be transferred to the Transferee and will form part of the NRFB sub-group. LBIL will continue to provide the same banking products and services in Jersey as before.

210. Put shortly, Mr Brown's objection is that there will be increased financial risk to residents of Jersey (and the other Crown Dependencies), such as he is, as a result of ring-fencing. He contends that the only providers of high-street banking in Jersey are the five big UK banks, which will not be permitted to provide their services in Jersey (and other Crown Dependencies) via their RFBs, so that residents in these jurisdictions will be obliged to bank with the non-ring-fenced arm of the banks. Mr Brown alleges that those using the ring-fenced banks in the UK will have greater protection as a result of ring-fencing, but that by contrast those using the non-ring-fenced banking arms will be subject to increased risk.

211. Further, Mr Brown is concerned that any failure of a NRFB would diminish the already-limited availability of high-street banking services in Jersey. The Jersey regulator and/or Government, and those of other Crown Dependencies, have limited control over UK companies and would arguably have very limited capacity to intervene to save a bank, even if they had the resources to do so.

212. For these and other reasons, Mr Brown considers that the UK ring-fencing provisions disadvantage him and other Jersey and Crown Dependency residents, by increasing financial risk and reducing access to banks, where no other high-street banking provision exists except for the big five banks.

213. Mr Brown added to these points in oral submissions, and advanced additional concerns as to (a) where LBIL's cash deposits would be held, his concern being lest they were within a non-ring-fenced entity; (b) the lack of consolidated accounts for the Transferee, and the adverse effect on its credit rating; and (c) whether the Group's computer platforms would be within the ring-fence (as he hoped).

214. Mr Brown's objections were thus not really directed at the Lloyds RFTS itself. Indeed, he described the ring-fencing proposals overall as "forward-looking and excellent". At least his written objections were directed rather at certain aspects of the substance of the ring-fencing legislation. As Mr Lloyd notes, in considering the written objections in his Supplementary Report, LBIL is not an entity impacted by the Scheme; and any adverse effects on Jersey residents that Mr Brown identifies are a consequence of the laws and regulations which make up the ring-fencing regime. He

is satisfied that the Group could not have changed the Scheme to address the adverse effects identified by Mr Brown.

215. As to his oral submissions, (a) all bank deposits have to be placed and/or invested somewhere, but that is subject to regulatory supervision; (b) the Transferee has as yet no business, and thus nothing to consolidate; and (c) shared services for the Group, including computer platforms will continue to be provided by the Transferors.

216. In short, none of Mr Brown's objections provide any basis for refusing sanction of the RFTS.

Mr Rowe's concerns and objections

217. Mr Rowe, a long-term customer of the Group, wrote to Lloyds Bank plc on 15 January 2018, on behalf of himself and Jo Taylor, as directors of Upwey Estates Limited (a property company), expressing concern that Lloyds Bank plc was shown, in the leaflet which they had received, as being permitted to sell hedging products and simple derivatives to non-RFIs as these might be mis-sold to retail customers. Mr Rowe's objection is made in the context of his allegation that in 2008 his property company was mis-sold an Interest Rate Hedging Product ("IRHP") or Swap by Lloyds Bank and that the product was "quashed" during the FCA sponsored review into this mis-selling.

218. Lloyds Bank plc responded by a letter dated 26 January 2018, explaining that the issue of what products a RFB was permitted to sell was different from the question of the suitability of the product for a particular client, that matter being subject to separate legislation and regulation, not dealt with in the leaflet Mr Rowe was sent about ring-fencing. Lloyds Bank plc also confirmed that Upwey Estates Limited was a non-RFI.

219. Mr Rowe filed a written statement of representation on 27 February 2018, repeating his concern about the ability of the RFB to sell complex financial products to retail customers. He contended that complex products should not be permitted in the RFB and that if non-RFI customers needed to hedge something they should be dealing with the NRFB, where the necessary expertise lies.

