

# **The Scottish and Northern Ireland Banknotes Regulations 2009:** a consultation on secondary legislation

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June 2009



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The Scottish and  
Northern Ireland Banknotes  
Regulations 2009:  
a consultation on  
secondary legislation

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# 1

## Introduction

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- 1.1** The issuance of national banknotes is usually a monopoly of the central bank, which in the United Kingdom is the Bank of England. The United Kingdom is highly unusual in permitting a limited number of commercial banks to issue their own banknotes.
- 1.2** This right to issue was set out in the Bank Notes (Scotland) Act 1845, the Bankers (Ireland) Act 1845, and the Bankers (Northern Ireland) Act 1928. Once implemented, Part 6 of the Banking Act 2009 will repeal and replace certain provisions of these previous Acts.
- 1.3** The Bank Charter Act 1844 prohibited any new banks in England and Wales from issuing banknotes and barred existing note-issuing banks from expanding their issue. The 1845 legislation in Scotland and Ireland made similar provision in respect of banks in those nations, but allowed certified issuers to expand their issue subject to meeting certain conditions. At that time, a total of 21 banks applied to become certified to continue issuing banknotes in Scotland and Ireland.
- 1.4** That number has reduced over time through mergers, insolvency, or by banks choosing to stop issuing – to a total of seven issuing banks. The banks currently authorised to issue banknotes in Scotland are: Bank of Scotland; Clydesdale Bank; and The Royal Bank of Scotland. The banks currently authorised to issue banknotes in Northern Ireland are: Bank of Ireland; AIB Group (UK), trading as First Trust Bank; Northern Bank; and Ulster Bank.
- 1.5** There are currently approximately £3.2 billion Scottish notes and £1.7 billion Northern Ireland notes in circulation. In comparison, there are approximately £46 billion Bank of England banknotes in circulation.
- 1.6** The Government is committed to maintaining the long-standing tradition of commercial banknote issuance in Scotland and Northern Ireland, and is not seeking to discourage the authorised commercial issuers of banknotes from continuing with this practice.

### The Banking Act 2009

- 1.7** HM Treasury consulted on the arrangements concerning the commercial issuance of banknotes in Scotland and Northern Ireland in July 2005 (“Banknote issue arrangements in Scotland and Northern Ireland: a consultation document”) and in January and July 2008 (“Financial stability and depositor protection: strengthening the framework” and “Financial stability and depositor protection: further consultation”).
- 1.8** Following dialogue with the authorised banks and other stakeholders, the Government brought forward legislation within the Banking Bill 2008 to introduce a framework to provide enhanced protection for holders of Scottish and Northern Ireland banknotes, and to update, modernise and strengthen the regime for commercial note issue, which dates back over 160 years.
- 1.9** The Banking Bill was introduced in the House of Commons on 7<sup>th</sup> October 2008, had its first reading in the House of Lords on 17<sup>th</sup> December 2008 and received Royal Assent as the Banking Act 2009 on 12<sup>th</sup> February 2009.

**1.10** The seven commercial banks that are currently authorised to issue banknotes will continue to be authorised to do so with the commencement of Part 6, provided that:

- their issuing rights are not terminated by the Treasury under the provisions of this Part,
- they remain solvent; and
- they retain permission to accept deposits under Part 4 of the Financial Services and Markets Act 2000.

**1.11** The Government's aim is to ensure that holders of Scottish and Northern Ireland banknotes have a level of protection similar to that of holders of Bank of England notes, and, in the event of an authorised bank failing, can expect to obtain full face value for their notes. This is an important part of the Government's commitment to protecting consumers.

## Summary of the framework

**1.12** The framework governing the issue of Scottish and Northern Ireland banknotes is set out in primary legislation.

**1.13** The detail is to be set out in banknote regulations and banknote rules. This is because it is necessary to provide the authorities with the appropriate flexibility to make detailed provision as appropriate, depending on criteria such as Parliamentary scrutiny and the ability to make changes quickly.

**1.14** The regulations are subject to the affirmative resolution procedure which ensures Parliamentary scrutiny at that level. Banknote rules may only make provision where required or permitted to do so by the banknote regulations. There will be no duplication of provision in the banknote regulations and rules, just further provision as is necessary. The banknote regulations and rules will complement each other accordingly.

**1.15** It is important for the Bank of England to have additional freedom – within the remit of the regulations approved by Parliament – to make and modify detailed banknote rules adaptable to changing or particular circumstances and to capture operational detail.

**1.16** The key features of the new regime are:

- the authorised banks will have to hold certain assets ('backing assets') to at least match the value of their banknotes in circulation and with the potential to enter circulation at all times;
- no less than 60 per cent of the value of banknotes in circulation must be backed by current Bank of England banknotes and/or current UK coin;
- the remaining value of banknotes in circulation and the value of banknotes with the potential to enter circulation (for example, in bank branch tills, ATMs and in transit) must be backed by an equivalent amount, which may take the form of funds held in a segregated interest-bearing account at the Bank of England, remunerated at Bank Rate<sup>1</sup>; and
- backing assets will be ring-fenced for the benefit of noteholders to protect them in the event of an issuing bank failing.

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<sup>1</sup> Interest shall be calculated on a daily basis at the rate paid on commercial bank reserves at the Bank of England.

## Consultation

**1.17** The proposal to protect noteholders would involve a change in their relative status, in the event of the insolvency of the issuing bank, compared with other creditors. This consultation exercise is intended to assist the Treasury in finalising the most appropriate way of achieving the policy aim.

**1.18** A number of issues and questions on which the Government would welcome views are highlighted throughout this document. You should not confine your response to the questions if you wish to make further comments.

## Consultation Stage Impact Assessment

**1.19** The Government would also welcome comments on the Consultation Stage Impact Assessment (IA), which can be found in Annex B. The final IA – which will be introduced alongside the secondary legislation when it is laid before Parliament – will be developed based on the responses to this consultation exercise.

## Next steps

**1.20** The Government welcomes responses to this consultation document by 9 September 2009. More information on the consultation process and how to respond can be found at Annex A.

**1.21** Subject to consultation responses, the Government will lay the Scottish and Northern Ireland Banknotes Regulations 2009 ('the banknote regulations') before Parliament in October 2009.

**1.22** Subject to achieving Parliamentary approval, it is currently envisaged that the banknote regulations will then come into force in late 2009.



# 2

## The banknote regulations

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**2.1** Chapter 3 contains a draft of the banknote regulations, on which the Government is consulting. This chapter provides a general overview of certain key aspects of the banknote regulations. The structure of this chapter mirrors that of the regulations accordingly.

**2.2** In line with better regulation principles, this consultation will be open for 12 weeks. Subject to consultation responses, the Government will then proceed to lay draft regulations before Parliament. These regulations will be subject to the draft affirmative procedure, and therefore must be approved by both Houses of Parliament<sup>1</sup>.

### Part 1 – General

#### Interpretation

**2.3** The banknote regulations include several definitions (as also used throughout this consultation document) with broadly the following meanings:

- **the Act** means the Banking Act 2009;
- an **approved location** is a location approved by the Bank of England for the holding of backing assets;
- **backing assets** are Bank of England banknotes, current coins of the UK, or funds held in a designated account at the Bank of England;
- **Bank of England banknotes** are banknotes issued by the Bank of England;
- **excluded banknotes** are notes that the Bank of England may designate as notes that do not have to be backed;
- the term **location** can include a vehicle;
- **rules** are the banknote rules made by the Bank of England under these regulations;
- a banknote is **in circulation** from the time that it is issued by an authorised bank until the time it is returned to the bank; and
- a banknote has the **potential to enter circulation** if it is not in circulation or an excluded banknote.

### Part 2 – Banknote rules

**2.4** Under the existing legislation, regulation of commercial banknote issuance is undertaken by HM Revenue & Customs (HMRC). The institutional arrangements are no longer a good fit with the objectives of HMRC. Therefore the role of regulator of commercial banks authorised to issue banknotes will be transferred to the Bank of England in line with its existing responsibility for maintaining confidence in the value and physical integrity of the currency throughout the UK and its expertise in the area of banknote issuance.

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<sup>1</sup> More information on Parliamentary procedure can be found at [www.parliament.uk](http://www.parliament.uk)

**2.5** As set out in Chapter 1, in order to carry out its new role effectively, the Bank of England will make banknote rules, which will be largely focused on operational aspects of the new framework. This offers the flexibility and scope required to make detailed provision as required.

**2.6** Regulation 3 provides that before making rules, the Bank of England must consult the authorised banks. Rules must be approved by the Treasury and must be made in writing and be published.

**2.7** The Bank of England intends to start consultation on draft rules prior to the close of this consultation, although the rules cannot be finalised and made with the approval of the Treasury until the regulations have been made by Parliament.

## **Part 3 – Requirements as to backing assets, unissued notes and ceasing issuing notes**

### **Backing assets**

**2.8** Authorised banks are required to hold backing assets in accordance with the banknote regulations and the banknote rules.

**2.9** Regulation 4 specifies the following assets as ‘backing assets’:

- Bank of England banknotes of such denominations and series as are specified in the rules;
- current coins of the United Kingdom; and
- funds placed on deposit in sterling in an account held by the Bank of England and designated by the Bank of England for the purposes of this regulation<sup>2</sup>.

**2.10** At least 60 per cent of backing assets held in respect of an authorised bank’s banknotes in circulation must be held in Bank of England banknotes or current coins of the United Kingdom (regulation 4(3)).

**2.11** The Government’s aim in introducing this legislation is to ensure better protection for holders of Scottish and Northern Ireland banknotes. The relative holdings in different types of backing assets results in an overall revenue neutral outcome for the Exchequer. This helps to maintain the Government’s position of not seeking to discourage the practice of commercial banknote issuance in Scotland and Northern Ireland. The noteholders’ interests are not affected by the proportion of backing assets held in Bank of England banknotes or coin or in an interest-bearing account.

**2.12** Under current practice authorised banks are entitled to hold their backing assets at the Bank of England or at a limited number of their own locations. Evidence shows that they tend to hold the majority of their backing assets with the Bank of England. From a regulatory perspective, holding backing assets with the Bank of England has benefits in terms of providing increased confidence of compliance. In contrast, there may be value to authorised banks in holding at least some of the backing assets at their own approved locations.

**2.13** The new regulatory regime therefore maintains a degree of flexibility in terms of where an authorised bank may hold its backing assets. However, it does provide the Bank of England the power to impose requirements in this regard if necessary.

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<sup>2</sup> Funds held in this manner are to be remunerated at the official Bank of England rate.

2.14 Specifically, regulation 4(4) gives the Bank of England the power to limit the proportion of an authorised bank’s backing assets held either in approved locations or in current coins of the United Kingdom. The intention of these powers is to aid the Bank of England in ensuring that the holding of backing assets is in line with the intended objectives of the new legislation, and help it protect against inappropriate manipulation.

**Question 1:** Do you agree that it is appropriate for the Bank of England to be able, if necessary, to set a limit on the level of backing assets held in approved locations and on current coins of the United Kingdom that can be held as backing assets?

2.15 The rules may specify requirements with which an authorised bank must comply where it places funds in a designated ‘backing assets’ account (as specified in Regulation 4(2)(c)), such as setting standard terms and conditions. The rules may also specify requirements with which an authorised bank must comply when holding backing assets in an approved location (see Paragraph 2.31).

