



HM TREASURY

The Scottish and Northern Ireland Banknote Regulations 2009:

summary of consultation responses

October 2009



HM TREASURY

The Scottish and Northern Ireland Banknote Regulations 2009:

summary of consultation responses

October 2009



Official versions of this document are printed on 100% recycled paper. When you have finished with it please recycle it again.

If using an electronic version of the document, please consider the environment and only print the pages which you need and recycle them when you have finished.

© Crown copyright 2009

The text in this document (excluding the Royal Coat of Arms and departmental logos) may be reproduced free of charge in any format or medium providing that it is reproduced accurately and not used in a misleading context. The material must be acknowledged as Crown copyright and the title of the document specified.

Where we have identified any third party copyright material you will need to obtain permission from the copyright holders concerned.

For any other use of this material please write to Office of Public Sector Information, Information Policy Team, Kew, Richmond, Surrey TW9 4DU or e-mail: licensing@opsi.gov.uk

ISBN 978-1-84532-646-3
PU821

1

Summary of consultation responses

Introduction

1.1 *The Scottish and Northern Ireland Banknotes Regulations 2009: a consultation on secondary legislation* was published on 17th June 2009. Comments were requested by 9th September 2009. During the consultation period, officials from the Treasury and the Bank of England met with each of the seven authorised banks to discuss the proposed regulations.

1.2 In order to facilitate the consultation, the Bank of England shared a preliminary draft of their proposed banknote rules with the authorised banks, together with some draft conditions that they might impose in certain circumstances. This was done in strict confidence, and on the basis that the form or substance of the final rules and conditions may differ from the preliminary draft.

1.3 In total, 8 written responses to the consultation were received. The section below contains a summary of those responses.

1.4 The Treasury, taking account of the views of the Bank of England, has considered all the responses to the consultation in finalising the regulations for introduction in Parliament.

Summary of responses

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?

1.5 Respondents broadly agreed to the principle of this regulation, acknowledging that it may be important in terms of security and also to prevent the possibility of exploitation for commercial advantage.

1.6 Responses noted that the power to restrict backing assets in this way is an important part of ensuring consumer confidence and the noteholder protection that is sought under the new regime.

1.7 However, several respondents commented that they would like to see the Bank of England act with a degree of flexibility in order to ensure that changing circumstances and requirements can be adequately addressed. As stated in the consultation document, 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.

1.8 If the Bank decides to impose a limit on either backing assets held at any approved location, or the percentage of backing assets in the form of current UK coin, then any such rules will be made in consultation with the relevant issuing bank(s).

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

1.9 The regulations themselves authorise the Bank of England to define conditions and requirements for 'excluded notes' (notes not required to be backed). Respondents welcomed the fact that the Bank of England had shared and discussed with them a draft of the banknote rules, and broadly agreed that the principles according to which excluded notes are designated as such are appropriate, although there was some discussion about the exact scope of what would constitute an excluded note.

1.10 One respondent correctly identified that, under the draft rules that were circulated, excluded notes will need to be fully backed if they were to accidentally enter circulation, for example through theft. This reinforces each authorised bank's incentive to adopt security measures to mitigate against such risk.

1.11 Some respondents noted that they would like to see similar standards and security requirements in place as those governing the Note Circulation Scheme for Bank of England notes. Harmonisation is desirable wherever it is appropriate. However it is important that excluded notes are designated as such with specific regard to the requirements of the new banknote regime, rather than the requirements of the Note Circulation Scheme.

1.12 When visiting each of the authorised banks, HM Treasury and Bank of England officials discussed at length the sort of requirements that might constitute notes being designated as excluded. The draft of the banknote rules will take into account these discussions and interested parties will have an opportunity to comment further before the rules are finalised.

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

1.13 Following discussions regarding the initial draft of the banknote rules, respondents broadly agreed with the proposed criteria and conditions attached to approved locations.

1.14 Respondents noted that there might be a more streamlined process for approval of a location for multiple purposes (for example, locations for the holding of excluded notes or approved locations for the holding of backing assets). The Bank of England has confirmed that it intends to use a combined form, so only one form will need to be completed per site, for a variety of specific purposes as requested.

1.15 Respondents suggested that holding sites under the Note Circulation Scheme should have automatic approval under the new regime. While the Bank acknowledges there is likely to be an overlap of these sites, automatic approval is not appropriate as the two schemes serve different purposes, and some additional information will be required.

1.16 Some respondents argued that the approval of locations for the holding of backing assets other than at the Bank of England should not be limited to the territory of issue. The Bank of England has confirmed that these locations may be situated outside the territory of issue, but under no circumstances will backing assets be able to be held outside the United Kingdom.

