Financial stability and depositor protection:

special resolution regime

July 2008

Cm 7459

BANK OF ENGLAND

HM TREASURY

Financial stability and depositor protection: special resolution regime

Presented to Parliament by
the Chancellor of the Exchequer
by Command of Her Majesty

July 2008

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1 INTRODUCTION

Over the past two decades, the financial integration of the world's economies has proceeded rapidly. The increasingly global and fast-moving nature of financial markets has brought many benefits to the UK as a financial centre, and to UK consumers, who enjoy access to a world class range of innovative and secure financial services.

Increased financial globalisation also means that developments in one market can be quickly transmitted to others. The recent sustained period of disruption in global financial markets, starting in summer 2007, has had a widespread impact on firms and markets across the world, as well as in the UK.

This sustained period of market instability has required a response by firms, national authorities and international institutions. The Treasury, Bank of England and Financial Services Authority (together, the Authorities) along with the Financial Services Compensation Scheme (FSCS) have been working to develop the UK's response. The Authorities set out their latest proposals for financial stability and depositor protection on 1 July 2008 in the document *Financial stability and depositor protection: further consultation*. This document explained the comprehensive set of actions the Authorities intend to take both in the UK and working with international counterparts to address five key objectives:

- strengthening the stability and resilience of the financial system – in the UK and internationally;
- reducing the likelihood of individual banks facing difficulties;
- reducing the impact if, nevertheless, a bank does get into difficulties;
- providing effective compensation arrangements in which consumers have confidence; and
- strengthening the Bank of England, and ensuring effective coordinated actions by authorities, both in the UK and internationally.

An important component of the Authorities' proposals, particularly with respect to the objective of reducing the impact – on the banking system, financial markets, and the economy as a whole – of a bank getting into difficulty, is the special resolution regime (SRR). The Authorities recognise that it is vitally important to have in place regulatory and supervisory arrangements to minimise the risk of banks experiencing difficulties which bring them close to failure. However, in the rare cases in which there is a significant risk of a bank failing, it is also important that the Authorities have access to appropriate tools for dealing with the situation at the appropriate time. The SRR provides these tools. This document presents the Authorities' proposals for the SRR in more detail including, where appropriate, draft clauses.

PURPOSE OF THIS DOCUMENT

1.1 The Treasury, the Bank of England and the Financial Services Authority (FSA) (together, the Authorities) published their latest proposals for financial stability and depositor protection on 1 July 2008. *Financial stability and depositor protection: further consultation* (hereafter referred to as the July consultation) built on the proposals published by the Authorities in January this year, provided a response to issues raised in consultation, and sought further views on key outstanding questions. The document

also set out the Authorities' intention, responding to stakeholder requests, to provide more technical detail on the special resolution regime (SRR). This latest document provides stakeholders with the detail they have sought on the SRR, including draft legislative clauses, and seeks their views on the detail of the Authorities' proposals in this important policy area.

1.2 The Authorities recognise that the measures and tools included in their proposals for a SRR include significant new powers, marking important changes in the institutional, legal and insolvency arrangements for banks operating in the UK. In view of this, and of the interest shown by stakeholders in understanding the detail of how the regime would work, this document presents the Authorities' proposals in more detail, including, where appropriate, draft clauses for inclusion in the forthcoming legislation.

1.3 This technical document sets out the detail of how the Authorities intend the SRR to work in practice in support of the SRR objectives, and contains many of the draft legislative clauses, which will provide for the creation and implementation of the regime. The publication of this document is intended to enable all stakeholders with an interest, particularly those with relevant technical expertise and knowledge, to engage with the Authorities on the detail of the proposals, prior to the introduction of the primary legislation later in 2008. This will help ensure that the measures which are introduced are effective, providing the Authorities with the necessary additional tools for dealing with those rare cases of bank failure, whilst maintaining the UK's position as the world's pre-eminent international financial centre.

Proposals

1.4 The proposals are set out in this document for consultation. The Authorities are seeking the views of stakeholders, particularly on the legislative framing of the proposals. The proposals cover:

- the objectives for the SRR (including draft clauses);
- the roles of the Authorities in relation to the SRR (including draft clauses);
- the governance arrangements for the SRR (including draft clauses);
- powers for the Bank of England to transfer of all or part of the failing bank to a private sector purchaser or to a publicly-controlled bridge bank (including draft clauses on the powers to effect this);
- a special bank administration procedure to facilitate partial transfers to a bridge bank;
- powers for the Treasury to take a failing bank into temporary public sector ownership;
- powers to set up compensation arrangements for failing banks, their creditors and shareholders (including draft clauses); and
- powers for a bank to be put into a bank insolvency procedure (including draft clauses).

1.5 The document also sets out the proposed scope of firms that will be included in the SRR, in particular the application of the regime to building societies.

Draft clauses

1.6 The document includes draft clauses which give effect to the proposals in the areas of most interest to respondents of the previous consultation documents, namely

the objectives, roles and governance arrangements of the SRR, the powers to transfer property, rights and liabilities, and the compensation arrangements. In addition to specific consultation questions, views on the draft clauses are also invited.

Working with other authorities

1.7 Over the coming period, the Government will continue to engage with the devolved administrations in relation to their responsibilities. The Government will also work with colleagues in the European Commission, and continue to learn lessons from the operation of similar regimes which exist in many other countries.

Impact assessment

1.8 This consultation document does not contain a formal impact assessment of the policy proposals set out in each chapter. The impact assessment published alongside the July consultation document provides the necessary analysis of the benefits, costs and risks of the special resolution regime.

Next steps

1.9 Responses to the questions raised in this document are requested by 15 September 2008. Respondents are invited to submit their response to this document either as a standalone response, or as part of their response to the July consultation, which includes high-level questions on the SRR.

2 SRR OBJECTIVES, ROLES AND GOVERNANCE

The July consultation outlined at a high level the Authorities' proposals for the objectives, roles and governance arrangements for a special resolution regime (SRR) for banks.

This chapter provides further detail on those proposals and is accompanied by draft clauses. This chapter sets out the:

- SRR objectives;
- roles of the Authorities in the SRR; and
- governance of the SRR.

SRR OBJECTIVES

2.1 In *Financial stability and depositor protection: strengthening the framework* (the January consultation) the Authorities proposed the creation of a SRR to enable a more orderly resolution of failing banks. The SRR would provide the Authorities with tools to deal with banks that get into financial difficulty in a manner that supports the public interest in financial stability, continuity of banking services and depositor protection. Most stakeholders who responded to the January consultation document supported this approach.

2.2 The Government therefore intends to set out the objectives of the regime in legislation, to demonstrate the aims of the Authorities in initiating and operating the SRR. It is proposed that the SRR will have the following high-level statutory objectives:

- to protect and enhance the stability of the financial systems of the UK;
- to protect and enhance public confidence in the stability of the banking systems of the UK;
- to protect depositors; and
- to protect public funds.

2.3 An objective of ensuring continuity of banking services will be captured within the two statutory objectives to protect and enhance public confidence in the stability of the banking systems of the UK and to protect depositors.

2.4 Consistent with the comments made by some respondents to the January consultation about the potentially invasive nature of the SRR tools, it is proposed that in pursuit of the statutory objectives above, the Authorities should pay due regard to the rights of interested stakeholders. A wide range of stakeholders can potentially be affected by the exercise of different SRR tools, including the failing bank itself, and its creditors, shareholders and subordinated debtholders. In implementing any SRR tool the Authorities recognise that the action taken in any individual case must be proportionate to the aims pursued. Moreover the regime should seek to maintain the priority ranking and equitable treatment of classes of creditors under existing insolvency law. In recognition therefore of the Authorities' duties under the European Convention on Human Rights and the Human Rights Act 1998, it is proposed that, in

pursuit of the objectives above, a further statutory objective should govern how action taken within the SRR would be undertaken. This objective would be:

- to avoid interfering with property rights in contravention of a Convention right (within the meaning of Human Rights Act 1998).

2.5 A code of practice, discussed further below, will add further detail on the judgements to be made in relation to balancing these objectives.

2.6 The SRR objectives are set out in the draft clause 4 in Annex A.

> 2.1) Do you agree with the SRR objectives, as set out in draft clause 4?

ROLES OF THE AUTHORITIES WITHIN THE SRR

2.7 As discussed in the July consultation, any decision to trigger the SRR and to deploy one or more of the tools within it, would in practice only be taken following intensive discussion and consultation between the Treasury, the Bank of England, and the FSA through the Standing Committee at each stage of the decision-making process. Nevertheless, for reasons of accountability, the Government proposes that the forthcoming legislation should clarify the lead responsibility of each institution based on their duties and expertise:

- the FSA, as regulator, will be responsible for taking the regulatory decision that a bank has failed (or is likely to fail) to meet its Threshold Conditions[1], and, having regard to timing and other relevant circumstances, it is not reasonable likely that (ignoring the stabilisation powers) action will be taken by or in respect of the bank that will enable the bank to satisfy the Threshold Conditions. The FSA will also be responsible for supervisory decisions and regulatory actions in respect of any bank subject to the SRR;

- the Bank of England will be responsible for the operation of the SRR, including taking the decision on which of the SRR tools to use, and overseeing their operation (with the exception of the power to take a bank into temporary public sector ownership). The Bank of England will also remain responsible for liquidity support to any bank, in line with its functions as central bank;

- the Treasury will, in line with its functions as the finance ministry, be responsible for decisions involving public funds, and ensuring the UK's ongoing compliance with its international obligations. The Treasury will also be responsible for the temporary public sector ownership tool within the SRR; and

- the Financial Services Compensation Scheme (FSCS), which delivers the payment of compensation to eligible claimants, will also need to be involved in the SRR to be able to make an assessment of the readiness of a bank for

[1] The Threshold Conditions are set out in Schedule 6 to the Financial Services and Markets Act 2000 (FSMA). In so far as they relate to firms with permission to accept deposits they cover: legal status and location of offices, the effect that the close links a firm has with another person(s) could have on the FSA's ability to supervise the firm effectively, the adequacy of the firm's resources (both financial and otherwise) and the suitability of the firm to be authorised. The Threshold Conditions with greatest relevance to entry into the SRR are anticipated to be those of adequate resources and suitability,

payout to eligible claimants under the bank insolvency procedure, and deliver that payout should that option be chosen by the Bank of England.