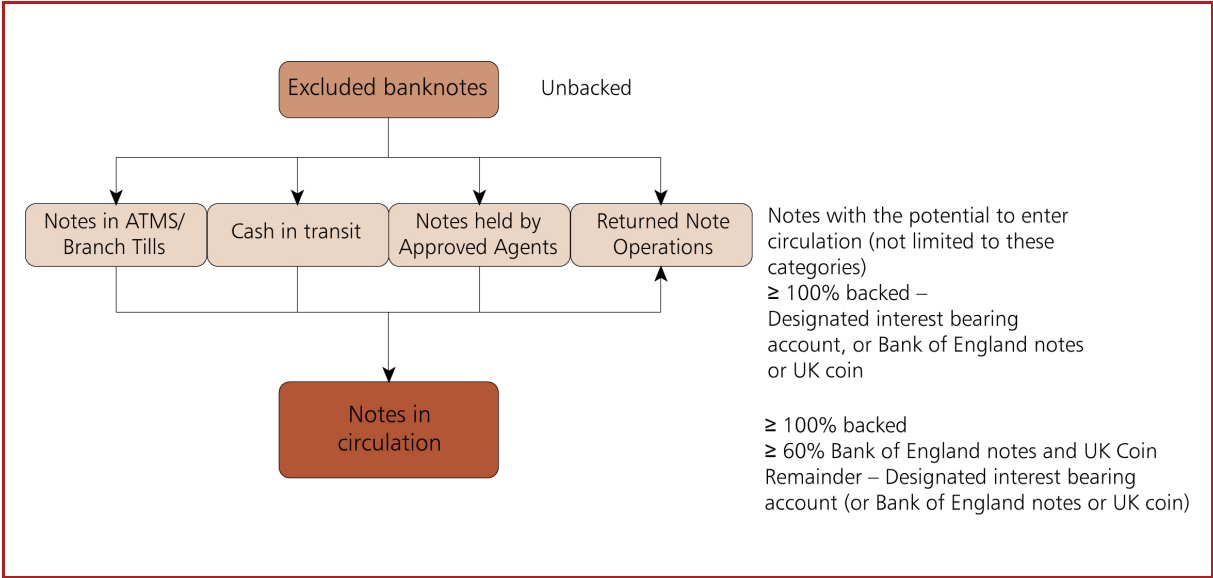
2.16 The banknote rules may also specify the procedure by which authorised banks may acquire or dispose of Bank of England banknotes and coins held as backing assets, such as prior and prompt notification to the Bank of England.

**Value of backing assets to be held by an authorised bank**

2.17 As set out in regulation 5, the banknote rules must make provision for determining the total value of the backing assets that an authorised bank must hold. It is envisaged that the rules will include provisions designed to ensure that, at any time an authorised bank has backing assets of a value not less than the combined total of its banknotes in circulation and its banknotes with the potential to enter circulation.

2.18 Figure 2.A illustrates the different backing requirements for the different categories of notes.

**Figure 2.A: Backing requirements**



## Excluded banknotes

**2.19** The Bank of England may designate certain unissued<sup>3</sup> banknotes as ‘excluded’ for the purposes of calculating the value of backing assets an authorised bank must hold. The banknote rules may specify certain requirements that must be met for a banknote to be considered an excluded note. For example, subject to meeting suitable conditions and requirements, notes held at the authorised bank’s cash centre could be excluded, as it is sufficiently unlikely that such notes will enter circulation.

**2.20** In designating ‘excluded banknotes’ for the purposes of backing requirements, the Bank of England may also impose conditions with which the notes must comply in order to be considered excluded. For example, it may be appropriate to specify requirements relating to the location and the physical conditions under which the banknotes are to be held. In some circumstances it is possible that unissued notes in highly secure transport, say between cash centres, could also be excluded.

**2.21** Excluded banknotes may remain unbacked by the issuer. However, should they in fact enter into circulation unintentionally (for example, as a result of theft) then they would immediately be required to be backed in full.

**Question 2:** Are the circumstances under which a commercial banknote may be designated as ‘excluded’ appropriate?

## Notes with the potential to enter circulation

**2.22** Unissued banknotes that are not excluded banknotes are considered to be ‘notes with the potential to enter circulation’, for example those in branch tills, in ATMs or in transit to branches and ATMs (see also Figure 2.A). When calculating the value of backing assets that an authorised bank must hold, the Bank of England will include the value of these notes. Because these notes could enter circulation at any time, it is necessary for them to be fully backed in advance in order to protect holders of Scottish and Northern Ireland banknotes as comprehensively as possible.

**2.23** Notes with the potential to enter circulation may be backed by funds in a designated interest-bearing account, or by Bank of England banknotes or current UK coin.

## Notes in circulation

**2.24** Authorised banks must fully back their notes in circulation. This refers to notes that have been issued by the authorised bank, but which have not been returned. Under section 209 of the Banking Act 2009 a note is issued when it passes **from** a person who holds it not as bearer but as a person carrying on the business of banking (“the issuing bank”) **to** a person taking it as bearer (“the bearer”).

**2.25** 60 per cent of notes in circulation must be backed by Bank of England banknotes and/or current UK coin. The balance must be backed by any permitted backing asset, including by funds in a designated interest-bearing account.

## Interest on a designated account

**2.26** Notes with the potential to enter circulation and the balance of notes in circulation that are not backed by Bank of England banknotes or current UK coin may be backed by funds held in a designated interest-bearing account. Funds must be held (in sterling) on deposit in an account

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<sup>3</sup> ‘Issue’ is defined in section 209 of the Banking Act 2009.

held by the Bank of England and designated as an account in which backing assets may be held for the purposes of these regulations.

**2.27** The Bank of England is only required to pay interest on funds held in a designated account up to the 'qualifying limit'. This qualifying limit is equal to the value of 40 per cent of an authorised bank's notes in circulation and all of its notes with the potential to enter circulation.

**2.28** There may be instances when authorised banks choose to slightly over-back their note issue to provide them with a margin of comfort that they will not inadvertently breach the banknote regulations or rules. The qualifying limit will ensure that authorised banks cannot excessively over-back their note issue to obtain any commercial advantage over non-authorised banks.

**2.29** The interest earned on funds held in this account will be calculated on a daily basis at the official Bank of England rate. The interest will be paid into the account at the end of such periods as are specified by the banknote rules.

### **Locations at which backing assets are to be held**

**2.30** Regulation 7 provides that backing assets in the form of Bank of England banknotes may be held either by the Bank of England or in an approved location. Backing assets in the form of UK coin must be held in an approved location.

### **Approval of locations subject to conditions**

**2.31** Subject to specified conditions, the Bank of England may approve a location as one in which backing assets in the form of Bank of England notes and current UK coin may be held.

**2.32** The specified conditions will depend on the circumstances of a particular location. However, by way of example, in appropriate circumstances conditions might be specified in relation to the security requirements each location must meet, the physical conditions under which backing assets are to be held within it, or the maximum value of backing assets held at that location.

**2.33** The purpose of such conditions is to ensure that the security of the approved location is adequate for the holding of backing assets, and also so that the backing assets can be robustly segregated and the quantity of the backing assets can be quickly and easily checked, by inspection and sample counting, to ensure that there is full backing at all times.

**Question 3:** Are there specific conditions or criteria that you would expect to be taken into account when approving a location?

### **Ownership of, and interests in, backing assets**

**2.34** Backing assets are the property of the authorised bank. They are held for the purpose of protecting holders of the authorised bank's banknotes.

**2.35** In order to maintain the integrity of the ring-fence around the backing assets in order to protect noteholders in the event of insolvency (see Paragraphs 2.80-2.85), no person may have any interest in or right over a backing asset except as provided in the banknote regulations. This means that, in line with the objective of noteholder protection, the backing assets will be held solely for their benefit.

### **Unissued banknotes**

**2.36** The Bank of England may specify in the banknote rules certain requirements that must be met if an authorised bank wishes its agents to hold its notes otherwise than as bearer.

**2.37** The Bank of England may approve agents subject to specified conditions and, in approving an agent, will be mindful of factors such as experience and the ability to maintain adequate security requirements.

**2.38** Whether a note is being held by a person as bearer or not directly affects whether and when it is issued and hence the backing requirements of that note – be it as a note in circulation or a note with the potential to enter circulation – which is why the Bank of England may insist on certain requirements being met.

## **Cessation of note issue**

**2.39** Section 219 of the Banking Act 2009 provides that an authorised bank that stops issuing banknotes may not resume issuing banknotes in the future.

**2.40** This reflects requirements in the current legislation. For example, under the Bankers (Ireland) Act 1845, section 13, it is unlawful for a banker who has agreed to relinquish the privilege of issuing bank notes to resume the issue of notes.

**2.41** The Government supports the tradition of commercial banknote issuance in Scotland and Northern Ireland, but this privilege should not be allowed to undermine public confidence in currency, which underpins the essence of our economy. Therefore it is appropriate that a bank cannot stop issuing banknotes on a temporary basis at its own convenience.

**2.42** Regulation 11 provides that banknote rules may specify the procedure to be followed by an authorised bank that intends to stop issuing banknotes, or which has its issuing rights terminated by the Treasury under section 223 of the Banking Act 2009, or which ceases to have permission to carry on the regulated activity of accepting deposits.

**2.43** In particular, the rules may specify: the period of notice the authorised bank must give; the arrangements that the authorised bank must make for publicising the proposed cessation of note issue, including the fact that it will only maintain backing assets for a period of two years from the date when it ceases to issue; and the arrangements the authorised bank must make for withdrawing its notes from circulation.

**2.44** These provisions give the Bank of England a degree of control over the withdrawal of the notes, in order to manage the supply of alternative notes effectively and ensure an orderly exchange of notes.

**2.45** Banknote regulations and rules may apply to an authorised bank up to two years after it stops issuing banknotes, in order to ensure that the safeguards – such as those regarding backing assets – are maintained while notes are still in issue in order to ensure that noteholders continue to be protected. After this time, the Bank of England must release any remaining backing assets to the authorised bank.

**2.46** The authorised bank will be responsible for any costs involved in withdrawing its notes from circulation after a voluntary cessation or termination of issuing rights.

**Question 4:** What notice period would be appropriate, in the event that an authorised bank wishes to cease issuing notes? Is a period of two years sufficient for banknote regulations and rules to continue to apply to authorised banks that have stopped issuing?

## Termination of right to issue

**2.47** Under section 223 of the Banking Act 2009 the Treasury may determine that an authorised bank has failed to comply with the banknote regulations or banknote rules and, having regard to the nature of the failure, may terminate the authorised bank's right to issue banknotes.

**2.48** Similarly, if an authorised bank ceases to have permission under Part 4 of the Financial Services and Markets Act 2000 to carry on regulated activities (or some other provision) then it loses the right to issue banknotes.

**2.49** Regulation 11 also applies to any authorised bank that loses its right to issue in either of these circumstances.

**2.50** The decision to terminate an authorised bank's issuing rights is only expected to be taken in the case of serious or persistent breaches of the regulations or rules. Such a decision will be taken by the Treasury in consultation with the Bank of England.

**2.51** This is a new and important power that underpins the new framework and ensures compliance with it, and underlines the seriousness with which the Authorities view these new provisions.

**Question 5:** Do you have any additional views or comments on the provisions of Part 3 of the regulations, which concerns backing assets, unissued notes and the cessation or termination of note issue?

## Part 4 – Information

### Provision of information to the Bank of England

**2.52** Regulation 12 imposes a requirement on the authorised banks to provide the Bank of England with information it may require in the course of undertaking the functions conferred on it under the banknote regulations or rules. The banknote rules may also require authorised banks to provide the Bank of England with information it needs in order to verify or monitor the authorised bank's compliance with a provision of the banknote regulations or banknote rules.

**2.53** The banknote rules may specify the period within which the information must be provided and the form that information must take.

### Reports as to banknotes and backing assets

**2.54** Regulation 13 provides that the banknote rules may require an authorised bank to provide reports to the Bank of England on: its banknotes in circulation; its banknotes with the potential to enter circulation; its excluded banknotes; banknotes that have been ordered from a printer; banknotes that have been printed or destroyed; and banknotes that are being held on behalf of the bank otherwise than as bearer (by an agent approved under regulation 10 (see Paragraphs 2.36 to 2.38)). Furthermore, the rules may require an authorised bank to provide a report to the Bank of England concerning its backing assets.

**2.55** Such reports may, among other matters, require information on the value of such notes, the location at which they are held, or the identity of the person holding them.

**2.56** The banknote rules may make provision about the frequency of any such reports, and for the reports to include an estimate of the value or description (for example a break-down by denomination and series) of the banknotes or the backing assets, or specify detail on the method by which such an estimate is obtained.