1.17 Respondents also asked that interim approval be given that allows conditions to be met for existing operations. With the agreement of the authorised banks, the Bank of England has commenced preliminary inspections of proposed sites in order to help facilitate a smooth cutover to the new regime. In certain circumstances, the Bank of England may grant approval subject to certain conditions being met or actions being taken within a specified timeframe.

1.18 There was some concern over the impact of an existing site not being approved under the new regime. The Bank of England will consider this impact, however their priority is to ensure that the aims of the new regime are met and noteholders are adequately protected.

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?

1.19 Respondents agreed that a 3 month notice period for voluntary cessation is appropriate.

1.20 The two year period for regulations and rules to continue to apply is set out in primary legislation, but no objections were raised to this period. It was suggested, however, that in practice a Note Exchange Programme is likely to be completed in a much shorter timeframe.

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?

1.21 Several isolated comments were raised by the authorised banks in response to this question.

1.22 One authorised bank raised the question of whether the interest-bearing account should have a minimum level of interest paid (suggested 1%). HM Treasury notes that the primary aim of the new regime is to protect the interests of noteholders. The split between interest bearing and non-interest bearing backing assets has been determined in a way that is deemed commercially fair and appropriate, and ensures that the taxpayer is no worse off as a result. Bank Rate is subject to fluctuation and it would not be appropriate to set a minimum interest rate that is payable without causing distortion or offering an unfair advantage to authorised banks over all other banks holding reserves at the Bank of England.

1.23 One respondent asked that the maximum amount of consultation is undertaken in developing the banknote rules. As noted, the Bank of England has already shared a preliminary draft of the rules with the authorised banks and discussed the provisions contained therein. As a result of those discussions, the Bank of England is currently working on a revised draft of the rules to share with interested parties, and will consult further before finalising the rules. The regulations contain a requirement that the Bank of England consults such authorised banks as are or may be affected by a proposed rule. A new regulation permits the Bank to rely on consultation carried out before the regulations come into force. This provision is necessary in order for the rules to be made in line with the timescale agreed with the authorised banks.

1.24 One respondent called for a clearly set-out approach to the roles and responsibilities of the various parties in the event that one of the authorised banks chooses to stop issuing banknotes, or has its issuing rights terminated by the Treasury. The processes to be followed will be set out in the banknote rules.

Part 4 – Information

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

1.25 All respondents agreed that the circumstances given appeared to be the right ones in which to publish or disclose information.

1.26 This respondent also noted that any disclosure must be made in accordance with other relevant legislation (such as the Human Rights Act), and that the Bank of England should also bear in mind that disclosure may involve releasing commercially sensitive information into the public domain.

1.27 Two respondents asked that data of a commercial or risk sensitive nature (for example, information relating to agents, market share, or notes in circulation) be set out as a territorial summary rather than by individual issuer. The regulations have subsequently been amended to reflect this.

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?

1.28 All of the authorised banks suggested that the Bank of England could publish this report as part of its Annual Report but had no strong views on whether the two should be combined or as standalone documents.

1.29 The Bank of England has agreed that it will publish its first report in Spring 2010, and is considering the form that the report will take.

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?

1.30 There was some concern over the use of the publication power to 'name and shame' those authorised banks that breach the banknote rules or regulations, in the case of non-material issues or where breaches are disputed by the authorised bank. In the case of the latter, the regulations stipulate that no such information can be published until the Bank of England has completed its own process for imposing a penalty and any subsequent judicial review has been determined.

1.31 The power of public censure is an important part of many enforcement regimes and is an effective deterrent against non-compliance. In exercising this power, one of the factors of which the Bank of England will be mindful is the impact on public confidence or other potential consequences.

1.32 One respondent asked for clarification on the nature of the reports that the Bank of England may require an independent auditor to produce. This will be set out in the rules.

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?

1.33 Respondents called for a more defined framework setting out how the note exchange programme will work in practice. Much of this detail will be included in the banknote rules, which are being informed by discussion with the authorised banks. The Bank of England will continue to solicit views and input as the rules are finalised.

1.34 Many of the authorised banks were concerned about the financial implications for the remaining authorised banks if another bank were to enter an insolvency process, and sought to mitigate any such costs arising.

1.35 The provisions set out in the Banking Act, the banknote regulations and the banknote rules, are designed to offer noteholders protection in the event that an authorised bank enters an insolvency process. In such an event, holders of the authorised bank's notes will be able to exchange them for face value. The Bank of England may seek the co-operation of the non-affected issuing banks to help effect an efficient note exchange programme.

1.36 It is likely that the non-affected authorised banks' market shares will go up, as they issue more of their own notes to replace those of the insolvent bank. These notes will need to be backed according to the standard provisions – it would not be appropriate to make other arrangements in such a situation. The robustness of the regime that guarantees noteholder protection would need to be maintained, particularly at a time when public confidence may have been damaged by an authorised bank entering an insolvency process.