FSA: controlling entry into the SRR

2.8 Any decision to use SRR tools in the case of a specific firm would be a very significant step. The Authorities have proposed that the initiation of the SRR should be based on an assessment of regulatory triggers by the FSA. The majority of stakeholder responses to the January consultation document supported these proposals. Stakeholders also agreed that any assessment should be based on both qualitative and quantitative information.

2.9 It is proposed that the legislation set out that FSA would make an assessment against certain conditions, which would have to be satisfied before the SRR tools could be exercised. The proposed conditions are:

- that a bank is failing, or is likely to fail[2] to meet its Threshold Conditions; and
- that having regard to timing and other relevant circumstances it is not reasonably likely that (ignoring the stabilisation powers) action will be taken by or in respect of the bank that will enable the bank to satisfy the Threshold Conditions.

2.10 It is proposed that the FSA will consult with the Bank of England and the Treasury before making its decision and that the Bank of England can make recommendations to the FSA.

2.11 Draft clause 7 in Annex A sets out these provisions.

2.12 The Threshold Conditions, as set out in FSMA, are fleshed out in the Threshold Conditions section of the FSA's Handbook and are reflected in detailed rules and guidance, throughout the Handbook, particularly in relation to capital and liquidity requirements. The FSA will consider updating its guidance, including relevant parts of the FSA Handbook.

2.2) Do you agree with the role of the FSA in determining the conditions for entering the SRR?

2.3) Do you agree with the conditions for entering the SRR as set out in draft clause 7?

The Bank of England: operating the SRR in the public interest

2.13 In line with the responses to the January consultation, the Government proposes that the operation of the SRR and the resolution tools within it, excluding temporary public sector ownership, will be the responsibility of the Bank of England. The Bank of England will, in consultation with the FSA and the Treasury, be responsible for the decision on which SRR tool to use (excluding temporary public ownership) and also for the subsequent implementation of the tool.

[2] The decision on the meeting the Threshold Conditions would leave out of account financial assistance provided by the Bank of England (except for ordinary market assistance) or the Treasury.

2.14 It is proposed that the Bank of England will consult the FSA and the Treasury in making its decision on which tool to use, and that the FSA can make recommendations to the Bank of England.

2.15 Decisions on the selection and implementation of those SRR tools, which could be used to transfer the whole or part of a failing bank's business outside of existing corporate and other legislative regimes, and to modify stakeholders' existing legal rights, must be justified on the basis of the public interest taking due account of competing private interests.

2.16 The Bank of England, in operating the stabilisation tools, would therefore be required to be satisfied that its actions were necessary having regard to the public interest represented in the following:

- the stability of the financial systems in the UK;
- public confidence in the stability of the banking systems of the UK (including through preserving continuity of banking services) ; and
- the protection of depositors.

2.17 The Bank of England would also have to ensure that actions taken in the public interest were proportionate, in line with the need to avoid interferences with property rights in contravention of the Convention rights of the Human Rights Act 1998, as acknowledged in the statutory objectives of the SRR. Safeguards and compensation arrangements (discussed in Chapter 3) are also proposed to support the Bank of England in pursuing this objective.

2.18 Further information on the operation of the regime and the public interest considerations will be set out in the code of practice, as discussed below.

2.19 The public interest considerations in operating the SRR are set out in draft clause 8 in Annex A.

> 2.4) Do you agree with the role of the Bank of England in operating the SRR in the public interest as set out in draft clause 8?

HM Treasury: protecting the public finances and the UK's international obligations

Public finances

2.20 Any decision by the Bank of England requiring the use of funds for which the Chancellor of the Exchequer is responsible, or with implications for public finances, would require the authorisation of the Chancellor of the Exchequer. Examples could include cases in which significant public funds would be required to effect resolution successfully, or in which it was considered that there was a significant risk that compensation would be required for those whose property rights would be interfered with (for example the bank, its shareholders or creditors). Should the Treasury withhold authorisation, the Bank of England would have a responsibility to reconsider the exercise of its SRR powers. The Treasury would be able to make a recommendation on an alternative use of the Bank of England's powers.

2.21 In some circumstances the Government may immediately need to commit significant public funds to prevent a bank collapsing and to minimise the risks of contagion in the markets. In such a situation it would be for the Treasury to make a

recommendation to the Bank of England as to the use of the SRR tools, and for the Bank of England to decide whether the use of the SRR tools is an appropriate way to provide that protection. The proposed draft clauses take account of this model through introducing a "financial assistance ground" for the SRR tools (see clause 8(4) and 8(5)). The financial assistance ground would only apply in cases where the Treasury had provided exceptional financial assistance in respect of the troubled bank as a response to a serious threat to financial stability and does not therefore include central bank funding where no liability is taken on by the Treasury.

International obligations

2.22 In line with the approach to the powers of other independent authorities and of the devolved administrations, in dealing with the UK's international obligations, the Chancellor of the Exchequer will remain responsible for ensuring compliance of actions, taken within the SRR, with such obligations. The grounds for Treasury involvement would be if it appears to the Treasury that the action proposed would be, or would be likely to be, incompatible with the UK's international law obligations. It is proposed that the Treasury would have a reserve power to ensure such obligations are respected. Should the Treasury's reserve power be used to overrule an action proposed by the Bank of England, the Bank of England would have a responsibility to reconsider the exercise of its stabilisation powers. The Treasury would be able to make a recommendation on an alternative use of the Bank of England's powers.

Temporary public ownership

2.23 The Treasury will also be responsible for the temporary public sector ownership tool within the SRR, in recognition of the fact that this tool would only be used as a last resort.

2.24 The draft clauses 8(4), 8(5), 9 and 10 in Annex A set out these roles for the Treasury.

> 2.5) Do you agree with the roles of the Treasury as set out in draft clauses 8(4), 8(5), 9 and 10?

GOVERNANCE OF THE SRR

2.25 The operation of the SRR will be governed by:

- the statutory objectives of the regime, as set out in primary legislation;
- supporting secondary legislation; and
- a code of practice setting out the roles and actions of the Authorities within the SRR.

2.26 As discussed above, the operation of the SRR will be the responsibility of the Bank of England, with the Treasury remaining responsible for the protection of the public finances.

2.27 As set out in the July consultation, the Government intends to legislate for the creation of a Financial Stability Committee (FSC) of the Court of the Bank of England, including external experts drawn from the non-executive membership of Court. The FSC will play an important role in overseeing the functions of the Bank of England in relation to financial stability. The Bank of England's executive will be accountable to the committee for its decisions and actions in financial stability, including, for example, market wide operations and firm-specific actions. The FSC will also play a key role within the Bank of England in overseeing the Bank of England's actions under the SRR.

Code of practice

2.28 It is proposed that a code of practice set out in more detail how the Authorities propose to use the SRR tools. It is proposed that the code should be a statutory code, made by the Treasury under primary legislation and laid before Parliament, which would oblige the Authorities to have regard to the code.

2.29 It is proposed that the code cover:

- how the Authorities should achieve the special resolution objectives;
- the process by which the Authorities and the FSCS will consult and provide recommendations to each other in taking decisions regarding the initiation and operation of the SRR;
- how the public interest test will be applied in relation to the private sector purchaser and bridge bank tools;
- how to determine that the second condition which the FSA will make an assessment against in determining that a bank enter the SRR (referred to in paragraph 2.9) is satisfied;
- how the choice between the different SRR tools will be made; and
- safeguards, in addition to those set out in legislation, that will be applied when operating the tools of the SRR.

2.30 Draft clauses 5 and 6 in Annex A set out the way the code of practice will operate. A draft code of practice will be published when legislation is introduced into Parliament.

2.31 The July consultation document confirmed that the memorandum of understanding (MOU), which sets out the roles and responsibilities for financial stability of the Treasury, the FSA and the Bank of England, will be updated in light of the new legislation. As a statutory code, it is proposed that the code of practice will be a separate document which complements the MOU, providing further detail on the operation of the SRR, as set out above.

2.6) Do you agree that the SRR objectives should be supplemented by a code of practice?

2.7) Do you agree with the proposed areas to be covered in a code of practice?

3 SRR TOOLS: STABILISATION POWERS AND COMPENSATION

The Authorities propose legislation for a set of special resolution regime (SRR) tools, including:

- the private sector purchaser tool;
- the bridge bank tool;
- partial transfers, including a new special bank administration procedure; and
- the temporary public ownership tool.

This chapter sets out:

- detail on how these tools will be used; and
- provisions for compensation for those whose property rights are interfered with through the use of the SRR tools, including arrangements for bank resolution funds.

The other SRR tool is the bank insolvency procedure. This is covered in Chapter 4. Extensions to apply the tools of the SRR to building societies are addressed in Chapter 5.

OVERVIEW OF THE SRR TOOLS

3.1 The previous chapter discussed the objectives of the SRR, the roles of each authority and the governance structures for the regime. This chapter sets out details on the pre-insolvency stabilisation tools of the SRR: a transfer to a private sector purchaser or bridge bank (including, in both cases, partial transfers) and temporary public ownership. Draft clauses for these tools may be found in Annex A (Groups 1 and 2).

3.2 As set out in Chapter 2, the Bank of England will be responsible for the decision on which SRR tool to use and also for the subsequent implementation of the tool (excluding temporary public ownership, which will be the responsibility of the Treasury).

3.3 Use of these tools could be supported by the option, already available to the Government, to provide financial support to a failing bank through funding or the provision of guarantees, subject to legal and other constraints.

3.4 The Authorities recognise the need for the SRR to operate within the requirements of European Community law obligations, including those relating to competition.[1] In particular, State aid rules[2] impose significant restrictions on the provision of state funding to companies, as part of the wider framework of competition law. These rules will determine the extent to which the use of the SRR tools may be supported by public funds. The Authorities will work with the European Commission over the course of the consultation period to ensure that any use by the Authorities' of the SRR tools is compatible with these rules.

[1] Wider issues for the SRR are raised by other aspects of Community commercial law, for example the Financial Collateral Directive is discussed in the safeguards for partial transfers section.

[2] As contained in Articles 87 to 89 of the EC Treaty and in legislation made thereunder.

Selecting an SRR tool

3.5 As discussed in Chapter 2, the special resolution regime will be conducted in accordance with the overall SRR objectives. A bank may get into severe financial difficulties for a variety of reasons and its failure will have a variety of consequences, depending on the circumstances. Accordingly, it is likely that the optimal resolution response will vary on a case-by-case basis. The Authorities consider, given these circumstances, that sufficient discretion should be retained to allow the selection of the most appropriate SRR tool, subject to safeguards set out in legislation and the code of practice.