**2.57** These provisions are important as they ensure that the Bank of England may obtain the information it needs in order to be confident that the appropriate value and type of backing assets are being held.

**2.58** It is intended that authorised banks will pick a time of the week when their notes in circulation are at a peak. The authorised banks will also estimate the value of their notes with the potential to enter circulation (by deducting the value of notes in circulation and excluded notes at that time from the total value of their notes) in order to calculate the level of backing that is required to account for their entire note issue, and the proportion of that backing that must be held in Bank of England notes and coins. These weekly peak estimates are to be provided in advance, while actual values for each day of the week will be reported retrospectively, in order for the Bank of England to ensure that sufficient levels of backing assets are being maintained at all times.

## **Independent reports**

**2.59** Regulation 14 provides that the rules may require an authorised bank to provide a report by an independent auditor. This report could concern the accuracy of the information or reports provided in accordance with the banknote rules (regulations 12 and 13), or the adequacy of methods used to compile any such information or reports.

**2.60** The rules may require the authorised bank to provide a report by a skilled person on any of the information it has provided under rules made under regulations 12 and 13. A skilled person is someone nominated or approved by the Bank of England, and who the Bank of England considers to have the necessary skills to make a report on the relevant matter.

**2.61** For example, such a person might be a forensic accountant, computer specialist or other investigator, engaged specifically to determine whether, when and how physical or computer records had been tampered with.

**2.62** The Bank of England may specify either in the rules or by notice to the authorised bank the period to which the report must relate. The rules may also specify certain other requirements that must be met, such as reporting in a standard format and by a particular means.

**2.63** Among other things, this regulation provides the Bank of England with the ability to verify independently the quality of the reports provided, in order to help the Bank carry out its functions under Part 6 of the Banking Act 2009 and ensure that the new legislation is being adhered to.

## **Publication or disclosure by Bank of England of enforcement action**

**2.64** Under Regulation 15, the Bank of England may publish details of any contravention of Part 6 of the Banking Act 2009, or of any sanction taken under sections 221 to 224 of the Act (Offence: unlawful issue, Financial penalty, Termination of right to issue and Application to court).

**2.65** It is common for a regulator to have the power to publish information relating to breaches or sanctions. For example, the FSA publishes notices of financial and other penalties imposed on approved persons. Indeed, the knowledge that such information can be released can itself act as a deterrent against compliance failures and help to establish a transparent disciplinary process.

**2.66** The Bank of England will seek to ensure that any release of information in relation to this regulation will be both appropriate to and supportive of its role as a regulator.

**2.67** The Bank of England may not publish or disclose details of a financial penalty or the termination of an authorised bank's right to issue banknotes within 3 months of the decision

notice<sup>4</sup>, or, if a claim or petition for judicial review is lodged, until that claim or petition has been determined. This is meant as a safeguard against premature publication or disclosure that may adversely affect an authorised bank.

## **Permitted publication or disclosure of value of banknotes and backing assets**

**2.68** Under Regulation 16, the Bank of England may publish information on the value of banknotes each authorised bank has in circulation (including by denomination), the value of each authorised bank's notes with the potential to enter circulation, and the value of backing assets held on or behalf of each authorised bank (which may be broken down by type of backing asset).

**2.69** The publication of this information on a regular basis will reassure holders of Scottish and Northern Ireland banknotes that their notes are adequately protected and, in the event of an issuing bank entering an insolvency process, that they can expect to receive full value for money. Publication of this data is also intended to encourage compliance with the new regime.

## **Permitted publication or disclosure of information**

**2.70** Regulation 17 contains various provisions about the publication and disclosure of information other than that permitted under Regulation 16. The Bank of England (or any person obtaining the information directly or indirectly from the Bank of England, such as the Treasury or the FSA) may, in certain circumstances (as set out in Regulation 17(2)), publish or disclose information provided to the Bank of England in accordance with the rules.

**2.71** The circumstances in which such information can be published or disclosed are:

- the authorised bank has given its consent to the disclosure;
- the information has been made available to the public from another source;
- the information is in the form of a summary or collection of information so framed as not to enable information relating to a particular authorised bank to be ascertained from it;
- the disclosure is made for the purpose of enabling or assisting the Bank of England to discharge its functions under these Regulations;
- the disclosure is made with a view to the instigation of, or otherwise for the purposes of, any criminal proceedings, whether under these Regulations or otherwise;
- the disclosure is made with a view to the enforcement of any civil penalty imposed under Regulation 33;
- the disclosure is made in pursuance of any Community obligation; or
- the disclosure is made to the Treasury or the FSA, and the Bank of England considers that the disclosure would assist the Treasury or FSA in the discharge of their functions under the Financial Services and Markets Act 2000 (FSMA) or, in the case of the Treasury, under the Banking Act or these Regulations<sup>5</sup>.

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<sup>4</sup> As set out in paragraph 3 of Schedule 3 of these Regulations, or section 223(3) of the Banking Act 2009 respectively

<sup>5</sup> The Treasury or the FSA may disclose information obtained by them under this paragraph for the same purpose

**Question 6:** Are the circumstances set out in Regulation 17(2) the right circumstances in which to publish or disclose information?

## Annual report by the Bank of England

**2.72** Regulation 18 provides that the Bank of England must report on the discharge of its functions under these Regulations at least once a year, and must send a copy of any such report to the Treasury.

**2.73** This report could form part of the Bank of England's Annual Report or be a standalone report, published on its website and available in printed form on request. This is an important way of ensuring transparency and accountability by the regulator, and monitoring the effectiveness of the new legislation.

**Question 7:** Do you have any view on the most appropriate form in which the Bank of England should publish the annual report on its functions under Part 6 of the Banking Act 2009?

**Question 8:** Do you have any additional views or comments on the provisions of Part 4 of the regulations, which concerns information, reports, publication and disclosure?

## Part 5 – Insolvency

### Interpretation of Part

**2.74** Part 5 of the regulations sets out in greater detail what would happen if an authorised bank were to enter an insolvency process. This Part includes several definitions (as also used throughout this consultation document), with broadly the following meanings:

- **appointed insolvency practitioner** means an insolvency practitioner appointed in respect of an insolvent bank for the purposes of an insolvency process.
- **insolvency process** means liquidation, bank insolvency, the appointment of a provisional liquidator, the appointment of a provisional bank liquidator, administration, bank administration, the appointment of a provisional bank administrator, receivership, a composition between a bank and its creditors, a scheme of arrangement of a bank's affairs and such processes as are specified in Part 1 of Schedule 2 (Insolvency processes in the Republic of Ireland).
- **insolvent bank** means an authorised bank that has entered an insolvency process.
- **note exchange programme** means the arrangements made by the Bank of England for the purposes of exchanging an insolvent bank's notes for an equivalent value of notes, coins or funds of another bank.
- **noteholder** means a person holding banknotes of an insolvent bank.
- **protected period** means the duration of the note exchange programme.
- **noteholder's claim** is a claim by a noteholder against an insolvent bank for payment of the amount of money recorded as payable on the banknotes issued by that bank of which the noteholder is bearer.

## Notification of insolvency

**2.75** Regulation 20 makes provision that the authorised bank must notify the Bank of England without delay if the authorised bank is, or is likely to become, insolvent. This will allow the Bank of England to make the appropriate arrangements for a note exchange programme as soon as possible.

## Note exchange programme

**2.76** In broad terms (simplified for the purposes of clarity), if an authorised bank were to enter an insolvency process, a note exchange programme will be triggered, whereby holders of that authorised bank's notes are entitled to exchange them for an equivalent value from the backing assets.

**2.77** Much of the detail of the note exchange programme will be set out in the banknote rules. However, the banknote regulations set out in broad terms what the rules may contain with regard to the note exchange programme. Regulation 21 gives the Bank of England rights to enable it to effectively administer a note exchange programme.

**2.78** When a note exchange programme is triggered by an authorised bank entering an insolvency process, the Bank of England may take immediate control of the insolvent bank's backing assets. The Bank of England must then make arrangements to ensure that noteholders may exchange the banknotes giving rise to their claims for value from the backing assets.

**2.79** Depending on the circumstances at the time, the Bank of England may determine the most appropriate way to satisfy noteholders' claims. In practice, the Bank of England may enlist the assistance of other banks, building societies, or other parties, in taking in notes to enable the process to be completed as quickly and efficiently as possible.

**Question 9:** Do you have any additional views or comments on how the note exchange programme should operate to best facilitate an orderly redemption of banknotes for face value?

## Rights of noteholders

**2.80** Regulation 22 sets out the rights of noteholders in the event of an authorised bank entering an insolvency process. This is an important part of offering noteholders protection, so that, in the event of an insolvency process, they would be able to exchange the notes of the authorised bank.

**2.81** Regulation 22 states that during the protected period (that is, the duration of the note exchange programme – see also Paragraph 2.88), noteholders of the insolvent bank have the right to have that bank's backing assets applied solely for the purposes of satisfying their claims. Correspondingly, during the protected period the noteholders will have no right to claim or participate in any insolvency process in respect of their claims. This sole right to the bank's backing assets may only be exercised by taking part in a note exchange programme, and lasts only as long as the note exchange programme, after which time the noteholders become unsecured creditors of the bank.

## Backing assets

**2.82** Regulation 23 complements Regulation 22 by setting out what happens to an authorised bank's backing assets in the event of insolvency.

**2.83** When the note exchange programme is triggered, the Bank of England may issue directions with which an insolvent bank must comply in relation to its backing assets. During the

protected period (the duration of the note exchange programme), the insolvent bank's backing assets can only be used for the purpose of satisfying noteholders' claims by way of the note exchange programme, and are excluded from any insolvency process.

**2.84** After the note exchange programme has concluded, Regulations 9(1)(b) and (2) cease to apply to any remaining backing assets, which the Bank of England must return to the insolvent bank.

**2.85** Together with other regulations, this Regulation 23 helps to set out the exact purpose of backing assets in an insolvency process and ensures that they are applied for the explicit purpose of satisfying the claims of noteholders, so that they have a similar level of protection to the holders of Bank of England banknotes.

### **Note exchange programme: commencement and duration**

**2.86** Regulation 24 makes provisions about the commencement and duration of the note exchange programme.

**2.87** This includes allowing the Bank of England to determine when the note exchange programme will commence (which can only be after the authorised bank has entered an insolvency process) and ensuring that this is brought to the attention of noteholders, the insolvent bank and any appointed insolvency practitioner.

**2.88** The note exchange programme will last for one year, although the Treasury may, after consulting with the Bank of England, extend this period. The Bank of England is responsible for bringing any such extension to the attention of the noteholders, the insolvent bank and any appointed insolvency practitioner.

### **Banknotes of an insolvent bank**

**2.89** When the note exchange programme is triggered, the Bank of England has the right to take control of any unissued banknotes of the insolvent bank, for example those paid for by the authorised bank but still held by the printer. The Bank of England may issue directions in relation to these unissued banknotes, with which an insolvent bank must comply. All other claims to, or interests in, such banknotes will cease to have effect once the protected period begins, or at the end of any transitional period for a temporary continuation of note issue granted by the Bank of England under Regulation 27(1).

**2.90** Regulation 25 is necessary in order to ensure that the Bank of England may collect in and destroy an authorised bank's unissued banknotes, after it has entered an insolvency process. This will help ensure that no new notes of the authorised bank are entering circulation after the note exchange programme is triggered, thereby not prolonging or complicating this process.

### **Rules relating to a note exchange programme and destruction of banknotes**

**2.91** Regulation 26 states that the banknote rules may make provision for the implementation of a note exchange programme.

**2.92** The banknote rules may also make provision for the collection and destruction of the insolvent bank's banknotes. In particular, such provisions might specify the procedure which noteholders must follow in order to make their claims, requirements with which an insolvent bank must comply, assistance and information that an insolvent bank must provide and permissions or consents which the insolvent bank must grant to the Bank of England or a person acting on its behalf.