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

1.37 Respondents observed that six months should be seen as the absolute maximum, as public reluctance to take such notes should be expected. However, the need to have the ability to make transitional arrangements was accepted.

1.38 The Bank of England will judge the need for temporary continuation based on the prevailing circumstances of the individual case, if and when the need arises.

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?

1.39 Other than views expressed in response to questions 9 and 10, respondents commented in addition that the co-operation of an appointed insolvency practitioner would be necessary to ensure that the Note Exchange Programme works efficiently in the case of an authorised bank entering an insolvency process.

1.40 A few respondents queried whether the 'protected period' should be commenced from the date an authorised bank enters an insolvency process rather than the start of the Note Exchange Programme. This could, however, cause difficulties. For example, on the making of a winding up order, the commencement of liquidation is deemed to be the time and date when the petition was presented to court (which may have been some time before). For clarity, HM Treasury prefers to start the protected period on a date to be determined by the Bank of England. It is also appropriate that the Bank of England be afforded some discretion over the start of the Note Exchange Programme. In practice, it is very likely that a Note Exchange Programme will commence very soon after an authorised bank enters an insolvency process.

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?

1.41 Very few additional comments were raised in relation to Part 6 of the regulations (although please note responses to question 15, about Schedule 3).

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?

1.42 Respondents were broadly happy with Schedules 1 and 2, which have now been completed.

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.

1.43 All respondents asked whether an independent appeals or arbitration panel would be established, in the event that an authorised bank wanted to dispute a penalty imposed by the Bank of England. The Bank of England has confirmed that the penalty policy will set out an appeals process to which authorised banks may have recourse if they are dissatisfied with the Bank's decision. The penalty policy will reflect this and will be shared with interested parties in due course.

1.44 A few respondents noted that the 21 day period within which to make representations against a penalty decision was overly short. As a result, this has been extended to 30 days.

1.45 Overall, respondents welcomed the flexibility offered by the Bank's proposed approach to the penalty policy (as shared in the preliminary draft of the banknote rules). In deciding whether to impose a penalty, the Bank of England will act reasonably and has the flexibility to reduce penalties, in accordance with the individual circumstances.

1.46 Several respondents requested that 'single recurring errors' (for example, multiple errors caused by a wrongly entered formula that caused several mistakes before it was picked up) be treated as one breach. This is a point for the penalty policy and is being considered by the Bank of England.

General

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

1.47 Most respondents had no additional comments. The underlying intention of the regulations – that of ensuring noteholder protection – was welcomed.

1.48 It was observed that much of the operational detail of the new regime will be contained in the banknote rules, and respondents welcomed collaboration to date by the Bank of England in sharing initial thoughts and continuing to engage with the authorised banks on the contents of its draft rules.

1.49 Some respondents added that the rules should be sufficiently flexible to allow them to evolve over time and to be able to deal with unforeseen circumstances. HM Treasury and the Bank of England believe that this flexibility is achieved through the framework of cascading powers and the interaction between primary legislation, regulations and rules.

1.50 As noted in response to question 7, from Spring 2010 the Bank of England will publish an annual report that will also act as a review of the rules to ensure that they continue to be fit for purpose.

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?

1.51 As indicated in previous questions, respondents noted that non-affected banks may bear additional costs if another authorised bank were to cease issuing (voluntarily or through insolvency or termination). The Impact Assessment has been updated to reflect this view although it is inappropriate to include any such costs in the quantifiable analysis as it would not be a regular cost but a one-off if and when a particular situation were to arise.

1.52 One respondent asked for clarification in the case of an authorised bank choosing to stop issuing banknotes. The bank in question would be responsible for withdrawing its own notes, but would not be expected to bear any additional costs faced by the other authorised banks. This would also apply in a case where HM Treasury terminates a bank's issuing rights. In these cases, however, the Bank of England will work with all banks to facilitate as smooth a transition as possible.

1.53 A couple of respondents noted that costs to upgrade security to required standards for approved and/or designated locations should be reflected in the Impact Assessment. These costs cannot be accurately estimated or quantified until the conditions governing the required specifications are finalised. The potential for these costs has been noted in the Evidence Base of the Impact Assessment.

HM Treasury contacts

This document can be found in full on our website at:
hm-treasury.gov.uk

If you require this information in another language, format or have general enquiries about HM Treasury and its work, contact:

Correspondence and Enquiry Unit
HM Treasury
1 Horse Guards Road
London

SW1A 2HQ

Tel: 020 7270 4558

Fax: 020 7270 4861

E-mail: public.enquiries@hm-treasury.gov.uk