Alternative model

3.6 The Authorities have also considered an alternative general model of a special insolvency regime for banks. This is discussed in Box 3.1. Given the risks and problems, it is not the Authorities' proposed model.

Box 3.1: Alternative model – a special insolvency regime for banks

In high-level terms, after an appropriate pre-insolvency regulatory threshold had been reached, special insolvency regimes would generally involve the Authorities putting the whole of a failing bank into a unique and modified form of insolvency procedure.

A key feature of such a regime for banks within the UK could be that the office-holder would have some form of public interest duty, in addition to a duty to the creditors of the insolvent bank. In the case of bank resolution, the public interest duty might be similar to the objectives of the Authorities' proposed SRR.

The office-holder would be given appropriate powers in order to effect an orderly resolution of a failing bank. These powers would include giving the office-holder the flexibility to consider all possible types of sale of some or all of the failing bank's business to realise value for creditors, subject to the wider public interest objectives. This might be achieved either through normal corporate action or special transfer powers. Within the regime, appropriate provisions would provide for how the office-holder would report to and co-operate with the Authorities. There would generally be a role for the court in safeguarding the interests of creditors.

Special insolvency regimes exist in the UK for a range of important industries and legal entities, including certain types of utility and transport companies (for example, protected energy companies, railways and water companies). These regimes may be used where the application of ordinary insolvency law might lead to the withdrawal of essential services, which it is in the public interest to maintain. However, the key distinction between the banking sector and these industries is that the latter tend to be monopolies. On the whole, consumers in these industries do not have ready access to alternative services. This is not the case for customers of banks.

Special insolvency for banks also has some potentially problematic features. Putting the bank into a modified form of insolvency as a first step is unlikely to enhance consumer or market confidence, particularly in the ability of the bank to continue to meet its financial obligations. Further, it puts the bank into a governance framework that is very unlike that of other commercial banks. Taken together, these factors could reduce the likelihood of a private sector solution.

For these reasons, the Authorities do not propose to establish a form of special insolvency regime for UK banks. The Authorities' preferred model is more in line with aspects of the US approach to resolving failing banks. While the United States has a statutory insolvency regime for banks that is distinct from that which applies to other companies, it does not use this model. One important US method for resolving failing banks, whereby assets and liabilities are split between a newly created bridge bank and the residual company, is broadly similar to the bridge bank tool proposed for the UK.

Stabilisation powers

3.7 The stabilisation powers are the means through which the pre-insolvency stabilisation tools (the private sector purchaser, bridge bank and temporary public ownership tools) are effected. These tools are designed to give the Authorities the power to intervene at a pre-insolvency stage, before the formal point of insolvency is reached. This would enable the Authorities to intervene in respect of the failing bank while it has some net worth, thereby increasing the likelihood of an orderly resolution in support of public policy objectives. It should be noted, however, that before the stabilisation powers may be used, the Financial Services Authority (FSA) would make an assessment against certain conditions (as set out in full in Chapter 2).

3.8 The stabilisation powers are comprised of property transfer and share transfer powers. For the private sector purchaser and bridge bank tools, these powers will be conferred upon the Bank of England; for temporary public ownership, the share transfer powers will be conferred upon the Treasury.

Property transfers

3.9 The property transfer powers may be used to effect the transfer of a failing bank's property, rights and liabilities (including a partial transfer) to a private sector purchaser or a bridge bank.

3.10 The Government is proposing powers which allow the same range of property, rights and liabilities to be transferred that may take place under normal commercial circumstances. In addition, to ensure that the Authorities have complete control over any transfer, and to accelerate the processes where necessary, it is proposed that these powers should include the ability to transfer property that would not otherwise be transferable, for example where a contract includes a prohibition on transfer or required consent of a third party. Draft clauses for these powers are included in Annex A, specifically Group 2.

3.11 The Government is also proposing to take an enabling power in the primary legislation to allow the Treasury by order to make further provision as to the nature and effect of the property transfer powers. The Authorities envisage that such orders, if necessary, would be permanent[3] and of general application. It is also proposed that a draft of the order would need to be approved by a resolution of both Houses of Parliament, unless the Treasury considered it expedient in urgent cases to make such an order with immediate effect.

> 3.1) What are your views on the breadth of the property transfer powers in clauses 14 to 23? Are there particular powers that are lacking?

Share transfers

3.12 The share transfer powers may be used to transfer a failing bank to a private sector purchaser, or to take the bank into temporary public ownership.

3.13 The Authorities propose powers broadly similar to the share transfer powers set out in the Banking (Special Provisions) Act 2008. The powers would allow for the transfer of all, or specified classes, of the securities of a bank. Securities would be defined widely to reflect the diverse nature of banks' capital instruments and extend to preference shares and debt instruments with equity characteristics potentially conferring control (for example, innovative Tier 1 capital resources). In relation to the temporary public ownership tool, the powers would, as with the Banking (Special

[3] Unless and until they were varied or revoked by the exercise of the same enabling power.

Provisions) Act 2008, include provisions to ensure that the Treasury could assert control over a bank quickly at the time of the transfer, and would make incidental provision including power to de-list the securities of a bank, convert securities and modify their terms.

3.2) What are your views on the nature of these powers?

PRIVATE SECTOR PURCHASER

3.14 The January consultation document proposed legislation to give the Authorities powers to direct and accelerate transfers of a failing bank's business (either property or shares) to a purchaser, in order to facilitate a private sector solution.

3.15 A private sector solution is likely to be the resolution outcome that best meets the SRR objectives. Such an outcome has the potential to maintain financial stability, provide continuity of banking services to depositors, achieve desirable outcomes for creditors and counterparties, and protect public funds.

3.16 The private sector purchaser tool would be more flexible than the existing provisions to transfer the business of a bank under Part 7 of the Financial Services and Markets Act 2000 (FSMA). While a Part 7 transfer can overcome many of the difficulties associated with a transfer, it requires a willing seller and willing buyer, an application to court and the chance for affected parties to be heard in court, together with time for various procedural steps to be taken. In the context of a bank in crisis this process is likely to be too uncertain and too lengthy – especially so in the case of a large and complex bank – and could be frustrated for a number of different reasons. Moreover, Part 7 could only be used to effect the transfer of the assets and liabilities of a bank, not its shares.

3.17 The Authorities believe that the Bank of England should have the power to effect a transfer to a private sector purchaser in situations where the conditions for entering the SRR are met and there are sufficient public interest grounds for intervention. The stabilisation powers would give the Bank of England the means to effect the transfer of a failing bank's business either by the transfer of the bank's shares, or of its property, rights and liabilities, to a private sector purchaser who is willing to accept the transfer.

3.18 The private sector purchaser tool may also be used to effect partial transfers of a failing bank's business to a purchaser. This is discussed below.

BRIDGE BANK

3.19 The January consultation document proposed that the Authorities should have powers to take control of all or part of a failing bank's business by way of a bridge bank.

3.20 This tool would give the Bank of England the opportunity to stabilise the bank, preserve franchise value and ensure consumers have continued access to banking services. It would also provide the Bank of England with time to pursue a private sector solution where this could not have been immediately arranged, for example by allowing potential acquirers to carry out due diligence on the business. If these measures are effective in preserving the net worth of the bank, they should encourage competitive bids from private sector purchasers. The bridge bank tool has been successfully used in the United States on a number of occasions.

3.21 If all of a failing bank's business is transferred to a bridge bank, the old corporate entity that was the bank – the 'residual company' – will contain little or no property. It is unlikely that the Bank of England would decide to transfer the failed bank's capital instruments (that is, all debt instruments that qualify as Tier I, II or III capital). Following the transfer, the failed bank will be wound up in an orderly manner.

3.22 The bridge bank tool may also be used to effect partial transfers of a failing bank's business to a bridge bank. Partial transfers are a feature of some other countries' resolution regime and have been employed in the US and the Scandinavian, Latin American and South East Asian banking crises.

Governance of a bridge bank

3.23 There are two legislative constraints on governance structures for banks. The Financial Services and Markets Act 2000 (FSMA) requires that a bank is a body corporate or partnership.[4] In addition, banks have to reach and maintain the minimum requirements for authorisation under the Banking Consolidation Directive.[5] Any bridge bank established by the Bank of England would have to satisfy these requirements and be authorised by the FSA.

3.24 At present, the Authorities propose that a bridge bank will be a Companies Act company limited by shares. Under this model, the Bank of England would hold all of the shares, or in appropriate circumstances at least a controlling interest (for example, where a non-controlling interest was held by a party wishing to acquire the bridge bank).

3.25 The Authorities believe that this approach gives the Bank of England an appropriate means for aligning the objectives of the management of the bridge bank with the objectives of the SRR. In addition, the Companies Act model is conducive to running the bridge bank as far as possible in the same way as other banking entities. For this reason, and because its corporate governance structure would be familiar and well understood, it should be more straightforward to facilitate an onward sale of the bridge bank to a purchaser in due course.

3.26 The Authorities will continue to explore other frameworks for governance arrangements which may be capable of meeting the SRR objectives.

> 3.3) Do you consider that a company limited by shares, with the Bank of England as the sole or controlling shareholder, would be the most appropriate governance structure?

Bank resolution fund

3.27 The Authorities propose that a bank resolution fund should be established whenever the Bank of England uses the bridge bank tool. A detailed treatment of bank resolution funds may be found at the end of this chapter. In brief, the purpose of a bank resolution fund is to provide for the return of the net proceeds of the resolution to the residual company.

Operating a bridge bank

3.28 If the Bank of England decides that a bridge bank is the most appropriate resolution tool, it will establish a separate company, apply for FSA authorisation to

[4] Schedule 6, paragraph 1(2).

[5] Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions (recast).

carry on the relevant regulated activities and use the property transfer powers to transfer property, rights and liabilities from the failing bank to the bridge bank.

3.29 The Authorities are clear that this power must be exercised in a timely manner in order properly to achieve the objectives of the SRR. The Authorities will ensure that as much preparatory work has been undertaken as is practicable in advance of effecting a transfer to a bridge bank, though it will only be practicable to finalise some of the relevant issues once the details of the particular failing bank are known.