220. Mr Rowe's objection is, in essence, that he fears future mis-selling of hedging or simple derivatives by Lloyds Bank plc. However, the objection is not focussed on the Scheme or its impact on his company so much as on the process of selling individual products to particular customers. RFBs are permitted by the ring-fencing regime to sell the kind of hedging product and simple derivatives (to non-RFIs), which Mr Rowe alleges they should not. It is inherent in the Group's choice of the Wide RFB that Lloyds Bank plc will continue to offer this sort of product to customers, the suitability of the product for the particular customer being a matter for Lloyds Bank plc to satisfy itself of in accordance with the legislation and regulation governing these matters.

221. The Regulators and the Skilled Person have considered Mr Rowe's concerns and objections. Neither has suggested that they tell against sanction of the Lloyds RFTS. Mr Lloyd states in his Supplementary Report (in section 5) that in his opinion, "the Group has responded to [the] filed objection in an appropriate manner." The choice as

to what business can be undertaken by a RFB is a matter of policy; the policy choice is not a matter for this Court.

[N] *Effective Date*

222. So far as the Scheme itself is concerned, the Effective Date is defined in Schedule 1 to the Scheme as: (a) 28th May 2018; or (b) such date as is agreed between the Transferors or the Transferees between the date of order sanctioning the Scheme and 30th June 2018; or (c) such other date as the Transferors and Transferee acting together, shall determine, and as the Court may allow.

223. As previously indicated (see paragraphs [117] and [142] above), the Applicants seeks to include as part of the Order sanctioning the Scheme, and pursuant to limb (c) of the definition of Effective Date, a provision to enable the Effective Date to be changed to 16th July 2018, if the Transferors and the Transferee determine that it is not practicable for the transfer to take place on 28th May 2018.

224. The Applicants present this as sensible contingency planning and have summarised the possibility of logistical difficulties as follows in their skeleton argument:

> "The potential problem is that during the ongoing operational assurance testing of IT systems and processes an issue could possibly be identified which might cause the Transferors and the Transferee to re-assess if a smooth migration of the business can take place on 28 May 2018. The necessary testing is due to be completed in early April 2018. The Applicants have not, to date, identified any reason to think that 28 May 2018 will not be achievable. The Applicants expect to be in a position to be able to determine whether it is safe or not to go ahead with the transfer on 28 May 2018 by or during the week commencing 16 April 2018.
>
> …
>
> Given there is a potential risk that it may not be practicable to proceed with the transfer on 28 May 2018 the Applicants have identified 16 July 2018 as a suitable alternative and later date for the transfer to take place. Earlier dates have been ruled out as clashing with the Group's financial half-year end, as there is a risk that the major changes to the Group's IT systems involved in the migration of the Transferring Business to the Transferee might disrupt the Group's ability to gather the necessary financial data needed for the half-year results."

225. Communications concerning the Scheme have stated that the Effective Date is expected to be 28th May 2018, but have made it clear that this is subject to possible change and have advised customers and other stakeholders to check the dedicated ring-fencing 'microsite' on the Group's website where any change will be posted.

226. Mr Lloyd has confirmed in the Supplementary Report as follows:

> "Any change in the Effective Date due to implementing the contingency plan, if required, may result in some additional planning work for customers, i.e. to prepare for the operational transfer of business and duplication of agreements pursuant to the Scheme. Based on discussions held with the Group, and my review of information received from the Group, I do not expect a change in the Effective Date due to implementing the contingency plan to impact my overall conclusions set out in Section 2 of this Supplementary Report."

227. The Regulators are the persons principally concerned, not least with respect to their decision to vary the Transferee's mobilisation restrictions with effect from 24th May 2018 (see paragraph [142] above), which was premised on a delay being a possibility rather than a specific risk. However, the Regulators too are content with the proposed addition to the Order, and furthermore have confirmed that the Transferee will have before the Scheme takes effect (on either 28th May 2018 or 16th July 2018[5]) the authorisation required to enable the business which is to be transferred to it (if the Scheme is sanctioned) to be carried on in the place to which it is to be transferred.

228. But it is important also to note that they have made clear that they will keep under review the operational readiness of the Transferors and the Transferee to bring the Scheme (if it is sanctioned by the Court) into effect on the intended effective date of 28th May 2018. If the Applicants determine that the effective date of the Scheme must be 16th July 2018, the PRA will decide whether or not to vary its decision so that the mobilisation restrictions are lifted with effect from 12th July 2018. That decision will require the consent of the FCA. If the mobilisation restrictions cannot properly be lifted from that date, the Scheme will not take effect on 16th July 2018. In that case (as contemplated in the Draft Order), Court approval will be required for any later effective date.