## Temporary continuation of note issuing

**2.93** In certain circumstances, it may be appropriate for an authorised bank temporarily to continue to issue notes for a transitional period after insolvency, or if its issuing rights are terminated. For example, this could be in order to facilitate the note-exchange programme, or to help effectively manage the operation of an insolvency process, or to meet one of the objectives of the Special Resolution Regime.

**2.94** Under regulation 27, the Bank of England may in such cases, and with the consent of HM Treasury, grant an authorised bank permission to continue to issue notes for a period up to six months from the date the bank loses its right to issue banknotes (either through insolvency or through losing permission to carry on the regulated activity of accepting deposits). The Bank of England may grant permission before or after the authorised bank loses the right to rely on section 213 (Saving for existing issuers) of the Banking Act 2009. During this transitional period the total of the authorised bank's banknotes in circulation and with the potential to enter circulation must not exceed the value of backing assets held.

**2.95** Permission to issue banknotes for a transitional period may be made subject to specified conditions, and with reasonable notice, the Bank of England may withdraw such approval or amend the conditions to which approval is subject.

**Question 10** Is six months an appropriate limit for the temporary continuation of note issuance?

## Notes issued after loss of note issuing rights

**2.96** Regulation 28 ensures that holders of banknotes issued after an authorised bank loses its authorisation through insolvency or by losing permission to carry on the regulated activity of accepting deposits are still able to exchange those notes for value. This addresses the situation where, for example, ATMs are still dispensing notes to customers on demand immediately after authorisation has been removed but members of the public may not yet be aware of that fact. As these notes would have been classified as having the potential to enter circulation, they would still have been fully backed, and therefore noteholders will still be able to satisfy their claims in respect of notes inadvertently issued after an authorised bank loses its authorisation.

## Modification of law of insolvency

**2.97** While not yet complete, Schedule 1 will set out the detail of modifications to insolvency law that are necessary in order to ring-fence the backing assets.

## Processes serving a similar purpose to insolvency and insolvency law

**2.98** As a historic consequence of the current legislation pre-dating the partition of Ireland, one authorised bank is incorporated in the Republic of Ireland. Part 1 of Schedule 2 sets out a draft of the insolvency processes in Republic of Ireland that are equivalent to those set out in section 217(6) of the Banking Act 2009 (see also Box 2.A).

## Foreign laws of similar purpose to Part 4 of the Financial Services and Markets Act 2000

**2.99** Similarly, Part 2 of Schedule 2 sets out the equivalent in the Republic of Ireland to Part 4 of the Financial Services and Markets Act 2000, as referred to in section 223(6) of the Banking Act 2009.

**Question 11:** Do you have any additional views or comments on the provisions of Part 5 of the regulations, which concerns the note exchange programme and insolvency?

## Part 6 – Enforcement

### Court orders

**2.100** The Bank of England may apply to the High Court or Court of Session for relief in respect of failure to comply with the banknote regulations or rules, or an order designed to ensure, or facilitate monitoring of, compliance with a provision of the regulations or rules.

### Penalties

**2.101** Other than the public censure penalty described above, the Bank of England may also impose a financial penalty of such amount as is reasonable on an authorised bank that fails to comply with any provision of the banknote regulations or rules.

**2.102** This is an important enforcement tool to help ensure compliance with regulations and rules that are necessary to offer noteholders protection.

**2.103** The existing offences in the 1845 legislation giving rise to financial penalties will be carried over into this new legislation through the rules and conditions.

**2.104** The banknote rules will contain further details of the penalty regime. Further detail on the process leading up to the imposition of penalties is set out in Schedule 3 of the banknote regulations.

**Question 12:** Do you have any additional views or comments on the provisions of Part 6 of the regulations, which concern enforcement?

## Schedule 1 – Modifications to the law of insolvency

**2.105** In the finished regulations, this schedule will contain modifications to the law of insolvency in the UK, which are required to ensure the backing assets are properly ring-fenced.

**Question 13:** Do you have any views on other modifications that should be included as part of Schedule 1 – Modifications to the law of insolvency?

## Schedule 2 – Similar processes and laws in the Republic of Ireland

**2.106** As noted above, one of the issuing banks is incorporated in the Republic of Ireland. In the finished regulations, this schedule will contain a full list of those processes and laws in the Republic of Ireland that equate to equivalent insolvency processes and Part 4 of the Financial Services and Markets Act 2000.

**Question 14:** Do you have any views on other modifications that should be included as part of Schedule 2 – Similar processes and laws in the Republic of Ireland?

## Schedule 3 – Imposition of penalties

### Notice of proposal

**2.107** Before imposing a financial penalty, the Bank of England must give a written notice to the authorised bank, stating that it intends to impose the penalty, the amount of penalty, the details of the regulations or rules that it considers to have been breached, what constitutes the breach (and any other facts that justify the imposition and amount of the penalty), and the date by which it must be paid.

**2.108** The Bank of England must give the authorised bank 21 days from the date on which the notice is received to make representations regarding the proposed penalty (including on factors relevant to mitigation where the breaches are admitted), and must consider any representations made to it. A penalty notice may only be issued within two years of the Bank of England first having knowledge of the breach.

### Variation of proposal

**2.109** It is possible that, as more information comes to light, or after considering representations made, the Bank of England may consider it appropriate to revise its original penalty.

**2.110** The Bank of England may only vary a proposed penalty if the authorised bank consents, if it is to reduce the amount of the penalty or defer the date by which it may be paid, or if the Bank of England gives written notice setting out the variation and reasons for it.

**2.111** If the Bank of England gives such a written notice, that notice must also specify the period (not less than 21 days) within which the authorised bank may make representations regarding the proposed variation. The Bank of England must consider any such representations made.

### Decision notice

**2.112** Under Paragraph 3, the Bank of England must give a written decision notice to the authorised bank as soon as is reasonably practicable after imposing the penalty. The written decision notice must specify that the Bank of England has imposed a penalty and the amount of that penalty, the details of the regulations or rules that it considers to have been breached, what constitutes the breach (and any other facts that justify the imposition and amount of the penalty), and the manner in which the Bank of England requires the penalty to be paid.

**2.113** The decision notice must also state the date by which the penalty must be paid, which cannot be less than three months from the date on which the notice is received. This is to allow the authorised banks time to challenge the decision by judicial review.

### Maximum penalty

**2.114** Note issue is a small part of authorised banks' overall operations. However, its operation in line with the regulatory framework is important both for consumer confidence and ensuring that banknotes continue to play an effective role in the economy. Any infraction of the regulations or rules relating to note issue should carry a penalty directly relevant to that part of the authorised bank's business. Therefore the regulations state that the maximum amount of a penalty in a given calendar year, either for a single breach or cumulatively, is 10 per cent of the average value of the authorised bank's banknotes in circulation over the previous calendar year. If an authorised bank were to be found guilty of serious or persistent breaches this might be grounds for withdrawal of the right to issue by HM Treasury.

**2.115** It is important that any financial penalty that is imposed is effective as a deterrent against non-compliance with the banknote regulations or rules, yet still reasonable given the circumstances. By setting a maximum limit, relative to the authorised bank's notes in circulation, Parliament will have some confidence that any penalty the Bank of England decides to impose will not be unduly onerous to the authorised bank, while still serving as an effective sanction.

## Statement of policy on penalties

**2.116** The Bank of England will issue a published statement of policy as a component of the banknote rules in respect of the amount or type of penalty it may impose and its policy on mitigation. The statement will distinguish between penalties for under-backing and those for other breaches.

**2.117** Because each authorised bank (with one exception) is also regulated by the FSA, the Bank of England's penalty policy will also take into account and be consistent with the FSA's current statement of policy<sup>6</sup>, particularly in relation to the form and content of the penalty notices envisaged by the draft Schedule 3 to the Regulations.

**Question 15:** Is this broad approach to establishing a penalty policy appropriate? The Government would welcome additional comments or views on the principles set out in Paragraphs 2.107 to 2.117.

**Question 16:** The Government would welcome any additional views or comments that you feel are appropriate in order to finalise the banknote regulations.

## Conclusion

**2.118** As stated above, the Government is committed to maintaining the long-standing tradition of commercial banknote issuance in Scotland and Northern Ireland, and is not seeking to discourage the authorised commercial issuers of banknotes from continuing with this practice.

**2.119** The Government believes that these regulations meet the intended objective of strengthening noteholder protection through a framework that enhances protection for holders of Scottish and Northern Ireland banknotes. Together with the banknote rules, the regulations update, modernise and strengthen the regime for commercial note issue, which dates back over 160 years.

**2.120** The Bank of England intends to start consultation on draft rules prior to the close of this consultation.

**2.121** A copy of the draft regulations can be found in Chapter 3. Chapter 4 contains a list of all the questions found throughout this consultation document, although respondents should not feel limited to putting forward their views solely on the specific questions raised. Annex A contains further details on how to respond to this consultation. A Consultation Stage Impact Assessment can be found in Annex B, on which the Government would also welcome responses.

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<sup>6</sup> Part 6 of the Decision Procedure and Penalties Manual <http://fsahandbook.info/FSA/html/handbook/DEPP>

# 3

## The banknote regulations: draft

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DRAFT STATUTORY INSTRUMENTS

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**2009 No.**

**BANKS AND BANKING**

**Scottish and Northern Ireland Banknotes Regulations 2009**

*Made* - - - - [ ]

*Coming into force* - - [ ]

The Treasury make these Regulations in exercise of the powers conferred by sections 208 to 210, 215 to 220, 222 to 224, 226 and 259(1) of the Banking Act 2009(a).

**PART 1**

**General**

**Citation and commencement**

1. These Regulations may be cited as the Scottish and Northern Ireland Banknotes Regulations 2009 and shall come into force on [ ] November 2009.

**Interpretation**

2.—(1) In these Regulations—

“the Act” means the Banking Act 2009;

“approved location” is a location approved by the Bank of England under regulation 7(1)(b) or (2);

“backing assets” has the meaning given by regulation 4(2);

“Bank of England banknotes” means banknotes issued by the Bank of England;

“excluded banknote” has the meaning given by regulation 5(3);

“location” includes a vehicle;

“rules” means rules made by the Bank of England under these Regulations.

(2) For the purposes of these Regulations—

(a) a banknote is in circulation from the time that it is issued by an authorised bank until the time that it is returned to the bank;

(b) a banknote has the potential to enter circulation if the banknote is not—

(i) in circulation; or

- (ii) an excluded banknote.
- (c) a reference to the value of a banknote is a reference to the face value of that note.

## PART 2

### Banknote rules

#### Rules

3.—(1) The Bank of England may, subject to the provisions of these Regulations, make rules about any aspect of the treatment, holding or issuing of banknotes by authorised banks.

(2) The Bank of England must make rules in respect of the matters referred to in regulations 4(2)(a), 5(1), 6(4)(b) and 11(1).

(3) Before making any rule, the Bank of England must consult such authorised banks as are or may be affected by the proposed rule.

(4) Rules (including any rule amending or revoking a rule) may only be made with the approval of the Treasury.

(5) Rules must be made in writing and published by the Bank of England.

## PART 3

### Requirements as to backing assets, unissued notes and ceasing issuing notes

#### Backing assets

4.—(1) An authorised bank must have backing assets in accordance with these Regulations and the rules.

(2) The following kinds of assets are specified as backing assets—

- (a) Bank of England banknotes of such denominations and series as are specified in the rules;
- (b) current coins of the United Kingdom; and
- (c) funds placed on deposit in sterling in an account held by the Bank of England and designated by the Bank of England for the purposes of this regulation.

(3) At least 60% of a bank's backing assets which are held by a bank in respect of its banknotes in circulation must consist of assets of the kinds specified in paragraph (2)(a) and (b).

(4) The rules may prohibit an authorised bank from maintaining more than a specified proportion of its backing assets—

- (a) in approved locations; or
- (b) in the form of current coins of the United Kingdom.

(5) The rules may specify requirements with which an authorised bank must comply where it—

- (a) places funds on deposit in an account designated under paragraph (2)(c); or
- (b) holds backing assets in an approved location.