Time limits

3.30 The Authorities do not expect a bridge bank to exist for a long period of time – it should only operate until either an appropriate private sector solution can be arranged and implemented or the possibility has been thoroughly explored. The Authorities therefore propose that the life span of a bridge bank should be time-limited, for example to twelve months. Such a time limit would be set out in legislation and be subject to extension through an appropriate statutory power. The Authorities are seeking views on whether the power to make extensions should be limited or whether any such extension should be subject to certain conditions.

3.4) Do you agree that the lifespan of a bridge bank should be limited? What do you think is an appropriate length of time?

3.5) Do you think that the extension of a bridge bank's lifetime should be subject to certain conditions? If so, what?

Corporate governance

3.31 As discussed above, at this stage the Authorities' lead option for bridge bank ownership is a company limited by shares in which the Bank of England is the controlling shareholder. In summary, the corporate governance framework could incorporate the following features:

- the Bank of England, as shareholder, would have the power to exercise normal shareholder rights;
- the composition of the board would be decided by the Bank of England on a case-by-case basis. Once the banking business transferred to the bridge bank is stabilised, the Bank of England would aim to establish a full board of directors (including independent non-executive directors);[6]
- the Bank of England would set the strategic direction of the bridge bank through the agreement of a business plan, in consultation with the other Authorities. The plan would be likely to include: a commercial strategy; a funding plan, including arrangements for repaying any public money that has been lent; a risk management strategy; and an approach for complying with State aid and regulatory requirements;
- once agreed, the bridge bank's management would have day-to-day autonomy to take the necessary actions to implement the business plan;
- the bridge bank would have similar public reporting requirements to other commercial banks; and
- the bridge bank would be authorised and supervised by the FSA.

[6] The Bank of England would take appropriate steps to remove senior members of management who had contributed to the failure of the firm.

Endgame

3.32 In order to achieve a successful sale of the bridge bank to the private sector, the Bank of England would seek to identify a purchaser, for example through a competitive bidding process. In evaluating the bids the Bank of England would need to take into account the SRR objectives and the wider public interest; subject to these, the Bank of England would also have regard to the interests of the failing bank in the net proceeds of resolution (under the bank resolution fund, considered at the end of this chapter). Having made its selection, the Bank of England would sell the bridge bank to the selected purchaser. This could be achieved through a standard commercial agreement (for example a share sale, or an asset sale using the existing Part 7 process).

3.33 While the Authorities will put every effort into resolving the bridge bank and pursuing a private sector solution, there may be some circumstances where this is not possible. In these situations there are two options: first, the bridge bank could be wound up in an orderly manner which maintains financial stability; secondly, the Government could take the bridge bank into temporary public ownership.

PARTIAL TRANSFERS

Splitting a bank

3.34 In addition to whole-bank resolution options, the Government intends to legislate to give the Bank of England the power to transfer part of a failing bank's business, so that the failing bank's business is split between a 'newco' and the 'residual company'. The Bank of England will decide which are the most appropriate assets and liabilities to transfer out of the failing bank depending on the particular circumstances.[7]

3.35 The stabilisation powers include the power to transfer some of the property, rights and liabilities of a bank, which could be used in relation to two of the stabilisation tools: the private sector purchaser and bridge bank tools. In the case of the private sector purchaser tool, a purchaser would acquire some of the assets and liabilities on the failing bank's balance sheet; for the bridge bank tool, the Bank of England would transfer some of a failing bank's assets and liabilities to a bridge bank.

Split between bridge bank and residual company

3.36 The Bank of England may decide that the SRR objectives are best met by transferring part of a failing bank's business to a bridge bank. For example, if only a relatively small proportion of a bank's balance sheet poses a risk to financial stability (such as the retail deposit book or, potentially, such deposits as are protected by the FSCS) it may only be necessary in order to stabilise the situation to transfer this portion of the bank.

3.37 A partial transfer to a bridge bank may also be suitable in cases where there has been a significant deterioration in the quality of a distinct part of a bank's balance sheet (for example, if the firm has had to write down substantial losses on a particular class of asset or if there is significant uncertainty regarding the viability of an existing business line). This portion of the balance sheet could be left behind in any transfer, sanitising the bridge bank from some of the difficulties faced by the original entity. This might help to facilitate the sale of the bridge bank. In such circumstances, this could benefit the failed bank's stakeholders, including creditors left behind in residual company, by virtue of the bank resolution fund mechanism considered at the end of this chapter.

3.38 In addition, if only a small portion of a failing bank's activities pose risks to financial stability, or a large portion of the bank's balance sheet is impaired, the

[7] Which may involve moving either the 'good' or 'bad' assets.

potential commitment of public funds to support the bridge bank may be less than in a whole-bank transfer.

Split between purchaser and residual company

3.39 Alternatively, a private sector purchaser may be willing to buy only part of a bank. It is also possible that a better price may be obtained from the sale as a going concern of a combination of the higher quality assets and liabilities; if 'healthy' parts of a failing bank's business can be separated out from the old entity, this is likely to be a more attractive prospect and may deliver a better outcome in time than the winding up the whole of the failing bank. In such circumstances and where appropriate, the Bank of England could effect a partial property transfer to a private sector purchaser.

Stakeholder views

3.40 Many respondents to the January consultation expressed concerns about partial transfer powers. Respondents were concerned, for example, that any splitting process would disturb property and contractual rights, creditor rankings and collateral, and set-off and netting arrangements. While these matters were raised in relation to the SRR as a whole, stakeholders were especially concerned about partial transfers.

3.41 In addition, a common theme from nearly all stakeholders – across consultation document responses and bilateral meetings alike – was that the January consultation did not include sufficient detail on partial transfers. Stakeholders sought further information from the Authorities on how partial transfers would work in practice and what safeguards would be put in place.

Detailed description

3.42 The Authorities understand that the practical issues involved in undertaking a partial transfer are of a higher order of magnitude than those for a whole-bank transfer. However, on balance, the Authorities believe that the potential merits (noted above) of partial transfers justify taking these powers. Nevertheless, the practical difficulties of implementing a partial transfer – including the need to establish effective safeguards – may mean that the powers will only be suitable in certain circumstances. This section sets out a detailed narrative that describes each aspect of a partial transfer. It considers the different forms of partial transfer that the Bank of England may effect, the practical issues likely to result and the safeguards proposed by the Authorities.

A proposed framework for partial transfers

3.43 The Authorities believe that the most likely scenario for a partial transfer is for the deposit book to be transferred to a private sector purchaser. Depositors would be protected because their claims would be wholly transferred to a stable firm; creditors in the residual company would benefit from net proceeds from the resolution, as discussed in further detail below. The deposit book could also be transferred to a bridge bank if there was no immediately available private sector acquirer.[8]

3.44 The Authorities also believe that there may be some other circumstances in which partial transfers might be used.[9] These include:

1. facilitating a pre-agreed partial private sector solution (for example, where two parties have already been engaged in negotiations for a business transfer); and
2. sanitising the bank's balance sheet by separating out parts that had significantly deteriorated in quality or would otherwise be expected to

[8] In this case, the Bank of England would also transfer assets exceeding the liability of the deposit book.

[9] Also, technically, a partial transfer would be effected where the Authorities wished to effect a whole-bank transfer in respect of a bank which has assets or liabilities that are not readily transferable (for example property governed by foreign law).

reduce appreciably the attractiveness of the bank to a private sector purchaser.[10]

3.45 The Authorities propose that these situations be set out in the statutory code of practice as a set of 'comply or explain' guidelines for the use of partial transfers. The code of practice would include further details on the scope of each particular set of circumstances.

3.46 The Authorities believe that defining clear guidelines for the use of partial transfers in the code of practice has a number of advantages. By describing clearly the circumstances in which the tools could be used, safeguards may be tailored to deal with specific conditions, allowing more effective protection for appropriate classes of creditors. Furthermore, the presence of such guidelines in the code of practice would in itself provide an additional safeguard to stakeholders on the use of partial transfer powers. Details on other safeguards are set out below.

3.47 The Authorities also recognise that it will be important to maintain a degree of flexibility in the code of practice, so as not to constrain the ability of the Bank of England to act in appropriate cases in support of the overall SRR objectives. Views on the balance between flexibility and restrictiveness are sought.

> 3.6) Do you think that partial transfers increase the chances of the successful operation and sale of a bridge bank and the chances of a private sector purchase?
>
> 3.7) Do you agree that guidelines, setting out when partial transfers might be used, should be provided in the code of practice?
>
> 3.8) Would these guidelines provide reassurances about how the Authorities might use partial transfers?
>
> 3.9) Do you agree with the situations in which it is proposed that the partial transfer powers could be exercised?
>
> 3.10) What is the appropriate level of flexibility for the situations in which these powers can be used?

Implementing a partial transfer

3.48 A number of significant practical obstacles would need to be overcome for a partial transfer to be effectively implemented. These issues are likely to limit the circumstances in which a partial transfer would be both practically feasible and the optimal resolution tool.

Liabilities

3.49 In implementing a transfer, the Bank of England would decide which liabilities to transfer out of the failing bank, based upon the SRR objectives. It is likely that in practice this would involve selecting liabilities that are a risk to financial stability or which might be most attractive for a private sector purchaser. The Authorities expect that in the majority of cases this selection would include the bank's retail deposit book (or such deposits as are protected by the FSCS).

Assets

3.50 Assets would need to be transferred alongside any liabilities, with a margin of assets over liabilities to strengthen and capitalise the bridge bank. Two practical issues

[10] Which may include moving either the 'good' or 'bad' assets.

could slow the process of selecting and transferring appropriate assets. First, the time required for appropriate due diligence to be undertaken;[11] and secondly, difficulties with separating and transferring certain critical assets (for example, those whose transfer is governed under foreign law).

3.51 In effecting a partial transfer, the Bank of England would, in the transfer instrument, specify the assets and liabilities to be transferred in whatever level of detail appropriate to the circumstances. The process would need to enable the newco to comply with the regulatory capital requirements for banks.

Systems

3.52 Bank systems, for example information technology and communication infrastructures, are often bespoke and usually complex in nature. These systems are essential for the bank to function and provide consumers with the full range of banking services. The Authorities do not expect that it would always be realistic to transfer, restructure or replicate all such systems in a short period of time. Commercial solutions would be sought for transfers which cannot, or cannot easily, be effected through statutory powers alone, for example, where systems contracts are governed under foreign law.