[O] *In all the circumstances, should the Court sanction the Scheme?*

229. The complexities of the Scheme and the reorganisation of which it is part are obvious. So too is the importance that the legislature should be taken to attach to the careful assessment of the Scheme by the Court, even after its assiduous review in a long and iterative process by the Regulators and its detailed scrutiny by the Skilled Person. Hence my decision to reserve judgment, and then to provide this detailed explanation of the reasons for my decision after providing a shorter summary of my overall conclusions in time to accommodate the parties' tight time-table and the need for certainty that they strongly emphasised.

230. Having emphasised that the Court's role is substantive and not ministerial, there remain the question as to what is the Court's role (as distinct from the other reviewing agencies) and how, in such a complex matter, involving business structures, financial

[5] As regards 16th July 2018 ('the contingency date') this confirmation (a) does not pre-judge the Regulators' decision to lift (or not) mobilisation restrictions in time for the Scheme to take effect on contingency date; and (b) is given on the basis that, as the Draft Order anticipates, if the mobilisation restrictions are not lifted, the Scheme will not take effect on the contingency date because the Transferee will not have the necessary permission under FSMA 2000.

products and client interests and concerns across such a broad and varied base, the Court is to discharge its responsibility.

231. No scheme is perfect or beyond improvement; but, as emphasised in the *London Life* case in the context of a long-term insurance company transfer scheme, and reiterated by the Chancellor in the *Barclays* judgment, the Court's role is not to wonder about improvements (though of course it may propose some if it wishes) but to determine whether or not to sanction, having regard to the answers to the Statutory Question, and its appreciation of the overall consistency and fairness of what is proposed.

232. I accept in that context that given the compulsory nature of the ring-fencing process and the statutory deadline of 1st January 2019 there could theoretically be circumstances where the Court might sanction a scheme notwithstanding an equivocal (or worse) assessment by the Skilled Person; but in practice that may be unlikely, it being difficult to conceive that an application would have come to the court in such circumstances.

233. In guiding its approach, the Regulators' input and appearance is of crucial assistance; yet if anything the ultimate guide or litmus test is to be provided by the Skilled Person, and the Court's assessment of any particular objections put forward at the hearing.

234. In reality, the Court will be looking to test a scheme which has elicited a satisfactory ultimate conclusion from the Regulators and the Skilled Person, and its task is not to second-guess but to explore the assessments and their nuances, and to satisfy itself (or not) that there is nothing materially lacking or inconsistent, illogical or discordant, in the reports such as to undermine the reliability of the answers given in them to the Statutory Question which must be answered, nor any 'blot' on the scheme.

235. In that task, the Court is greatly assisted by the submissions of Counsel for all the statutory consultees; but also by persons who believe themselves adversely affected by reference to particular features which they consider affect them: for the exploration of individual adverse effect may expose some broader deficiency in the proposals, or even call in question the overarching design, which is primarily a matter for the directors in the exercise of their duties (with the caveat earlier explained).

236. In the present case, the Skilled Person has answered the Statutory Question by concluding that he is satisfied that either (a) the Scheme is not likely to adversely affect any persons other than the Transferors or (b) where the Scheme is likely to have an adverse effect, that the effect is no greater than reasonably necessary to achieve the relevant ring-fencing purpose set out in section 106B(3)(a). He has confirmed that conclusion in the Supplementary Report.

237. As noted previously, Mr Lloyd's two reports in this matter appear to me to be exemplary: meticulous and comprehensive, clear and candid. He has adopted a clear and transparent approach, identified adverse effects, explored whether they are more than necessary, worked with the Applicants to mitigate them, and explained in detail his conclusion that they are no greater than reasonably necessary to achieve the statutory purpose. I have detected no material inconsistency, illogicality or discordance in his assessments, nor any reason to doubt or qualify the overall conclusions he has reached.