(6) Rules may specify the procedure by which authorised banks may acquire or dispose of Bank of England banknotes and coins held as backing assets.

#### Value of backing assets to be held by an authorised bank

5.—(1) The rules shall make provision for determining the value of backing assets which must be held by an authorised bank.

(2) Excluded banknotes are not to be taken into account for the purposes of any such determination.

(3) An excluded banknote is a banknote of an authorised bank which satisfies—

- (a) such requirements as the Bank of England may specify in the rules; and
- (b) such conditions as may be specified for the purposes of this regulation by the Bank of England in relation to the banknotes of the bank.

(4) The Bank of England may, by giving reasonable notice to an authorised bank, amend or revoke any condition relating to its banknotes.

(5) The Bank of England must consult an authorised bank before specifying a condition in relation to its banknotes under paragraph (3)(b), or amending or revoking such a condition under paragraph (4).

### **Interest on a designated account**

6.—(1) The Bank of England must pay interest to an authorised bank on the funds held by the bank in an account designated under regulation 4(2)(c).

(2) If the amount of funds held by the bank in a designated account exceeds the qualifying limit, the Bank of England shall only be required to pay interest on an amount equal to the qualifying limit.

(3) For the purposes of this regulation, the qualifying limit is an amount equal to the total of—

- (a) 40% of the value of an authorised bank's banknotes in circulation; and
- (b) the value of the bank's banknotes with the potential to enter circulation.

(4) Interest shall be—

- (a) calculated on a daily basis at the rate paid on commercial bank reserves at the Bank of England; and
- (b) credited to the account at the end of such periods as are specified in the rules.

### **Locations at which backing assets are to be held**

7.—(1) Backing assets in the form of Bank of England banknotes must be held either—

- (a) by the Bank of England; or
- (b) at one or more locations for the time being approved by the Bank of England.

(2) Backing assets in the form of coins must be held at one or more locations for the time being approved by the Bank of England.

### **Approval of locations subject to conditions**

8.—(1) The Bank of England may approve a location under regulation 7(1)(b) or (2) subject to specified conditions, including as to the maximum value of backing assets which may be held at that location.

(2) Where an authorised bank holds backing assets at an approved location, it must comply with any conditions specified by the Bank of England under paragraph (1).

(3) The Bank of England may by giving reasonable notice to an authorised bank—

- (a) withdraw its approval under regulation 7(1)(b) or (2); or
- (b) amend or revoke any condition to which the approval is subject.

(4) The Bank of England must consult such authorised banks as are or may be affected by a proposed condition to which an approval may be subject, the proposed withdrawal of its approval under paragraph (3)(a), or any proposed amendment or revocation of a condition under paragraph (3)(b).

### **Ownership of, and interests in, backing assets**

9.—(1) A bank's backing assets are—

- (a) assets of the bank; and
- (b) held for the purpose of protecting holders of banknotes of the bank in accordance with these Regulations and the rules.

(2) No person may have any interest in or right over the backing assets, except as provided in these Regulations.

### **Unissued banknotes**

10. The rules may specify requirements with which an authorised bank must comply where it authorises an agent to hold banknotes on its behalf otherwise than as bearer.

### **Cessation of note issue**

11.—(1) The rules shall set out the procedure which an authorised bank must follow if it—

- (a) intends to cease issuing banknotes; or
- (b) loses the right to rely on section 213 of the Act (saving for existing issuers) by virtue of—
  - (i) a determination by the Treasury under section 223(1)(b) of the Act (termination of right to issue); or
  - (ii) section 223(5) of the Act (bank ceasing to have permission to carry on the regulated activity of accepting deposits).

(2) Where an authorised bank stops issuing banknotes—

- (a) these Regulations and the rules shall continue to apply to the bank for a period of two years from the date on which it stops issuing banknotes; and
- (b) the Bank of England must, at the end of that period, return to the bank any of the bank's backing assets which it still holds.

(3) Rules under paragraph (1) may, in particular, specify—

- (a) in a case where an authorised bank intends to cease issuing banknotes, the period of notice which the bank must give to the Bank of England before it stops issuing banknotes;
- (b) the arrangements which an authorised bank must make for the purpose of bringing the following matters to the attention of the public—
  - (i) the proposed cessation or termination of note issue;
  - (ii) the effect of the Regulations and rules ceasing to apply after a period of two years;and
- (c) the arrangements which an authorised bank must make for the purpose of removing its banknotes from circulation.

## **PART 4**

### **Information**

#### **Provision of information to the Bank of England**

12.—(1) The rules may require authorised banks to provide the Bank of England with such information as it may reasonably require for the purpose of—

- (a) exercising its functions under these Regulations or the rules; or
- (b) verifying or monitoring a bank's compliance with a provision of these Regulations or the rules.

(2) The rules may specify the period within which, and the form in which, the information is to be provided.

(3) No person may be required by rules made under paragraph (1) to supply information that the person could not be compelled to supply in evidence in civil proceedings in the High Court or, in Scotland, in the Court of Session.

### **Reports as to banknotes and backing assets**

**13.**—(1) The rules may require an authorised bank to provide reports to the Bank of England in respect of its banknotes which—

- (a) are in circulation;
- (b) have the potential to enter circulation;
- (c) are excluded banknotes;
- (d) have been ordered from a printer;
- (e) have been printed;
- (f) have been destroyed; or
- (g) are being held on behalf of the bank otherwise than as bearer.

(2) The rules may require an authorised bank to provide reports to the Bank of England in respect of its backing assets.

(3) The rules may make provision—

- (a) for the frequency with which such reports must be provided and the period to which they must relate; and
- (b) for the reports to include an estimate of the value of any description of banknotes or backing assets, and the method by which such an estimate is to be obtained.

### **Independent reports**

**14.**—(1) The rules may require an authorised bank to provide the Bank of England with a report by an independent auditor on—

- (a) the accuracy of the information or reports provided in accordance with rules made under regulation 12 or 13; and
- (b) the adequacy of the methods used by the bank to calculate or obtain the information or compile the reports.

(2) The rules may require an authorised bank to provide the Bank of England with a report on any matter about which the Bank of England has required or may require the provision of information or a report under rules made under regulation 12 or 13.

(3) A report under paragraph (2) must be made by a person who—

- (a) is nominated or approved by the Bank of England; and
- (b) appears to the Bank of England to have the skills necessary to make a report on the matter concerned.

(4) A report under paragraph (1) or (2) must—

- (a) relate to such period as may be specified either in the rules or by notice by the Bank of England to the authorised bank; and
- (b) satisfy such other requirements as may be specified in the rules.

### **Publication or disclosure by Bank of England of enforcement action**

**15.**—(1) The Bank of England may publish or disclose details of—

- (a) anything done in contravention of Part 6 of the Act or these Regulations or the rules;

- (b) any action taken under sections 221 to 224 of the Act (which may include details of the reason for the action and its result).

(2) But the Bank of England must not publish details of any action taken under section 222 (financial penalty) or 223 of the Act—

- (a) before the end of a period of 3 months beginning with the relevant date; or
- (b) if a claim or petition for judicial review has been lodged, until that claim or petition has been determined.

(3) For the purposes of paragraph (2)(a), the relevant date is—

- (a) in a case where action has been taken under section 222 of the Act, the date when the bank receives the decision notice referred to in paragraph 3 of Schedule 3 to these Regulations;
- (b) in a case where the Treasury has determined for the purposes of section 223(1)(b) of the Act that an authorised bank should no longer be permitted to issue banknotes in reliance on section 213 of the Act, the date when the bank receives the notice referred to in section 223(3) of the Act.

### **Publication or disclosure of value of banknotes and backing assets**

16. The Bank of England may publish or disclose—

- (a) the value of an authorised bank's banknotes in circulation;
- (b) the value of an authorised bank's banknotes with the potential to enter circulation,
- (c) a breakdown of the value of the banknotes referred to in paragraph (a) or (b) by reference to the denomination of the banknotes;
- (d) the value of the backing assets held by an authorised bank;
- (e) a breakdown of the value of an authorised bank's backing assets by reference to the kinds of assets specified in regulation 4(2).

### **Permitted publication or disclosure of information**

17.—(1) Information provided to the Bank of England in accordance with the rules may be published or disclosed by—

- (a) the Bank of England, or any officer or servant of it; or
- (b) any person obtaining the information directly or indirectly from the Bank of England,

in any of the circumstances mentioned in paragraph (2).

(2) The circumstances referred to in paragraph (1) are—

- (a) the authorised bank has given its consent to the disclosure;
- (b) the information has been made available to the public from another source;
- (c) the information is in the form of a summary or collection of information so framed as not to enable information relating to a particular authorised bank to be ascertained from it;
- (d) the disclosure is made for the purpose of enabling or assisting the Bank of England to discharge its functions under these Regulations;
- (e) the disclosure is made with a view to the instigation of, or otherwise for the purposes of, any criminal proceedings;
- (f) the disclosure is made with a view to the enforcement of any civil penalty imposed under regulation 33;
- (g) the disclosure is made in pursuance of any Community obligation;
- (h) the disclosure is made to the Treasury or the Financial Services Authority, and the Bank of England considers that the disclosure would assist the Treasury or Financial Services

Authority in the discharge of their functions under the Financial Services and Markets Act 2000(a) or, in the case of the Treasury, under the Act or these Regulations.

(3) The Treasury or the Financial Services Authority may, for the purpose of assisting them in the discharge of their functions under the Financial Services and Markets Act 2000 or, in the case of the Treasury, under the Act or these Regulations, disclose information obtained by them under paragraph (2)(h).

### **Annual report by Bank of England**

**18.**—(1) At least once a year the Bank of England must publish a report on the discharge of its functions under these Regulations.

(2) The Bank of England must send a copy of each such report to the Treasury.

## **PART 5**

### **Insolvency**

#### **Interpretation**

**19.**—(1) In this Part—

“appointed insolvency practitioner” means an insolvency practitioner appointed in respect of an insolvent bank for the purposes of an insolvency process;

“insolvency process” means—

- (a) liquidation;
- (b) bank insolvency;
- (c) the appointment of a provisional liquidator;
- (d) the appointment of a provisional bank liquidator;
- (e) administration;
- (f) bank administration;
- (g) the appointment of a provisional bank administrator;
- (h) receivership;
- (i) a composition between a bank and its creditors;
- (j) a scheme of arrangement of a bank’s affairs; and
- (k) the processes specified in Part 1 of Schedule 2;

“insolvent bank” means an authorised bank which has entered an insolvency process;

“note exchange programme” means the arrangements made by the Bank of England for the purposes of regulation 21(1);

“noteholder” means a person holding banknotes of an insolvent bank;

“protected period” means the duration of the note exchange programme.

(2) In this Part, a reference to a noteholder’s claim is a reference to a claim which is—

- (a) by a noteholder against an insolvent bank; and
- (b) for the payment of the total amount of money recorded as payable on the banknotes issued by that bank of which the noteholder is bearer.

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(a) 2000 c.8.

### **Notification of insolvency**

**20.** An authorised bank must notify the Bank of England without delay if it is, or is likely to become, insolvent.

### **Note exchange programme**

**21.—**(1) The Bank of England must make arrangements in relation to an insolvent bank to ensure that—

- (a) noteholders may exchange the banknotes giving rise to their claims for an equal value of banknotes, coins or funds of such other bank as the Bank of England may specify; and
- (b) the insolvent bank's backing assets are applied for the purpose of satisfying noteholders' claims.

(2) The reference to another bank in paragraph (1)(a) includes a reference to the Bank of England.

(3) The Bank of England shall have the right, for the purpose of such arrangements, to—

- (a) take immediate control of the insolvent bank's backing assets;
- (b) exchange backing assets for other assets, and require the insolvent bank to hold those other assets as backing assets;
- (c) transfer the backing assets to noteholders in satisfaction of their claims;
- (d) satisfy the claims of noteholders with banknotes, coins or other funds belonging to the Bank of England and obtain reimbursement from the backing assets.