3.53 In the case of a partial transfer, both the newco and the residual company would need access to appropriate essential services. The newco would need access to systems supporting the parts of the failed bank's business that had been transferred to it; and the residual company would have similar needs for those parts of the bank's business remaining with it. The implication is that, for at least an initial period, systems (and any other essential assets) which could not be immediately transferred may have to remain in the residual company but operate on a commercial basis to support the newco. This is discussed further below.

Position of the residual company

3.54 In most situations it is envisaged that it would not be possible to split a bank into two solvent entities. In such circumstances the residual company would therefore be an insolvent firm. This has insolvency law implications which are set out in more detail below.

Solvent residual company

3.55 In the rare cases where a solvent residual company remained once the initial partial transfer had been effected and any systems and services issues been resolved, the newco and the residual company might be able to be operate as distinct entities. In the preliminary stages – before systems and services could be replicated or transferred – it would be likely that systems and services would need to be shared between the newco and the residual company. There are two potential ways to deliver this:

1. ideally, a commercial contract would be negotiated between the two parties, setting out that the residual company provide services to the newco for a fee; or

2. if this is not possible, the Bank of England would have the power to impose certain high-level obligations on the residual company to provide services to the company that acts as a bank. A commercial fee would be paid for these services.

[11] This is likely to be a more difficult exercise than the process of selecting collateral for a loan.

3.56 In general, little may be required in those situations where the residual company remains solvent and can continue to operate as a going concern in its own right.

Insolvent residual company

3.57 In the majority of circumstances, however, the residual company would be insolvent and hence need to be in some form of insolvency procedure. It may not be possible to begin to wind-up certain parts of the residual company's business if they are needed to provide services essential to the operation of the bridge bank. There will therefore be a need for a provision for the residual company to operate to the extent necessary to support the bridge bank in circumstances where it would otherwise be placed into an insolvency procedure and, as a result, be unable to continue normal operations. In such circumstances, safeguards would need to be put in place in order to protect the interests of the creditors left in the residual company to ensure they are not prejudiced by such continuation.

3.58 In order to address the likely interconnections between the residual company and the newco, a modified form of insolvency – a special bank administration procedure – is required. Such a procedure would be limited to a residual company rendered insolvent through a partial transfer to a bridge bank and, in such circumstances, would be used instead of ordinary insolvency procedures. It is described in the following section (paragraph 3.80). The special bank administration procedure is distinct from the bank insolvency procedure set out in Chapter 4.

Subsequent transfers

3.59 Subsequent transfers involve the movement of assets or liabilities between the newco and residual company after the initial partial transfer. The Authorities propose that the Bank of England should have the flexibility to undertake such subsequent transfers between a bridge bank and a residual company (but not in the case of a transfer to a private sector purchaser).

3.60 These subsequent transfers could be used to optimise the balance sheet of the bridge bank. For example, assets could be moved from a bridge bank to the residual company if a class of assets in the bridge bank were to suffer a significant deterioration in quality and hence became undesirable for potential purchasers. Subsequent transfers may also be especially useful in a fast-burn situation, where the Authorities do not have sufficient time to do comprehensive due diligence prior to the transfer.

3.61 The Bank of England, however, would seek to not move liabilities from a bridge bank back to a residual company after their initial transfer to the bridge bank. This would provide certainty to creditors whose claims had been moved to the bridge bank that they would remain in the bridge bank. This reduces the risk that such creditors would seek to terminate their relationship with the bridge bank. The Authorities are considering how to best to implement this safeguard; at this stage, it is envisaged that it will be included in either secondary legislation or the code of practice.

3.62 The Authorities are seeking views on whether the Bank of England should be able to use the stabilisation powers to effect these subsequent transfers. The alternative is that they should be arranged on commercial terms between the management of the bridge bank and the residual company.

3.11) Do you think the Bank of England should have the flexibility to make subsequent transfers between a bridge bank and a residual company?

3.12) Do you think the Bank of England should have the power to make subsequent transfers using the stabilisation powers?

3.13) Do you agree with the restrictions the Authorities propose for subsequent transfers (that they should only occur between a bridge bank and a residual company and not involve moving liabilities from the bridge bank to the residual company)? Should there be additional restrictions?

Residual company creditor compensation

Bridge bank and residual company split

3.63 To ensure the capitalisation and solvency of the bridge bank, it is likely that the value of the assets transferred would be greater than the value of the liabilities. The effect is that creditors who remain in the residual company may be worse off than creditors who would have had the same insolvency priority in a whole-bank insolvency but are transferred to the bridge bank. If the new legislation made no provision for this situation the Authorities' choice to use a partial transfer would in such circumstances be detrimental to the remaining creditors of the residual company.

3.64 The Authorities believe that it is appropriate to address this issue. Rather than providing compensation fixed by reference to value attributed to the business transferred at the time of the transfer, the Authorities propose to provide the residual company with a contingent economic interest in the net proceeds of the resolution (for example, the proceeds of the sale of the bridge bank to a purchaser in due course, less any costs of the resolution).[12] The Authorities propose a mechanism called the bank resolution fund to achieve this, which is considered at the end of this chapter. The Authorities consider that this provides a fair way of providing compensation to the residual company (and therefore its creditors) for the business that has been transferred to the bridge bank: creditors would receive real and significant compensation linked to the ultimate outcome of the resolution.

3.65 It is possible that in some circumstances the bank resolution fund might be insufficient in size to compensate appropriately those creditors left in the residual company for the amount they have been made 'worse off' by the Authorities choosing a partial transfer. However, the Authorities believe that these circumstances will be limited, for example to situations influenced by external market conditions, because in most cases, as has been demonstrated by international experience, the intervention of the Authorities would be likely to increase the value of the part of the bank's business transferred (as it is likely to have been realised on a going concern value, rather than just a break-up value). As such, the bank resolution fund stands to be a relatively generous means of compensation, especially given the Authorities are not proposing to impose a 'ceiling'. In addition, the Bank of England would operate under high-level management duties during the course of the resolution, as set out in further detail below.

[12] These would include the administrative costs of the resolution, and payments or shares of the proceeds of sale to reflect the risks to which any public moneys were exposed during the course of the resolution and any subsidy provided.

3.14) Do you think that the bank resolution fund is an appropriate means for compensating creditors left in the residual company?

Purchaser and residual company split

3.66 Certain creditors left in the residual company created through a partial transfer to a private sector purchaser of a failing bank's business may also be eligible for specific compensation. This is discussed at the end of this chapter.

Preserving set-off and netting arrangements

The importance of netting

3.67 Set-off and netting arrangements are used between commercial counterparties substantially to off-set liabilities and preserve their capital positions. Many bank counterparties rely on these arrangements to manage their risk profiles; they are widely recognised and provide one of the principal mechanisms by which parties address credit risk. Without restrictions, the transfer of some but not all of a counterparty's financial contracts under a partial transfer has the potential to disrupt these arrangements and create adverse implications for counterparties' regulatory capital positions.

Financial Collateral Directive

3.68 The Financial Collateral Directive[13] provides for financial collateral arrangements (which are often used in connection with set-off and netting arrangements) to take effect in accordance with their terms. It also provides for close-out netting provisions (as defined in the Financial Collateral Directive) to take effect in accordance with their terms. While the Authorities would not exercise the SRR tools in a way which was incompatible with the Directive, the Authorities believe it is appropriate to make explicit provision for a safeguard to respect the integrity of the range of transactions, rights and obligations that are subject to set-off or netting arrangements in defined circumstances.

Master netting agreements

3.69 The Authorities have considered protecting all legally enforceable master netting agreements. Generally these netting arrangements will reflect structures commonly used by bank counterparties and are likely to be governed by documentation based upon industry standard agreements.[14] Under such a safeguard, the Bank of England would not be able to 'cherry-pick' particular transactions[15] from within a valid master netting agreement; the relevant master netting agreement, the underlying transactions and any rights and obligations forming part of the arrangement would have to be treated as a single agreement and either be wholly transferred to the newco or not at all.

Risks

3.70 There are, however, downsides to adopting this general approach; principally that a counterparty may seek to include a number of different types of contracts which are not typically netted under a particular master netting agreement. If this occurred, the Bank of England's flexibility to transfer discrete parts of a bank's business might be significantly impaired.

Qualifying financial contracts

3.71 In the light of these risks and drawing from experience from the United States, the Authorities are proposing a safeguard that would be limited to defined 'qualifying financial contracts' (QFCs). These would comprise those types of financial contracts in respect of which the Authorities believed cherry-picking under netting arrangements

[13] Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements.

[14] Such a safeguard would also cover netting arrangements bespoke to a particular contract using deal-specific documentation

[15] For example, only transferring those that were 'in the money' for the failed bank.

should not occur. At this stage, the Authorities expect that these financial contracts might include repurchase agreements, options, swaps, futures, forwards contracts and certain deposits.[16] The safeguard would require the Bank of England to not only respect the mechanisms of close-out netting in relation to QFCs but to also respect the integrity of the range of transactions expressed to be subject to a netting arrangement by not cherry-picking them. The safeguard would mean that:

- netting arrangements wholly comprised of QFCs would be protected in that the relevant transactions could not be cherry-picked; and
- where a netting arrangement includes a mix of QFCs and non-QFCs, the QFCs under the netting arrangement would not be disturbed but the non-QFCs could be cherry-picked.

3.72 The Authorities anticipate that the list of QFCs will encompass the types of financial contracts that are commonly entered into by counterparties in financial markets. In particular, the Authorities appreciate the importance to counterparties of contracts which are used for the purposes of regulatory capital and would have appropriate regard for these. A list of qualifying financial contracts would be maintained in secondary legislation; this would have to be updated in line with developments in financial products.

3.73 Outside of a safeguard for QFCs, the Bank of England would make a decision about whether to protect the integrity of other forms of netting arrangements (and not cherry-pick contracts) based on the specific requirements of the resolution. Such an assessment would be based upon the public interest and the SRR objectives (which include an objective to avoid contravening Convention rights). The effectiveness of close-out netting arrangements including purely non-QFCs would only be assured to the extent provided for by the Financial Collateral Directive (where applicable)

3.74 The main disadvantages of this safeguard relate to defining and maintaining a sufficiently clear and comprehensive list of QFCs. In addition, counterparties may be encouraged to restructure contracts so that they are deemed to qualify as QFCs. If counterparties were able to manipulate the scope of the safeguard on a wide scale there would be similar difficulties for the Authorities as with a complete master netting agreement safeguard.

3.75 As a practical matter, the Authorities recognise the due diligence challenges which might arise in relation to deciding how to apply a partial transfer and the relevant safeguard to master netting arrangements and the transactions under them.