238. The Regulators have manifested the care they have taken in the iterative process pursuant to which the Scheme has finally been formulated and in assessing the Scheme against their own published statements and having regard to their respective functions.

239. The evidence provided by the Applicants themselves has also been clear and comprehensive. I asked in argument my wish to know whether the Scheme was recommended by all directors of the various entities concerned unanimously; and received the reassurance that it was.

240. I remain satisfied that the Communications Plan was both appropriate and complied with except in respects which were probably unavoidable and, in any event, immaterial in terms of their ultimate purpose.

241. I am satisfied that the concerns and objections, filed and unfiled, have appropriately been considered and addressed. In at least one case, an unfiled objection has led to modification and improvement. I do not consider, however, that any of the filed or non-filed objections revealed any defect in the Scheme as such; and nor did Mr Brown's oral submissions.

242. In all the circumstances, I have seen no reason not to sanction the Scheme.

[P] ***Form of Order***

243. Pursuant to an order pursuant to section 111 of FSMA sanctioning the Scheme the Applicants further seek an order that the terms of the Scheme shall take effect under section 112 of FSMA without further act or instrument and as if each were separately set out in the Order.

244. Section 112 of FSMA gives the Court power to make orders ancillary to a sanction order under section 111(1):

> "(1) If the court makes an order under section 111(1), it may by that or any subsequent order make such provision (if any) as it thinks fit—
>
> (a) for the transfer to the transferee of the whole or any part of the undertaking concerned and of any property or liabilities of the authorised person concerned;
>
> (b) for the allotment or appropriation by the transferee of any shares, debentures, policies or other similar interests in the transferee which under the scheme are to be allotted or appropriated to or for any other person;
>
> (c) for the continuation by (or against) the transferee of any pending legal proceedings by (or against) the authorised person concerned;

(d) with respect to such incidental, consequential and supplementary matters as are, in its opinion, necessary to secure that the scheme is fully and effectively carried out.

(2) An order under subsection (1)(a) may—

(a) transfer property or liabilities whether or not the authorised person concerned otherwise has the capacity to effect the transfer in question;

(b) make provision in relation to property which was held by the authorised person concerned as trustee;

(c) make provision as to future or contingent rights or liabilities of the authorised person concerned, including provision as to the construction of instruments (including wills) under which such rights or liabilities may arise;

(d) make provision as to the consequences of the transfer in relation to any occupational pension scheme (within the meaning of section 150(5) of the Finance Act 2004) operated by or on behalf of the authorised person concerned.

(2A) Subsection (2)(a) is to be taken to include power to make provision in an order—

(a) for the transfer of property or liabilities which would not otherwise be capable of being transferred or assigned;

(b) for a transfer of property or liabilities to take effect as if there were—

(i) no such requirement to obtain a person's consent or concurrence, and

(ii) no such contravention, liability or interference with any interest or right,

as there would otherwise be (in the case of a transfer apart from this section) by reason of any provision falling within subsection (2B).

(2B) A provision falls within this subsection to the extent that it has effect (whether under an enactment or agreement or

> otherwise) in relation to the terms on which the authorised person concerned is entitled to the property or subject to the liabilities in question.
>
> (2C) Nothing in subsection (2A) or (2B) is to be read as limiting the scope of subsection (1)."

245. These powers are further supported and enhanced by s112A:

> "(1) Subsection (2) applies where (apart from that subsection) a person would be entitled, in consequence of anything done or likely to be done by or under this Part with an insurance business transfer scheme, a banking business transfer scheme or a ring-fencing transfer scheme-
>
> (a) to terminate, modify or acquire or claim an interest or right; or
> (b) to treat an interest or right as terminated or modified.
>
> (2) The entitlement-
>
> (a) is not enforceable in relation to that interest or right until after an order has been made under section 112(1) in relation to the scheme; and
>
> (b) is then enforceable in relation to that interest or right only insofar as the order contains provisions to that effect.
>
> (3) Nothing in subsection(1) or (2) is to be read as limiting the scope of section 112(1)."