### **Rights of noteholders**

**22.—**(1) The noteholders in respect of an insolvent bank shall during the protected period—

- (a) have the right to have the bank's backing assets applied solely for the purpose of satisfying their claims; and
- (b) have no right to claim or participate in any insolvency process in respect of their claims.

(2) The right referred to in paragraph (1)(a) may only be exercised by a noteholder by participating in a note exchange programme.

(3) At the end of the protected period—

- (a) the right referred to in paragraph (1)(a) shall cease; and
- (b) the prohibition referred to in paragraph (1)(b) shall no longer apply to the noteholders' claims.

### **Backing assets**

**23.—**(1) After the commencement of the protected period, the Bank of England may issue directions with which an insolvent bank must comply in relation to the bank's backing assets.

(2) An insolvent bank's backing assets shall during the protected period—

- (a) be used solely for the purpose of satisfying noteholders' claims by means of the note exchange programme; and
- (b) be excluded from any insolvency process.

(3) At the end of the protected period—

- (a) regulation 9(1)(b) and (2) shall cease to apply to any remaining backing assets; and
- (b) any remaining backing assets under the control of the Bank of England shall be returned to the insolvent bank.

### **Note exchange programme: commencement and duration**

24.—(1) The Bank of England must determine the date on which a note exchange programme commences, which must be after an authorised bank has entered an insolvency process.

(2) A note exchange programme shall continue for a period of one year, or for such longer period as the Treasury may determine after consulting the Bank of England.

(3) The Bank of England must make such arrangements as it considers appropriate for ensuring that the commencement of a note exchange programme and any extension by the Treasury of its duration are brought to the attention of the noteholders, the insolvent bank and any appointed insolvency practitioner.

### **Banknotes of an insolvent bank**

25.—(1) After the commencement of the protected period—

- (a) the Bank of England shall have the right to take immediate control of the banknotes of the insolvent bank which have not been issued;
- (b) the Bank of England may issue directions with which an insolvent bank must comply in relation to its unissued banknotes.

(2) All other claims to or interests in such banknotes shall be extinguished on the commencement of the protected period or, if the Bank of England has granted the bank permission under regulation 27(1) to issue notes for a transitional period, at the end of that period.

### **Rules relating to a note exchange programme and destruction of banknotes**

26.—(1) The rules may make provision for the implementation of a note exchange programme and for the collection and destruction of an authorised bank's banknotes.

(2) In particular, the rules may specify—

- (a) the procedure which noteholders must follow in order to make their claims;
- (b) requirements with which an authorised bank must comply;
- (c) assistance and information which an authorised bank must provide; and
- (d) permissions or consents which the authorised bank must grant to the Bank of England or a person acting on its behalf.

### **Temporary continuation of note issuing**

27.—(1) The Bank of England may, with the consent of the Treasury, permit an authorised bank to issue banknotes for a transitional period of no more than six months after the bank has lost the right to rely on section 213 of the Act by virtue of section 220(5) or 223(5) of the Act.

(2) The Bank of England may grant such permission before or after the authorised bank has lost the right to rely on section 213.

(3) Where the Bank of England permits a bank to issue banknotes under paragraph (1), the total value at any time during the transitional period of the bank's banknotes in circulation and with the potential to enter circulation must not exceed the value of the bank's backing assets at that time.

(4) Permission under paragraph (1) may be made subject to specified conditions.

(5) The Bank of England may, by giving reasonable notice to the insolvent bank—

- (a) withdraw permission under paragraph (1);
- (b) amend the conditions to which the permission is subject.

### **Notes issued after loss of note issuing rights**

28.—(1) This regulation applies where any banknotes are issued by an insolvent bank—

- (a) after it loses the right to rely on section 213 of the Act by virtue of section 220(5) or 223(5) of the Act; and
  - (b) without the permission of the Bank of England under regulation 27(1).
- (2) The holders of any such banknotes may participate in a note exchange programme despite the matters referred to in paragraph (1)(a) and (b).

**Modification of law of insolvency**

29. Schedule 1, which contains modifications of the law of insolvency, has effect.

**Processes serving a similar purpose to insolvency**

30. For the purposes of section 217(6)(h) of the Act (backing assets), the processes in the Republic of Ireland set out in Part 1 of Schedule 2 serve a similar purpose to the processes listed in section 217(6)(a) to (g).

**Laws serving a similar purpose to Part 4 of the Financial Services and Markets Act 2000**

31. For the purposes of section 223(6) of the Act, the provision of the law of the Republic of Ireland referred to in Part 2 of Schedule 2 serves a similar purpose to Part 4 of the Financial Services and Markets Act 2000 (permission to carry on regulated activities).

## PART 6

### Enforcement

**Court orders**

32. The Bank of England may apply to the High Court or the Court of Session for—
- (a) relief in respect of failure to comply with these Regulations or with the rules; or
  - (b) an order designed to ensure, or facilitate monitoring of, compliance with a provision of these Regulations or the rules.

**Penalties**

33.—(1) Where the Bank of England is satisfied that an authorised bank has failed to comply with any provision of these Regulations or of the rules, it may impose a penalty on the authorised bank.

(2) Schedule 3 contains supplementary provisions in relation to the imposition of penalties under this regulation.

Date

*Signatures*  
Two of the Lords Commissioners of Her Majesty's Treasury

Modifications to the law of insolvency

**Interpretation**

1. In this Schedule, a reference to backing assets is a reference to the backing assets of an authorised bank.

**Modifications to the Insolvency Act 1986 and the Insolvency (Northern Ireland) Order 1989**

2. The provisions of the Insolvency Act 1986(a) and the Insolvency (Northern Ireland) Order 1989(b) shall apply in relation to an authorised bank—

- (a) with any reference to “property” or “asset” modified so that it does not include a reference to the backing assets during the protected period; and
- (b) with the modifications specified in the following table;

provided that sub-paragraph (a) does not apply to the reference to “assets” in section 123(3) of the Insolvency Act 1986 or article 103(2) of the Insolvency (Northern Ireland) Order 1989.

<i>Provision of Insolvency Act 1986</i>	<i>Provision of Insolvency (Northern Ireland) Order 1989</i>	<i>Subject</i>	<i>Modification</i>
Section 4	Article 17	Company Voluntary Proposal - Decision of meetings	A meeting may not approve any proposal or modification which affects— (a) the rights of the noteholders under regulations 9(1)(b) and 22(1)(a); (b) the rights of the Bank of England in relation to the backing assets; or (c) the backing assets during the protected period.
Section 42	Article 52	Receivers and managers – General Powers	A receiver may do anything necessary or expedient for the purpose of ensuring that an authorised bank complies with the directions referred to in regulation 23(1).
Section 55	N/a	Receivers (Scotland) - Powers	A receiver may do anything necessary or expedient for the purpose of ensuring that an authorised bank complies with the directions referred to in regulation 23(1).
Section 126	Article 106	Liquidation – power to stay or restrain proceedings against company	This section and article do not prevent the Bank of England from bringing or continuing any action or proceedings under or by virtue of these Regulations in relation to the backing assets.
Section 128	Article 108	Liquidation – avoidance of	This section and article do not apply to anything done by the Bank of England in relation to the

(a) 1986 c.45.

(b) S.I. 1989/2405 (N.I. 19).

		attachments	backing assets during the protected period.
Section 130(2) and (3)	Article 110(2) and (3)	Liquidation – Consequences of Winding-up order	These subsections and paragraphs do not apply to any action or proceedings brought by the Bank of England under or by virtue of these Regulations in relation to the backing assets.
Section 143	Article 121	Liquidation – General Functions	A liquidator must also ensure that an authorised bank complies with the directions referred to in regulation 23(1).
Section 144	N/a	Liquidation – custody of company’s property	The reference in this section to “things in action” does not include a reference to an account designated by the Bank of England for the purposes of regulation 4(2)(c).
Section 165	Article 140	Liquidators – Voluntary winding up	A liquidator— <ul style="list-style-type: none"> <li>(a) must also ensure that an authorised bank complies with the directions referred to in regulation 23(1); and</li> <li>(b) may do anything necessary or expedient to ensure such compliance.</li> </ul>
Sections 167	Article 142	Liquidators – Winding up by the court	A liquidator— <ul style="list-style-type: none"> <li>(a) must also ensure that an authorised bank complies with the directions referred to in regulation 23(1); and</li> <li>(b) may do anything necessary or expedient to ensure such compliance.</li> </ul>
Section 436	Article 2	Expressions used generally	The reference to “property” shall be modified in accordance with paragraph 2(a) of this Schedule.
Part III of Schedule A1(a)	Part III of Schedule A1(b)	Company Voluntary Arrangements – Effects of Moratorium	Nothing in Part III shall prevent the Bank of England from— <ul style="list-style-type: none"> <li>(a) taking any step; or</li> <li>(b) bringing or continuing an action or proceedings brought under or by virtue of these Regulations;</li> </ul> against an authorised bank in relation to its backing assets.
Paragraph 43 of Schedule B1(c)	Paragraph 44 of Schedule B1(d)	Administration – Moratorium on other legal process	This paragraph shall not prevent the Bank of England from— <ul style="list-style-type: none"> <li>(a) taking any step; or</li> <li>(b) bringing or continuing an action or proceedings brought under or by virtue of these Regulations;</li> </ul> against an authorised bank in relation to its backing assets.
Paragraph 59 of Schedule B1	Paragraph 60 of Schedule B1	Administration – General powers of administrators	An administrator may do anything necessary or expedient for the purpose of ensuring that an authorised bank complies with the directions referred to in regulation 23(1).

- (a) Schedule A1 was inserted by section 1 of, and paragraphs 1 and 4 of Schedule 1 to, the Insolvency Act 2000 (c. 39).
- (b) Schedule A1 was inserted by article 3 of, and schedule 1 to, the Insolvency (Northern Ireland) Order 2002 (S.I. 2002/3152 (N.I. 6)).
- (c) Schedule B1 was inserted by section 248(2) of, and Schedule 16 to, the Enterprise Act 2002 (c. 45).
- (d) Schedule B1 was inserted by article 3(2) of, and Schedule 1 to, the Insolvency (Northern Ireland) Order 2005 (S.I. 2005/1455 (N.I. 10)).

Paragraphs 67 and 68 of Schedule B1	Paragraphs 68 and 69 of Schedule B1	Administration – General Duties of administrators	An administrator must ensure that an authorised bank complies with the directions referred to in regulation 23(1).
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### Modifications to the Banking Act 2009

3. The provisions of the Act specified in the following table apply in relation to an authorised bank with the modifications specified in the table.

<i>Provision</i>	<i>Subject</i>	<i>Modification</i>
Section 103	Bank insolvency – General Powers, duties and effect	<p><b>1.</b> During the protected period, a bank liquidator—</p> <p>(a) must also ensure that an authorised bank complies with the directions referred to in regulation 23(1);</p> <p>(b) may do anything necessary or expedient to ensure such compliance;</p> <p>(c) may only exercise the powers conferred by this section in relation to the backing assets for the purpose of securing such compliance.</p> <p><b>2.</b> The provisions of the Insolvency Act 1986 specified in section 103 of the Banking Act 2009 apply subject to the additional modifications to those provisions specified in paragraph 2 of this Schedule.</p>
Section 104	Bank insolvency – Additional general powers	The reference to “property” shall not include a reference to the backing assets during the protected period.
Section 134	Northern Ireland	Where the Insolvency (Northern Ireland) Order 1989 is an equivalent enactment for the purposes of this section, then the Order shall apply subject to the additional modifications made to it by virtue of paragraph 2 of this Schedule.
Section 145	Bank administration – General powers, duties and effect	<p><b>1.</b> During the protected period, a bank administrator—</p> <p>(a) must ensure that the insolvent bank complies with the directions referred to in regulation 23(1);</p> <p>(b) may do anything necessary or expedient to ensure such compliance;</p> <p>(c) may only exercise the powers conferred by this section in relation to the backing assets for the purpose of securing such compliance.</p> <p><b>2.</b> The provisions of the Insolvency Act 1986 specified in section 145 of the Banking Act 2009 apply subject to the additional modifications to those provisions specified in paragraph 2 of this Schedule.</p>
Section 167	Northern Ireland	Where the Insolvency (Northern Ireland) Order 1989 is an equivalent enactment for the purposes of this section, then the Order shall apply subject to the additional modifications made to it by virtue of paragraph 2 of this Schedule.