[16] The Authorities expect that a large proportion of netting arrangements with respect to QFCs will already be protected by the Financial Collateral Directive.

> 3.15) Do you agree that an explicit safeguard to protect set-off and netting arrangements is required?
>
> 3.16) Do you agree with the risks of adopting a complete master netting arrangement safeguard?
>
> 3.17) Should the qualifying financial contracts approach be adopted, what do you think should be defined as qualifying financial contracts?
>
> 3.18) Can you suggest any alternative options for how the safeguard might be framed in a sufficiently wide but workable way?

Structured finance arrangements

3.76 In addition to netting arrangements, the Authorities believe it may be appropriate to have an explicit safeguard to protect interconnecting parts of a structured finance arrangement from being separated in the course of a partial transfer, thereby preventing the structured finance arrangement from operating in the way in which it was intended. However, the Authorities anticipate that there would be difficulties in defining and limiting the class of transactions which would benefit from such a safeguard in a way that would be sufficiently wide and flexible to reflect commercial realities whilst not unduly restricting the use and benefits of the partial transfer tool.

> 3.19) Do you agree that an explicit safeguard to protect structured finance arrangements is required?
>
> 3.20) Do you have any suggestions for how the safeguard might be framed in a sufficiently wide but workable way?

Creditors with security

Security interests

3.77 In order to protect the rights of security-holders, the Authorities propose a legislative safeguard that secured liabilities should not, save in some specific circumstances, be separated from the assets securing those liabilities. This would mean that the Bank of England must decide to transfer a secured claim and the associated secured assets to the newco, or leave both behind. In addition, the Authorities would not interfere with a creditor's right to enforce a security interest except where the transfer, or acts preparatory to it, was an event of default under the agreement in question.

Exceptions to the safeguard

3.78 The Authorities are seeking views on whether there are certain specific types of security interest which should not be covered by this safeguard. The Authorities recognise that counterparties may respond by reclassifying security interests to fit within the particular definition of the safeguard, indeed the precise classification of security interest is often a matter for court decision. But the Authorities' focus is on the characteristics and behaviour of the particular types of security interest in relation to which the safeguard could be available, rather than the precise description.

3.79 For example, if a floating charge was granted over the whole or substantially the whole of the bank's undertaking or assets, respecting such a safeguard would seriously impede, if not frustrate, the Bank of England's ability to effect a partial transfer. However, the Authorities believe that banks would very rarely if at all grant a floating charge over the whole or substantially the whole of a bank's undertaking or assets, so a

limitation to the safeguard framed in this way should not be overly restrictive for bank's counterparties.

> 3.21) Do you agree that a safeguard to protect all security interests could make a partial transfer practically difficult?
>
> 3.22) Which security interests should not be covered by this safeguard?

SPECIAL BANK ADMINISTRATION PROCEDURE

Introduction

Dealing with the affairs of the residual company

3.80 As noted above, the Authorities consider that a special form of insolvency procedure (based on existing administration provisions) will often be necessary, at least in the initial stages, to deal with the affairs of the residual company. This procedure would be designed both to operate and manage the residual company and fully to wind up its affairs once the residual company was no longer necessary to achieve the SRR objectives, although for flexibility other outcomes should also be provided for.

Current insolvency regime

3.81 Ordinary insolvency procedures and the proposed bank insolvency procedure (see Chapter 4) would be unsuitable to deal with the management and winding up of the residual company, given the potential need to maintain certain inter-relationships between the residual company and the bridge bank. For example, ordinary insolvency procedures would inevitably lead to tensions between the residual company and the bridge bank, particularly in respect of the ownership and control of assets. Moreover, ordinary administration or liquidation proceedings, which would be focussed on achieving the best outcome for creditors generally, would not necessarily provide a means for addressing potential short-term tensions between the bridge bank and the interests of creditors remaining in the residual company in a manner conducive to satisfying the SRR objectives. The new proposed bank insolvency procedure is designed to facilitate rapid FSCS payments to eligible claimants and so would not be capable of achieving what is required in the context of the residual company and partial transfers to a bridge bank. Indeed, the aim of the bank insolvency procedure would not be applicable to the residual company since depositors eligible for compensation under the FSCS would most probably have been transferred to the bridge bank.

Special bank administration procedure

3.82 The Authorities therefore propose the creation of a special bank administration procedure for the residual company which would be modelled on existing insolvency procedures - principally administration under Schedule B1 to the Insolvency Act 1986. It is recognised that given the overall objectives of the SRR, some significant departures from, and modifications to, these ordinary administration provisions will be necessary. In addition, the introduction of appropriate safeguards would be essential in order to protect the interests of creditors remaining in the residual company.

3.83 The Authorities suggest that this new procedure should exist alongside the general insolvency regime applicable to companies and partnerships under the insolvency legislation and also the bank insolvency procedure set out in Chapter 4.

Limitation on use of special procedure

3.84 It is proposed that the special bank administration procedure would only be applied to the residual company in conjunction with partial transfers to a bridge bank and not in respect of a partial transfer to a private sector buyer. In essence, this procedure is intended to allow the residual company to be kept functioning for a

specific purpose(s) and, once it is no longer needed for achieving resolution of the bridge bank, the procedure would be brought to a close; perhaps through conversion to an ordinary insolvency procedure.

3.85 The proposed regime is intended to give the Authorities flexibility to commence either the special bank administration procedure or ordinary insolvency proceedings in relation to the residual company, depending on the circumstances of a failing bank and the most appropriate means of resolving it.

> 3.23) Do you consider that where part of a failing bank's business is transferred to a bridge bank, a special bank administration procedure may be required to deal with the residual company?
>
> 3.24) Do you think that this special bank administration procedure should be confined to the residual company where a partial transfer is effected to a bridge bank or should it also apply, with any necessary modifications, where a partial transfer is effected to a private sector institution?

Overview

3.86 As a minimum, the Authorities consider that this new procedure will require:

- the appointment of an insolvency practitioner as special bank administrator to take over the management and affairs of the residual company. Such an appointment could be effected either directly by the Bank of England or on the making of a court order following an application by the Bank of England;
- specific and unique statutory objectives for the special bank administrator, aligned with the objectives of the Bank of England in implementing a partial transfer to a bridge bank and the running of that firm;
- the introduction of a moratorium restricting the ability of third parties to take action against the residual company or its assets;
- specific statutory duties and powers for the special bank administrator to ensure that the residual company can continue to function where necessary in support of a bridge bank, but also to allow, where appropriate, for the realisation of assets and the distribution of the proceeds to creditors;
- appropriate funding arrangements to ensure the continued functioning of the residual company to the extent necessary to fulfil the statutory objectives of the SRR;
- the restriction of certain creditors' rights in the proceedings, although for most purposes the Authorities would expect to replicate the normal statutory order of priority of creditors remaining in the residual company for distribution purposes;
- a supervisory role for the Bank of England within the special bank administration procedure so that it has necessary and appropriate controls to facilitate the successful resolution of the bridge bank;
- a variety of "end-games" to ensure that the procedure is terminated at the appropriate time and to provide, where necessary, for the completion of the winding up of the affairs of the residual company; and

- appropriate safeguards and compensation arrangements to protect the interests of creditors.

3.87 These points and additional proposals are considered in more detail in the following sections although no clauses have yet been drafted in relation to this proposed procedure.

Objectives

3.88 The Authorities consider that the special bank administration procedure should have a unique set of statutory objectives. These will need to be carefully defined to balance the rights and interests of creditors in the residual company with the over-arching aim of administering the residual company to the extent necessary to support and facilitate the successful resolution of the bridge bank. The objectives will also need to provide clear guidance to the special bank administrator on his aims and priorities.

Primary purpose

3.89 The Authorities consider that the primary purpose of the procedure should be to ensure the continuation of the residual company, to the extent required, to facilitate and support the operations of a bridge bank until such time as this support is no longer required. This would be at a point determined by the special bank administrator in agreement with the Bank of England.

3.90 It is suggested that the special bank administration procedure should generally terminate where:

- continuation of the residual company is no longer required to support the operations of the bridge bank; or
- at the point that the bridge bank is sold or its operations cease.

Secondary purposes

3.91 While it is considered that the primary purpose of the proposed regime should be to facilitate and support the operations of a bridge bank, possible secondary objectives for the special bank administrator, which would need to be defined carefully in the legislation, could include:

- winding up "non-essential" services and assets (that is, those not required for the purposes of the resolution of the bridge bank) in the best interests of the creditors of the residual company as a whole;
- completing the winding up of the affairs of the residual company where the Bank of England agrees that the continued existence or operation of the residual company is no longer required; this could be achieved through conversion to another form of insolvency process where that would be in the best interests of the creditors of the residual company as a whole; and
- working with the Bank of England to effect appropriate transfers of assets and liabilities between the bridge bank and the residual company.

3.25) Do you agree that the special bank administration procedure should have specific objectives?

3.26) Do you agree with the objectives and their priorities as proposed above? In particular, do you agree that the objective of supporting the bridge bank should take priority?

Grounds for commencement

Partial transfers to bridge bank

3.92 The Authorities propose that the special bank administration procedure should only be commenced following the triggering of the SRR - by the decisions of the Authorities - in circumstances where some of the assets and liabilities of a failing bank have been transferred to a bridge bank under that stabilisation tool.

Use of ordinary insolvency procedures

3.93 It is recognised, however, that the special bank administration procedure may not always be required. The residual company could potentially be allowed to enter ordinary insolvency proceedings (such as liquidation or administration) where no assets, systems or contracts etc. remaining in the residual company were considered essential to the functioning of the bridge bank and there was no other reason why the special bank administration procedure was needed for the successful resolution of the bridge bank.

Necessary support activities

3.94 It is therefore envisaged that the special bank administration procedure will be initiated where the continuation of the residual company is necessary to provide support to the operations of the bridge bank. This might be necessary where, for example, certain systems, contracts or services necessary to the operation of the bridge bank cannot immediately be transferred to the bridge bank or integrated with the bridge bank's infrastructure or contractual arrangements due to legal or practical obstacles.

3.27) Should the grounds for commencing or applying for special bank administration be linked to the partial transfer of assets and liabilities to a bridge bank?

3.28) Should any other grounds be included in the legislation?