246. The Court's powers to make ancillary orders under sections 112 and 112A of FSMA, which have long applied (albeit in originally less expansive form) to insurance business transfer schemes have been construed permissively. In particular, it seems clear that, in this context, "necessary" does not mean "vital", and the Court has the power to approve supplemental matters which will secure that the scheme is carried out and its full benefits conferred: and see *per* Knox J in *Re Hill Samuel Life Assurance* (unrep. 10 July 1995), which was approved by Lindsay J in *Re Norwich Union Linked Life Assurance Ltd* [2004] EWHC 2802.

247. Further, and as noted by Lindsay J in the latter case, there is nothing in the relevant provisions to confine the content of the scheme itself: and so there is no clear dividing line between that which falls within the business transfer scheme (and is sanctioned by an order under section 111) and that which is incidental, consequential and supplementary to the scheme (and which needs to be authorised under section 112(1)(d)). Lindsay J makes this point in the context of an insurance business transfer scheme in *Re Norwich Union Linked Life Assurance Ltd* [2004] EWHC 2802, para 11:

> "For my part, I would thus start from a position in which it is no necessary requirement of an IBTS that, whilst effecting a transfer of the kind provided for in s.105, it should do nothing else. Indeed, I see the line (if there is one) between that which, incidental or supplementary to or consequential upon the transfer in the scheme, may be within the scheme itself and what, at the time of the scheme or later, can only be authorised under s.112, as being unclear. This is not to say that the contents of an IBTS are boundless; its predominant purpose must be to result in one or more transfers of the described kind. Moreover, it may be (though I do not need to decide and do not decide this issue) that only such supplemental provisions can be within an IBTS as could be authorised under the more liberal view taken of what is "necessary" under s.112(2)(d). However, there are good reasons, if the proponents of a scheme from the outset see the need for a given supplemental provision, that it should be included within the scheme itself. That is what has been done in the case at hand. In that way policyholders have a four-fold protection; the supplemental provision comes within the purview of the FSA, it is reported on by the appointed Independent Expert, is explained to members and is required to obtain the sanction of the court as being "appropriate". By contrast, a subject dealt with only outside the scheme under s.112(1)(d) (but at the same time as the scheme or later), as it requires only the sanction of the court under s.112 , leaves those who might be affected by it unprotected in the other three ways. If the proponents of the scheme are in doubt as to which jurisdiction, s.111(1) or s.112(1)(d), is relevant they can, again as was done here, in effect invoke both."

248. The Chancellor expressly endorsed the *dicta* in these cases as being as applicable to ring-fencing schemes as they are to other Part VII schemes: see paragraph [118] of the *Barclays* judgment. I adopt that approach.

249. I have reviewed the provisions in the Lloyds RFTS which are included to enable the orderly transfers of business and assets and to secure that the scheme is fully and effectively carried out. For example (and see also paragraphs [67] to [95] above), I have considered the arrangements for splitting or sharing of security and guarantees under trust and like arrangements; for the transfers of Residual Assets and Liabilities; for the continuation of proceedings and the alteration of documents; for the exercise and enforcement of 'Preserved Rights'; and to give effect to Parts B and C of the Scheme. I am satisfied that all the provisions which form the operative part of the Lloyds RFTS and which are to be given effect, pursuant to its sanction, by order made under sections 112 and 112A of FSMA, properly fall within the ambit of the broad powers given to the Court.

250. In terms of the form of order required, there are two points which, given the novelty of the jurisdiction, I feel I should address. The first arises from the fact that, in the context of insurance business transfer schemes and ordinary banking business

transfers, Lindsay J's suggestion in *Re Norwich Union Linked Life Assurance Ltd* to the effect that any difficulty as to whether a provision is necessary may be overcome by inserting it in the scheme itself has resulted in a 'safety-first' approach of setting out in the scheme itself a large number of matters which might have been left to, but instead are repeated in, section 112 orders, with resulting duplication. Conscious of this, and of the detail and complexity of the Lloyds RFTS, Mr Moore proposed a more streamlined approach to the drafting of the section 112 and 112A orders, and invited the Court more simply to (a) sanction the scheme and (b) order all the terms of the scheme to take effect under or pursuant to sections 112 or 112A of FSMA. Mr Moore further recommended this course as obviating both the need to (a) write out in the Order many paragraphs of the Scheme or summarise them and risk unintended discrepancies between the terms of the order and the terms of the Scheme, or (b) the need to try and identify those provisions of the Scheme which might be considered to be incidental, consequential or supplementary, rather than properly part of the Scheme.