## SCHEDULE 2

Regulations 30 and 31

### Similar processes and laws in the Republic of Ireland

#### PART 1

Schemes of arrangement  
Protection of the court  
Receivership  
Liquidation

#### PART 2

Section 7 of the Central Bank Act 1971

## SCHEDULE 3

Regulation 33(2)

### Imposition of penalties

#### **Notice of proposal**

1.—(1) Before imposing a penalty under regulation 33, the Bank of England must give written notice to the authorised bank—

- (a) stating that it proposes to impose the penalty and the amount of the proposed penalty;
- (b) setting out the provision of the Regulations or rules which the Bank of England considers has been breached;
- (c) specifying the acts or omissions which, in the Bank of England's opinion, constitute the breach and any other facts which, in the Bank of England's opinion, justify the imposition of the penalty and its amount;
- (d) specifying the date by which the Bank of England proposes to require the penalty to be paid to it;
- (e) specifying the period (of not less than 21 days from the date on which the notice is received by the authorised bank) within which the authorised bank may make representations regarding the proposed penalty.

(2) The Bank of England must not give notice under sub-paragraph (1) in respect of a contravention of a provision of these Regulations or rules more than two years after the Bank of England first had knowledge of the facts giving rise to the breach.

(3) The Bank of England must consider any representations made during the period mentioned in sub-paragraph (1)(e).

#### **Variation of proposal**

2.—(1) The Bank of England may vary a proposal to impose a penalty only if—

- (a) the authorised bank consents to the variation,
- (b) the variation consists of a reduction in the amount of the proposed penalty or a deferral of the date by which the Bank of England proposes to require the penalty to be paid, or

(c) the Bank of England gives written notice to the authorised bank setting out the proposed variation and the reasons for it.

(2) Where the Bank of England gives notice under sub-paragraph (1)(c), the notice must also specify the period (of not less than 21 days from the date the notice is received by the authorised bank) within which the authorised bank may make representations regarding the proposed variation.

(3) The Bank of England must consider any representations made during the period mentioned in sub-paragraph (2).

### **Decision notice**

**3.**—(1) As soon as practicable after imposing a penalty, the Bank of England must give written notice to the authorised bank—

- (a) stating that it has imposed the penalty and the amount of the penalty;
- (b) setting out the provision of the Regulations or rules which the Bank of England is satisfied has been breached;
- (c) specifying the acts or omissions which, in the Bank of England’s opinion, constitute the breach and any other facts which, in the Bank of England’s opinion, justify the imposition of the penalty and its amount;
- (d) specifying the manner in which, and the date by which, the Bank of England requires the penalty to be paid.

(2) The date mentioned in sub-paragraph (1)(d) shall be at least 3 months after the date on which the notice is received by the authorised bank.

### **Maximum penalty**

**4.** The total amount of the penalties imposed on an authorised bank by the Bank of England in a calendar year must not exceed 10% of the average value of the bank’s banknotes in circulation in the previous calendar year.

### **Statement of policy on penalties**

**5.** The Bank of England must publish a statement of policy in respect of the amount of a penalty which may be imposed under these Regulations.

### **Service of notices**

**6.**—(1) The Bank of England may send a notice to the authorised bank by post.

(2) Where the Bank of England has sent a notice by pre-paid post to the registered office of the authorised bank, it shall be deemed to have been received by the bank on the second business day after posting.

## **EXPLANATORY NOTE**

*(This note is not part of the Regulations)*

# 4

## List of questions

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The Government would welcome views on the following questions:

### Part 3 – Requirements as to backing assets, unissued notes and ceasing issuing notes

Question 1: Do you agree that it is appropriate for the Bank of England to be able, if necessary, to set a limit on the level of backing assets held in approved locations and on current coins of the United Kingdom that can be held as backing assets?

Question 2: Are the circumstances under which a commercial banknote may be designated as 'excluded' appropriate?

Question 3: Are there specific conditions or criteria that you would expect to be taken into account when approving a location?

Question 4: What notice period would be appropriate, in the event that an authorised bank wishes to cease issuing notes? Is a period of two years sufficient for banknote regulations and rules to continue to apply to authorised banks that have stopped issuing?

Question 5: Do you have any additional views or comments on the provisions of Part 3 of the regulations, which concerns backing assets, unissued notes and the cessation or termination of note issue?

### Part 4 – Information

Question 6: Are the circumstances set out in Regulation 17(2) the right circumstances in which to publish or disclose information?

Question 7: Do you have any view on the most appropriate form in which the Bank of England should publish its annual report on its functions under Part 6 of the Banking Act 2009?

Question 8: Do you have any additional views or comments on the provisions of Part 4 of the regulations, which concerns information, reports, publication and disclosure?

### Part 5 – Insolvency

Question 9: Do you have any additional views or comments on how the note exchange programme should operate to best facilitate an orderly redemption of banknotes for face value?

Question 10: Is six months an appropriate limit for the temporary continuation of note issuance?

Question 11: Do you have any additional views or comments on the provisions of Part 5 of the regulations, which concerns the note exchange programme and insolvency?

### Part 6 – Enforcement

Question 12: Do you have any additional views or comments on the provisions of Part 6 of

the regulations, which concern enforcement?

### **Schedules**

Question 13: Do you have any views on other modifications that should be included as part of Schedule 1 – Modifications to the law of insolvency?

Question 14: Do you have any views on other modifications that should be included as part of Schedule 2 – Similar processes and laws in Republic of Ireland?

Question 15: Is this broad approach to establishing a penalty policy appropriate? The Government would welcome additional comments or views on the principles set out in Paragraphs 2.107 to 2.117.

### **General**

Question 16: The Government would welcome any additional views or comments that you feel are appropriate in order to finalise the banknote regulations.

### **Consultation Stage Impact Assessment**

Question 17: Do you have any additional views (supported by evidence, where possible) on the assumptions made in calculating these costs or on any other costs and/or benefits that should be taken into account for the purposes of this impact assessment?

Question 18: Do you have any views or additional comments on the assumptions made in this Impact Assessment?



# The consultation process

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## How to respond

**A.1** The Government welcomes comments on the questions posed in this consultation paper. Any comments should be sent to:

Sarah Gannaway  
Banknote Regulations Consultation  
3/E2 HM Treasury  
1 Horse Guards Road  
London  
SW1A 2HQ

Email: [sarah.gannaway@hm-treasury.gov.uk](mailto:sarah.gannaway@hm-treasury.gov.uk)

**A.2** Comments should be received by 9 September 2009.

## Confidentiality disclosure

**A.3** Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

**A.4** If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, among other things, with obligations of confidence. In view of this, it would be helpful if you could explain why you regard the information that you provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances.

**A.5** In the case of electronic responses, general confidentiality disclaimers that often appear at the bottom of emails will be disregarded unless an explicit request for confidentiality is made in the body of the response.

## Code of practice for written consultation

**A.6** This consultation process is being conducted in line with the Code of Practice for written consultation ([www.cabinetoffice.gov.uk/regulation/code.htm](http://www.cabinetoffice.gov.uk/regulation/code.htm)) which sets down the following criteria:

- consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy;
- be clear about what your proposals are, who may be affected, what questions are being asked and the timescale for responses;
- ensure that your consultation is clear, concise and widely accessible;

- give feedback regarding the responses received and how the consultation process influenced the policy;
- monitor your Department's effectiveness and consultation, including through the use of a designated Consultation Co-ordinator; and
- ensure your consultation follows better regulation best practice, including carrying out a Regulatory Impact Assessment if appropriate.

**A.7** If you feel that this consultation does not fulfil these criteria, please contact:

Angela Carden  
HM Treasury  
1 Horse Guards Road  
London  
SW1A 2HQ

Email: [angela.carden@hm-treasury.gov.uk](mailto:angela.carden@hm-treasury.gov.uk)

# B

## Consultation Stage Impact Assessment

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## Summary: Intervention & Options

<b>Department /Agency:</b> <b>HM Treasury</b>	<b>Title:</b> <b>Impact Assessment of The Scottish and Northern Ireland Banknotes Regulations 2009</b>	
<b>Stage:</b> Consultation stage	<b>Version:</b> CON/01	<b>Date:</b> 17 June 2009
<b>Related Publications:</b> Banknote issue arrangements in Scotland and Northern Ireland (July 2005), Financial stability and depositor protection (Jan and July 2008)		

**Available to view or download at:**

[http://www.hm-treasury.gov.uk/consult\\_liveindex.htm](http://www.hm-treasury.gov.uk/consult_liveindex.htm)

**Contact for enquiries:** [sarah.gannaway@hm-treasury.gov.uk](mailto:sarah.gannaway@hm-treasury.gov.uk)

**Telephone:** 020 7270 6273

**What is the problem under consideration? Why is government intervention necessary?**

Longstanding primary legislation regulating commercial banknote issuance in Scotland and Northern Ireland does not provide sufficient protection for the holders of such banknotes should an issuing bank fail. Part 6 of the Banking Act 2009, and the secondary legislation considered here, are seeking to modernise the arrangements underpinning commercial banknote issuance in Scotland and Northern Ireland. The overall aim is to ensure that holders of Scottish and Northern Ireland banknotes have a level of protection similar to that of holders of Bank of England notes, and, in the event of an issuing bank failing, can expect to obtain full face value for their notes.

**What are the policy objectives and the intended effects?**

The overall aim is to ensure that holders of Scottish and Northern Ireland banknotes have a level of protection similar to that of holders of Bank of England notes. The framework is set out in the Banking Act 2009 while the detail is to be captured in these banknote regulations. These regulations cover a variety of provisions but the principle objective is to ensure noteholder protection through the holding of sufficient backing assets at all times, and ring-fencing those backing assets in the event of insolvency. Accompanying powers are given to the Bank of England (the Bank) to monitor compliance and impose sanctions if necessary. The intended effect will be to strengthen underlying confidence in these notes as noteholders will have more robust protection.

**What policy options have been considered? Please justify any preferred option.**

These regulations form part of the legislative framework to be enacted under Part 6 of the Banking Act 2009. The Government has previously consulted on these arrangements (see related publications above). In doing so it considered alternative policy options, such as maintaining the status quo and securing a voluntary agreement between note issuers. Alternative options were discounted in the process of consultation and these regulations reflect the preferred option. A legislative option provides more robust protection for noteholders if a note issuing bank were to fail.

**When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?** Government will work closely with the Bank of England and the note issuing banks to ensure that the legislation achieves its intended effect. The Bank will publish an annual report on the performance of the new arrangements.

**Ministerial Sign-off** For consultation stage Impact Assessments:

*I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) the benefits justify the costs.*

Signed by the responsible Minister:



.....Date: 10 June 2009

## Summary: Analysis & Evidence

<b>Policy Option:</b>	<b>Description:</b>
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<b>COSTS</b>	<b>ANNUAL COSTS</b>		Description and scale of <b>key monetised costs</b> by 'main affected groups' These arrangements affect the 7 issuing banks, and the Bank of England as regulator. The main costs arise from stronger reporting requirements for the note issuers and the regulatory costs of the Bank to check compliance.
	<b>One-off</b> (Transition)	<b>Yrs</b>	
	£ 0.6m (approx)	1	
	<b>Average Annual Cost</b> (excluding one-off)		
	£ 0.6m (approx)		
<b>Total Cost (PV)</b>			£ 5.59m approx
Other <b>key non-monetised costs</b> by 'main affected groups'			

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>		Description and scale of <b>key monetised benefits</b> by 'main affected groups' These proposals are estimated to be revenue neutral in terms of seigniorage income for the Exchequer. There are small administrative benefits to HMRC as it will cease a minor reporting function.
	<b>One-off</b>	<b>Yrs</b>	
	£ 0		
	<b>Average Annual Benefit</b> (excluding one-off)		
	£ 0.001m		
<b>Total Benefit (PV)</b>			£ 0.009m approx
Other <b>key non-monetised benefits</b> by 'main affected groups' The main benefit is the improved level of protection that holders of Scottish and Northern Ireland banknotes will have in the event of an issuing bank failing and, if it should happen, that they can expect to obtain full face value for their notes. This improved protection also supports overall confidence in UK currency.			