Appointment of a special bank administrator

3.95 The Authorities propose that the special bank administration procedure should be commenced in one of two ways: either by the direct appointment of a special bank administrator (office-holder) by the Bank of England, or by the court making a special bank administration order on an (urgent and without notice) application by the Bank of England. In either scenario the choice of insolvency practitioner would in effect fall to the Bank of England, who would appoint or nominate for the appointment (respectively) of a duly qualified and suitably experienced insolvency practitioner willing to accept the position.

3.96 For clarity and consistency, the Authorities would prefer that initiation in all cases was either by a direct appointment or by an order of the court; and views are therefore invited on the most appropriate way to commence the special bank administration procedure. Some of the respective advantages and disadvantages of each are set out briefly below.

Court order

3.97 A key advantage of commencing the special bank administration procedure by court order is that this would reflect the way in which other insolvency proceedings commence, for example the FSA may make an application to the court for the appointment of an administrator in relation to a bank. This would also provide consistency with other existing special insolvency regimes, including the proposed bank insolvency procedure, which can only be commenced by an order of the court.

3.98 Such a provision may also offer reassurance to stakeholders generally and provide greater certainty over entry to the procedure.

Direct appointment by the Bank of England

3.99 The main downside to the court order route, which would be overcome by the direct appointment of a special bank administrator by the Bank of England, is the discretion this could provide to the court over whether to commence the procedure or make some other order in relation to the residual company. This could cause delays in the process and could potentially frustrate the benefits of using a bridge bank in a fast-burn scenario. Drafting appropriate grounds on which the court should base its decision and providing for an urgent and without notice hearing should help mitigate this risk.

3.100 As a balance, however an appointment is effected, the special bank administrator could be designated an officer of the court. Alternatively, in the interests of promoting the objectives of the SRR, where appointed directly the special bank administrator could be subject to the overall direction of the Bank of England; with the court ruling on any disputes arising in the resolution.

> 3.29) Should the special bank administration procedure be commenced by an order of the court or initiated automatically by the direct appointment of a special bank administrator by the Bank of England?
>
> 3.30) Should the special bank administrator be an officer of the court, or in the interest of promoting the objectives of the SRR should he or she be subject to overall direction by the Bank of England, with the court ruling on any disputes arising in the resolution?

Moratorium

3.101 Depending on which method of commencement is adopted, the procedure would commence either at the time the court makes an order appointing a special bank administrator or at the point when such an appointment is effected directly by the Bank of England.

Insolvency proceedings and legal processes

3.102 As in the case of ordinary administration proceedings, on the commencement of the procedure a moratorium would take effect to prevent other insolvency proceedings and legal processes being commenced or continued against the residual company or its property, subject to certain exceptions.

3.103 It is proposed that the moratorium would mirror, with some modifications, the current provisions of paragraphs 42 and 43 of Schedule B1 to the Insolvency Act 1986. These provide that:

- no resolution may be passed for voluntary winding up;
- no winding-up order may be made, except in the public interest or on the petition of the FSA; and
- other legal processes (including the enforcement of security, exercise of forfeiture by a landlord, levying of execution or distress or the commencement or continuation of other legal proceedings) are not allowed without the consent of the administrator or with the permission of the court.

Bank of England consent

3.104 In the case of the special bank administration procedure, it is proposed that the special bank administrator would require the consent of the Bank of England to allow such legal processes. The Authorities also propose that no winding-up order should be made by the court without the consent of the Bank of England, in order to remove the risk of such proceedings obstructing the successful resolution of a bridge bank.

Public interest winding up

3.105 In general, companies may be wound up on an application by the Secretary of State for the purposes of protecting the public. However, in this scenario the special bank administrator will have taken control of the residual company, the existing management are likely to have been dismissed and the residual company will only be being operated to achieve certain statutory objectives. Therefore, the likelihood of a public interest petition to wind up the affairs of the residual company appears remote.

Directors - CDDA 1986

3.106 To ensure that the directors of a failed bank do not evade responsibility for their actions, it is proposed that the provisions of the Company Directors Disqualification Act 1986 should be applied under the special bank administration procedure. In addition, as outlined below, it is proposed that conversion from the special bank administration procedure to liquidation will be allowed where appropriate and additional powers, for example to bring action for wrongful or fraudulent trading, could be given to the special bank administrator.

> 3.31) Are the moratorium provisions outlined above sufficient for the purposes of a special bank administration procedure? If not, what additional measures would be required?

Powers and duties of the special bank administrator

Powers of an administrator

3.107 The special bank administrator will need to be given appropriate duties and the necessary powers to achieve the objectives of the procedure. The Authorities consider that these can be drawn primarily from ordinary insolvency procedures, principally the powers and duties of an administrator set out in Schedules B1 and 1 to the Insolvency Act 1986; although it may also be useful to draw in some of the additional powers that a liquidator currently has under the insolvency legislation.

Role of the Bank of England

3.108 In order to minimise the risk of conflict between the operation of the bridge bank and the special administration of the residual company, it is proposed that the special bank administrator would only be permitted to exercise certain powers or take certain actions with the permission of the Bank of England or the court; and, as detailed further in the following section, the Bank of England would fulfil the functions of a creditors' committee in the procedure. The Authorities also consider that it should fall to the Bank of England to agree, or propose modifications to, the special bank administrator's proposals for the achievement of the objectives of the procedure.

3.109 In addition, to achieve the Authorities' statutory objectives, it is suggested that the special bank administrator would be barred from taking actions to recover any assets transferred from the failing bank to a bridge bank. As a result, antecedent recovery actions, such as the recovery of transactions at an undervalue, would not be permitted in relation to assets held by the bridge bank.

Additional powers

3.110 Under the provisions of the Insolvency Act 1986, a liquidator has four principal powers that are not available to an administrator. These are the right to:

- disclaim onerous property;

- bring proceedings before the court for fraudulent trading;
- bring proceedings before the court for wrongful trading; and
- effect a distribution to unsecured creditors without the permission of the court.

3.111 These powers could become available by converting the special bank administration procedure to a voluntary winding up (in much the same way as in ordinary administration – see below). However, given uncertainties about the possible duration of the special bank administration procedure, it may instead be preferable to bestow a special bank administrator with some or all of the above powers. At a minimum, the powers to disclaim onerous property (which would only be exercisable to the extent compatible with the need for the residual company to support the operations of the bridge bank) and initiate timely action in respect of alleged fraudulent or wrongful trading may be particularly beneficial for the creditors of the residual company.

> 3.32) Do you think that the existing powers of an administrator would be sufficient for the purposes of special bank administration?
>
> 3.33) Should the special bank administrator be given any additional powers, including some or all of the powers of a liquidator outlined above? If so, what extra powers do you consider would be appropriate?

Role of the Bank of England

3.112 As outlined above, the Authorities consider that the Bank of England should have an important role in the special bank administration procedure in order to facilitate the successful resolution of a bridge bank. This would be designed to maximise the chances of a successful sale of the bridge bank to the private sector within the statutory time period and at the best possible price, subject to the objectives of the SRR. That would in turn benefit the creditors of the residual company.

Funding

3.113 The Authorities will also need to ensure that appropriate funding mechanisms are introduced to ensure that the special bank administrator is able to keep the residual company functioning to achieve the purposes of the procedure. In practice, the bridge bank would be expected to pay for the services provided by the residual company on normal commercial terms, but provisions will need to be made to allow access to additional funding if required to ensure the viability of the residual company for the purposes of this procedure.

Creditors' committee functions

3.114 It is suggested that in a special bank administration procedure the Bank of England should fulfil the role of a creditors' committee. The Bank of England could therefore require the special bank administrator to provide information in relation to the exercise of his functions and would generally assist the special bank administrator in discharging his functions.

Additional roles

3.115 In addition, due to the unique nature of the special bank administration procedure and its primary objectives, the Authorities consider that the Bank of England should have additional functions in this procedure, including:

- considering and approving, with or without modification, the special bank administrator's proposals for achieving the objectives of the procedure;

- providing information to the special bank administrator in relation to the financial position of the residual company and the bridge bank;
- approving those assets, or types of asset, that may be realised immediately for the benefit of creditors (that is, "non-essential assets");
- effecting subsequent transfers of assets and liabilities between the bridge bank and residual company, subject to the safeguards set out earlier in this chapter;
- determining, with the co-operation of the special bank administrator, what essential services, assets and contracts etc., the residual company would be obliged to continue to provide in support of a bridge bank;
- determining whether to consent to the taking of certain actions in the procedure where those may prejudice the successful resolution of the bridge bank; and
- agreeing that the procedure may be terminated.

3.34) Do you agree that the Bank of England should have a key role to play in the special bank administration procedure to facilitate the successful resolution of a bridge bank and to assist in the winding up of the residual company in the interests of its creditors generally?

Position of creditors

3.116 As in existing special administration regimes, in order to ensure that the objectives of the special bank administration procedure can be met, the Authorities consider that it will be necessary to curtail some of the rights that creditors would have in an ordinary administration; although only where such changes are necessary to ensure the achievement of the objectives of the procedure.

Information on procedure

3.117 It is therefore proposed that, rather than an initial meeting of creditors being called to consider and agree, with or without modification, the special bank administrator's proposals, this would instead fall to the Bank of England. However, provisions will be made to ensure the timely supply of relevant information to creditors, including details that would be expected in an ordinary administrator's statement of proposals.

Challenges

3.118 The Authorities also suggest that it would be appropriate to preserve other rights from ordinary administration, such as the ability of creditors to requisition a further meeting of creditors and to challenge the special bank administrator's conduct of the company, subject to certain restrictions that the Authorities consider necessary to ensure that the principal purpose of the procedure is not compromised.

Statutory order of priority

3.119 To provide consistency with ordinary administration proceedings and to safeguard the interests of the creditors of the residual company, the Authorities would expect in most respects to replicate the normal statutory order of priority of creditors remaining in the residual company for distribution purposes.

Set-off

3.120 In addition, the Authorities suggest that the standard provisions on set-off could be adopted from ordinary administration, that is statutory set-off could only be applied at the point the special bank administrator gave notice on a proposed distribution to creditors. Alternatively where, for example, the special bank administration procedure

converted to a voluntary winding up to effect a distribution to creditors, set-off would apply from the date the liquidation proceedings commenced. The Authorities recognise that set-off is a very complex issue and, as in ordinary insolvency proceedings, specific rules in relation to set-off would be included in secondary rather than primary legislation.

3.35) Should the Bank of England rather than an initial meeting of creditors be responsible for considering and agreeing to, with or without modification, the special bank administrator's proposals?