251. The introduction of a new aspect of an older jurisdiction is a logical point at which to review previous practice. Mr Moore also supported his streamlined approach by reference to (a) the Order made by the Chancellor in the *Barclays* case and (b) what he informed me at the hearing was the practice in Scotland in all Part VII schemes.

252. After the hearing, Mr Moore very helpfully provided me with both (a) a copy of the Chancellor's order after the *Barclays* judgment and (b) a copy of the order made by the Court of Session on 22 March 2018 when sanctioning and giving effect to the ring-fencing scheme put forward by The Royal Bank of Scotland plc and others (which had likewise most helpfully been provided to him by Mr David Sellar QC, Counsel for the applicants in that case). As Mr Moore immediately accepted, both forms of order, though less detailed than had become the norm in the context of insurance companies schemes in this Court, did contain somewhat more detail than Mr Moore's preferred very short provision.

253. As it seems to me, even though the Scheme as well as a summary is to be appended, it is helpful for orders on their face to identify, even though not with the specificity adopted in the past, the salient operative parts of the scheme which are to be given effect by ancillary order. At my invitation, Mr Moore provided a slightly extended form as follows:

> "AND IT IS ORDERED that all the terms of the Scheme shall as and from the dates and times therein provided take effect under section 112 of FSMA without further act or instrument as if each were separately set out in this Order. Without prejudice to the generality of the foregoing (1) the transfers of the Transferring Business provided for by paragraph 4 of the Scheme and the transfers of property and liabilities (as defined by ss 112(12) and (13) of FSMA respectively) provided for by paragraphs 5 and 25 of the Scheme take effect pursuant to s.112(1)(a) of FSMA and transfer and vest as provided for by s.112(3) of FSMA as a result of this Order, (2) for the purposes of s.112A(2)(b) of FSMA the terms of the Scheme shall not prevent the exercise and enforcement of any Preserved Rights as therein defined, (3) the provisions in paragraph 13 of the

> Scheme relating to the continuation of proceedings take effect pursuant to s.112(1)(c) of FSMA and (4) the provisions of Part B and C of the Scheme, to the extent not already mentioned, take effect pursuant to s.112(1)(d) of FSMA."

254. That seems to me to strike an appropriate balance, at least for the Lloyds RFTS; and the Order has been sealed with a provision in that form.

255. The second point is this: the Applicants also sought the Court's approval for attaching the Summary of the Scheme to the Order, with a view to giving any person looking at the Order in the future a relatively straightforward guide to the Scheme, which the order sanctions; but making clear (as the Summary does on its face) that the Summary should not be relied on in place of the Scheme itself.

256. Again, I understand that this course was approved by the Chancellor in the *Barclays* case; and I can appreciate that it may be helpful. I therefore approve that attachment of a summary, with the caveat identified that the summary is not a substitute for the Scheme itself and a warning must be given accordingly.

Postscript

257. After substantially completing a final draft of this judgment, I was informed by e-mail that S&P and Moody's have finalised their respective credit ratings of LBCM and have issued press releases accordingly.

258. In short: (a) S & P have finalised the credit rating of LBCM at the same level as the preliminary rating A-/ Positive/ A-2 (Long term/ Outlook/ Short –term) and (b) Moody's have finalised LBCM's credit ratings one notch higher than the provisional rating at A1/ Stable/ P-1. Fitch has not confirmed its provisional ratings, but it is has been confirmed that it is expected to do so at or around the Effective Date.

259. I do not think I need elaborate: the update (for which I am grateful) simply very slightly improves the overall rating of LBCM and to that extent confirms that this aspect of the matter presents no reason for withholding sanction.

260. As a final postscript, I should record that I was informed yesterday (2nd May 2018) that the Applicants have decided that they intend to proceed with the originally planned Effective Date of 28th May 2018. In the event, therefore, it will not be necessary for the Applicants to take advantage of the provision in the Order allowing for a later Effective Date of 16th July 2018.