**Key Assumptions/Sensitivities/Risks** These arrangements will be ongoing but a 10 year timeframe has been assumed for the cost/benefit calculation. The discount rate used is 3.5%. It is not possible to quantify the benefits associated with improved noteholder protection or the improved confidence in UK currency. However, while considered unlikely, the economic costs of a loss of confidence in the currency would likely far outweigh the costs quoted above.

Price Base Year 2009	Time Period Years 10	<b>Net Benefit Range</b> (NPV) £	<b>NET BENEFIT</b> (NPV Best estimate) £ -5.58m approx
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What is the geographic coverage of the policy/option?		UK (mainly S&NI)		
On what date will the policy be implemented?		Q4 2009		
Which organisation(s) will enforce the policy?		Bank of England		
What is the total annual cost of enforcement for these organisations?		£ 0.5m approx		
Does enforcement comply with Hampton principles?		Yes		
Will implementation go beyond minimum EU requirements?		N/A		
What is the value of the proposed offsetting measure per year?		£ N/A		
What is the value of changes in greenhouse gas emissions?		£ N/A		
Will the proposal have a significant impact on competition?		No		
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	No	No	N/A	N/A

<b>Impact on Admin Burdens Baseline</b> (2005 Prices)			(Increase - Decrease)
Increase of £	Decrease of £	<b>Net Impact</b>	£

Key: Annual costs and benefits: Constant Prices (Net) Present Value

## Evidence Base (for summary sheets)

[Use this space (with a recommended maximum of 30 pages) to set out the evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Ensure that the information is organised in such a way as to explain clearly the summary information on the preceding pages of this form.]

### Introduction

Banknote issuance is normally a monopoly of the central bank, which in the United Kingdom is the Bank of England. However, 7 commercial banks in Scotland and Northern Ireland have retained the right to issue their own banknotes.

In Scotland, they are: Bank of Scotland; Clydesdale Bank; and the Royal Bank of Scotland. In Northern Ireland, they are: Bank of Ireland; First Trust Bank; Northern Bank; and Ulster Bank.

There are currently approximately £3.2 billion Scottish notes and £1.7 billion Northern Ireland notes in circulation. By comparison, there are approximately £46 billion Bank of England banknotes in circulation.

The Government is committed to maintaining the long-standing tradition of commercial banknote issuance in Scotland and Northern Ireland, and is not seeking to discourage commercial issuers of banknotes from continuing with this practice.

The Government stands behind all banknotes issued by the Bank of England. Banknotes issued by commercial banks in Scotland and Northern Ireland are a liability of each of those banks. This has always been the case.

Under existing legislation, the calculation of note cover is based on average notes in circulation and the average value of note-covering assets at the close of business on each Saturday.

In practice, the interpretation of this methodology has resulted in a number of issuing banks substituting some or all of the Bank of England banknotes that they hold as backing assets over the weekend for other assets during the week.

Moreover, the precise purpose of these note-covering assets is not set out in legislation. Therefore, in the event of an issuing bank becoming insolvent, there is no provision requiring the backing assets to be ring-fenced for noteholders in order that they can be given value for their notes from the note covering assets in priority over all other creditors. As the notes themselves do not confer preferred creditor status, note holders may not, therefore, receive full value for the notes they hold, should an issuer encounter financial difficulties.

The Banking Act 2009 therefore contains provisions that strengthen and modernise arrangements underpinning commercial banknote issuance that date back almost 160 years.

The Government's aim is to ensure that holders of Scottish and Northern Ireland banknotes have a level of protection similar to that of holders of Bank of England notes, and, in the event of an issuing bank failing, can expect to obtain full face value for their notes. This is an important part of the Government's commitment to protecting consumers.

### Affected groups

The new legislation will affect the 7 commercial banks that issue banknotes in Scotland and Northern Ireland. The position of holders of Scottish and Northern Ireland banknotes, as creditors, will be affected in insolvency. The transfer of regulatory responsibility will affect HMRC and the Bank of England.

### Banknote rules

The framework governing the issue of Scottish and Northern Ireland banknotes is set out in primary legislation, while the detail of the provisions of Part 6 is to be captured in the banknote regulations and banknote rules.

This is because it is necessary to provide the authorities with the appropriate flexibility to make detailed provision as appropriate, depending on criteria such as Parliamentary scrutiny and the ability to make changes quickly.

Banknote rules may only make provision as specified in the banknote regulations. It is important for the Bank of England to have additional freedom – within the remit of the Parliament-approved regulations – to make and modify detailed banknote rules adapt to changing or particular circumstances and to capture operational detail.

## **Backing assets**

One of the main changes encapsulated within the new framework is the need for issuing banks to hold backing assets at all times equal to the value of their notes in circulation and their notes with the potential to enter circulation.

In the event of an issuing bank getting into difficulties, these backing assets will be legally ring-fenced in order to allow holders of Scottish and Northern Ireland banknotes to exchange them for value.

The level of backing assets to be held also takes account of notes with the potential to enter circulation – such as those in ATMs or branch tills – to ensure that sufficient backing assets are held to guarantee constantly fluctuating circulation and also in case of those notes entering circulation inadvertently.

As set out in regulation 4(3), backing assets representing at least 60% of the notes in circulation must consist of Bank of England banknotes and current coins of the United Kingdom. The remainder may be held in a segregated Bank of England account that shall be remunerated at Bank rate.

The net result of the new backing asset requirements – across all 7 issuing banks – is estimated to be revenue neutral in terms of seigniorage income to the Exchequer.

## **Information**

In order to ensure compliance with the new regime, the regulations make provisions about reports that the issuing banks must submit to the Bank of England. The reporting software will be run across a web-interface and therefore no new software will be required for the purposes of reporting the required information. It is estimated that there may be a one-off cost to update the issuing banks' systems so that they are able to provide the required information, although this will vary by bank.

The reporting requirements replace the equivalent obligation that exists under the current legislation for issuing banks to report to HMRC on their notes in circulation, and their backing assets held at the Bank of England and in approved locations.

Some additional information (such as that pertaining to excluded banknotes, printing and destruction of notes) will be required, and issuing banks will be required to provide weekly estimates of their peak notes in circulation, as well as actual daily figures retrospectively. However it is estimated that these requirements should not present an undue cost or administrative burden on the issuing banks. These reports are necessary for the Bank of England to confirm that sufficient levels of backing assets are being held at all times, and therefore ensure noteholder protection.

The Bank of England may also require an issuing bank to provide a report by an independent auditor or skilled person about those reports that the issuing bank submits under Regulations 14. The costs of doing so are to be borne by the issuing bank.

## **Insolvency**

In the event of an issuing bank entering an insolvency process, the backing assets are to be ring-fenced for the benefit of note-holders participating in a 'note-exchange programme'. This is intended to allow them to exchange their notes for value. The costs for a note-exchange programme, when triggered by an authorised bank entering an insolvency process, are to be borne by the Issue Department of the Bank of England. Costs are expected to be negligible but cannot be accurately quantified as there is no precedent for such arrangements. The Bank of England will produce an annual report on the discharge of its functions under Part 6 of the Banking Act 2009, where it may provide details on any expenses (or receipts) incurred.

## **Ceasing issue**

If an issuing bank stops issuing banknotes voluntarily (or the Treasury terminates its right to issue) then the banknote rules will specify a procedure to be followed to ensure its notes are withdrawn from circulation. Any costs of administering this exchange are to be borne by the issuing bank. This is not expected to carry any additional costs over that which could be expected under the current regime.

## **Benefits**

There will be a negligible administrative saving to HMRC of an estimated £1000 per year. This is based on the assumption that HMRC currently has quite a limited regulatory role, whereby checking the data is supplied by the issuing banks, and that the reported figures for backing assets equal or exceed those for notes in circulation, currently amounts to approximately an hour's clerical work a week.

The principle benefit of the new framework is enhanced protection for holders of Scottish and Northern Ireland banknotes, to ensure that the £4.9 billion commercially issued banknotes in circulation in Scotland and Northern Ireland could be exchanged for value in the event of an issuing bank entering an insolvency process. This benefit could potentially be quantified by comparing the value that a noteholder might receive in an insolvency process under the current regime with what they would be expected to receive under the new framework.

Under the current legislation, if an issuing bank were to enter an insolvency process, then noteholders would become ordinary unsecured creditors in that process. As set out above, the current legislation does not make provision to ring-fence backing assets for the benefit of noteholders, and some of the backing assets held are substituted for other assets during the week. Therefore under the existing legislation, noteholders could theoretically receive less than face value for their notes in an insolvency process.

If this unlikely event were to occur, confidence in UK banknotes may be impacted more widely. It is not possible to quantify the cost of a broader loss of confidence.

## **Costs**

The Bank of England estimates that it will incur £500,000 one-off set-up costs, which covers the cost of development and implementation of the reporting and compliance systems for the new regime (estimate includes additional staff resource, software development and testing). The Bank of England estimates the annual costs of carrying out its role as regulator to be £500,000 per year. This includes staff costs for monitoring compliance by the issuing banks and system maintenance, including licences.

The Bank of England will undertake a regulatory role, rather than the administrative function currently undertaken by HMRC. Not only will they be checking daily data entries across more fields, but the Bank of England will also be monitoring this data more regularly, and will also

take action to corroborate such data, for example, by visiting approved locations and checking security provisions and that the backing assets are appropriately segregated and labelled.

It is estimated that the 7 issuing banks will have an initial set-up cost to get their systems to a point where they are able to provide the required information. However, this will vary by bank due to the differences in their existing systems. For some, the system requirements will be similar to that they already use for the Bank of England's Note Circulation Scheme (NCS). It is estimated that overall, the total one-off costs (for all 7 issuing banks) will be approximately £100,000.

Across all 7 banks, it is estimated that the new reporting requirements will have a cost of approximately £100,000 per year. This is based on an assumption that there will be an increased burden of approximately 2 hours per day to collate and report the required data, and for changes to storage requirements for excluded notes and backing assets (separation, labelling etc). This additional time will be incurred by a mixture of staff at different levels: cash centre workers, data entry, financial officers and managers. It is anticipated that there will also be some additional overhead costs (i.e. overtime, benefits, desk space, PC, contingency/DR plans, site/system maintenance, additional security provisions and so on), resulting in the overall estimate of £100,000 per year for all 7 issuing banks.

**QUESTION 17:** Do you have any additional views (supported by evidence, where possible) on the assumptions made in calculating these costs or on any other costs and/or benefits that should be taken into account for the purposes of this impact assessment?

## **Competition**

During two rounds of public consultation, no non-issuing banks raised concerns about there being an uneven playing field because no new issuers are permitted. However, some respondents felt that insufficient account had been taken of the costs associated with issuing banknotes and the social benefits supported by the income derived.

Government has since worked closely with the industry to better understand the relative costs and benefits of commercial banknote issuance.

This has resulted in a new framework that improves consumer protection for noteholders while supporting the continuation of the long-standing tradition in Scotland and Northern Ireland of banknote issuance.

This new framework was consulted on in the July 2008 document "Financial stability and depositor protection: further consultation", when responses indicated that it is broadly supported.

## **Risks**

Should an issuing bank stop issuing its own banknotes, there could be an additional cost to the Bank of England from increasing its distribution of banknotes. This assumes the bank concerned does not seek to dispense the notes of another commercial issuing bank.

**QUESTION 18:** Do you have any views or additional comments on the assumptions made in this Impact Assessment?

## Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

**Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.**

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	Yes	No
Small Firms Impact Test	No	No
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	No	No
Disability Equality	No	No
Gender Equality	No	No
Human Rights	No	No
Rural Proofing	No	No

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