3.36) Should the Bank of England rather than creditors fulfil the functions of a creditors' committee?

3.37) Should the rights of creditors to challenge the conduct of the procedure be subject to restrictions to ensure that the principal objectives are not jeopardised?

3.38) Do you agree that there should not be any substantial change to the ordinary statutory order of priority of creditors in the special bank administration procedure?

3.39) Should any special provisions relating to statutory set-off be introduced within a special bank administration procedure?

End of the procedure

Termination **3.121** The Authorities propose that the special bank administration procedure should be terminated, subject to the agreement of the Bank of England, where:

- the continuation of the residual company was no longer required to support the operations of a bridge bank; or
- the bridge bank had been resolved, that is, sold or closed.

Exit routes **3.122** As in ordinary administration proceedings, the Authorities propose that for flexibility there should be a variety of ways to bring the procedure to a close and these should include provisions for:

- conversion to voluntary winding up;
- dissolution; or
- the implementation of a company voluntary arrangement.

3.40) Do you agree that the procedure should only be terminated where the Bank of England provides consent?

3.41) Do you think that provisions should be made for a variety of ways to bring the procedure to a close, including conversion to ordinary insolvency procedures?

TEMPORARY PUBLIC SECTOR OWNERSHIP

3.123 The January consultation document stated that the Government was considering legislation to allow it to take temporary public ownership of a failing bank, as a last resort. The July consultation confirmed that the Government intended to bring

forward this legislation. The last consultation also stated that any decision involving the temporary public ownership of a bank would be for the Chancellor of the Exchequer.

3.124 Temporary public ownership would be effected using the share transfer powers. The Authorities propose that the tool should be subject to a similar public interest test to that set out in the Banking (Special Provisions) Act 2008. Accordingly, the Treasury may only exercise these powers in relation to a bank where it is satisfied that, in addition to the general conditions for exercising stabilisation powers (as set out in draft clause 7), one of two conditions are met:

- the exercise of the power is necessary to resolve or reduce a serious threat to the stability of the financial systems of the United Kingdom;
- the exercise of the power is necessary to protect the public interest, where the Treasury has provided financial assistance in respect of the bank for the purpose of resolving or reducing a serious threat to the stability of the financial systems of the United Kingdom.

3.125 Temporary public ownership is anticipated to be the most appropriate tool in situations such as the following:

- where a significant amount of public money has been made available to a failing bank in order to stabilise it;[17]
- where wholesale and long-term restructuring is required in order to return the bank to the private sector; and
- where the bank is subject to an extremely fast-burn or complex failure, such that there is insufficient time or means to effect a property transfer or share transfer to a private sector purchaser without significant risk.

3.126 A nominee of the Treasury would be the single shareholder of the shares of the failing bank transferred by virtue of the share transfer order and the Government would seek to introduce corporate governance arrangements in line with best practice as soon as possible in the resolution. Once transferred, a business plan would be agreed so that the objectives of management were the same as the Government's. These objectives would be defined in terms of the SRR objectives. The aim would be to take steps to return the banking business to the private sector swiftly.[18] A bank in temporary public ownership would continue to be authorised and supervised by the FSA.

3.127 The Authorities propose that a bank resolution fund should not be compulsory for a bank in temporary public ownership. Further details on the bank resolution fund mechanism are set out below.

> 3.42) Do you agree that temporary public ownership should be subject to similar public interest tests as the Banking (Special Provisions) Act 2008?

[17] Whether through facilities, or guarantee arrangements or otherwise.

[18] For example one possibility might be that, the bank could be sold to an interested private sector purchaser after a very short period of public ownership in which the Authorities remove bad assets from the bank's balance sheet.

COMPENSATION ARRANGEMENTS

3.128 As set out in the previous consultation documents the SRR should provide mechanisms to allow for compensation, where necessary, to be assessed for those whose property rights have been altered or removed as part of the implementation of the SRR tools.

3.129 The ways in which property rights are affected will depend on the tools used:

- in the case of property transfer powers (whether to a bridge bank or third party purchaser), the principal person whose property rights will have been interfered with will be the failing bank, in that its assets and liabilities will have been transferred to the bridge bank or the third party purchaser (as the case may be); and
- in the case of share transfer powers (whether to temporary public ownership or to a third party purchaser), evidently it is the owners of the shares who will have been deprived of their property.

3.130 In either case, though, there may have been consequential interferences with third parties' rights: for example, rights to terminate contracts may have been turned off in contracts transferred to a bridge bank (which would have otherwise operated as a result of the transfer).

3.131 This section discusses general arrangements for assessing compensation that may need to be provided to persons for (compensatable) interferences in their rights. This will ensure that the SRR operates in accordance with the requirements of the European Convention on Human Rights (in particular Article 1 of the First Protocol, which provides for the protection of property rights). The section on partial transfers signposts the particular compensation issues which arise in that context, which are considered more fully here.

Bank resolution fund

3.132 One of the ways that the Authorities intend to make provision for compensation is through the use of a bank resolution fund. A bank resolution fund would always be used where the bridge bank tool is used, and could be used where a bank is taken into temporary public ownership. Where used, each resolution fund would be established and relate to the resolution of a specific bank. A standing or permanent fund would not be necessary.

3.133 As outlined in the section above on the bridge bank tool, the bank resolution fund is intended to provide a mechanism to enable the Authorities to obtain control of a failing bank without obtaining economic benefits otherwise associated with ownership of the bank (other than in recovering the costs of resolution)[19]. The basic aim of this proposal is to signal that the Authorities have no interest in the proceeds of resolution

3.134 The bank resolution fund in the case of the bridge bank tool would provide the failing bank whose assets and liabilities were transferred with a contingent economic interest in the proceeds of resolution (that is, those proceeds arising from the sale of the whole or parts of the bridge bank minus the costs of resolution). Those proceeds would in the case of an insolvent residual company (see above, paragraph 3.63) then be

[19] Further considerations arise where public money have been provided to, or exposed to risk, in relation to the resolution or where subsidy has been provided

applied in accordance for most purposes with the ordinary priorities of insolvency to the residual company's creditors (and, should there be any surplus, to shareholders).

3.135 The Authorities propose that a bank resolution fund should be mandatory in the case of a bridge bank, where the aim will be to achieve a quick onwards sale where possible. It will, however, be available on a discretionary basis for temporary public sector ownership under the SRR in which circumstances the proceeds (after the deduction of any resolution costs) would be distributed to the former shareholders. Providing a bank resolution fund on a discretionary basis for temporary public sector ownership reflects the fact that the use of a fund would not be appropriate in circumstances where, for example, significant amounts of public funds have already been provided to the failing bank, or exposed to significant contingent risk. Therefore it may only be appropriate in a limited number of circumstances where the temporary public ownership tool is used.

Setting up the fund

3.136 It is proposed to set out in primary legislation enabling powers so the Treasury may make a resolution fund order which will establish and make provision for the control and administration of the bank resolution fund; the calculation of the costs of the resolution and the mechanisms for management and administration of the fund, including provision for the accrual of interest if appropriate.

Costs of resolution

3.137 As stated above the proceeds payable to the bank resolution fund will be gross proceeds from resolution net of the costs of resolution. The Government intends to set out in secondary legislation a framework for determining the costs of resolution including that an independent valuation mechanism be put in place to asses such costs. It is proposed that these costs would include amounts in respect of:

- any guarantees[20] provided by the Authorities to the creditors of the bank in the SRR;
- financial assistance[21] provided by the Authorities to support the operation of the bank in resolution; [22] and
- the administrative costs of the SRR – for example, the cost of advisory services procured by the Authorities in order to effect the resolution.

Management duties

3.138 It is proposed that legislation also set out high-level management duties on the Bank of England in relation to the proceeds of resolution (through their oversight of the operation of the bridge bank). Clearly the overriding duty would be to act in accordance with the SRR objectives, but it also proposed to impose a secondary duty not to act in a way which recklessly led to the destruction of value in the potential proceeds of resolution.

[20] For example, fees may already have been charged for the guarantee arrangements during the course of the resolution. However, it would be appropriate for the costs of resolution to address any subsidy provided during the course of resolution (that is, any difference between the fee actually charged and the market fee).

[21] Again, the issue of recovering any subsidy arises here.

[22] Where significant sums of public financial assistance (whether guarantees, liquidity support or otherwise) are required, it may also be appropriate for the taxpayer to receive a share of the proceeds of resolution to reflect the risk to which public funds are exposed. Resolution fund orders would provide the flexibility to establish the conditions under which a share would be payable when resolution funds are established.

3.43) Do you agree that the Authorities should have the power to put in place a bank resolution fund for a bridge bank and temporary public sector ownership?

3.44) Do you agree that the bank resolution fund should be mandatory in the case of the bridge bank tool, but optional in the case of temporary public ownership?

3.45) Do you agree that the bank resolution fund should comprise only the net proceeds of resolution (that is, less the costs of resolution)?

Compensation arrangements

Compensation mechanisms

3.139 The Authorities also propose that the Treasury should have the power to make compensation orders, which would provide for the assessment of compensation in a number of cases:

- In the case of temporary public ownership where a bank resolution fund was not used, a compensation order would provide for the assessment of such compensation, if any, as was to be paid to the former shareholders of the bank.
- In the case of both the bridge bank and temporary public ownership tools, a compensation order would provide for the assessment of such compensation, if any, as was to be paid to third parties whose property rights were interfered with in consequence of the transfer.

3.140 An independent valuer will be appointed to determine the amount of compensation payable under the order. The Authorities propose that the independent valuer should be appointed by a person chosen by the Treasury for this purpose and expect it is likely that the independent valuer will be an experienced commercial professional.

Independent valuer

3.141 It is proposed that the independent valuer will not be a civil servant or servant of the Crown. Rather, he will be a person contracted to perform specific functions and will be independent of the Authorities, ultimately accountable to the court. The function of the valuer will broadly be to determine the amount of compensation, if any, that should be paid to any party in accordance with the compensation order.

Powers of the independent valuer

3.142 The Authorities propose to take an enabling power so that the Treasury may confer on the independent valuer powers to assist him in the performance of his function. In addition to conferring on the independent valuer a general power to perform his functions and to appoint staff, it is proposed that the legislation should allow Ministers to confer on him the power to:

- **apply to court to require people to provide information, or attend to give evidence to him**. Certain categories of information may be excepted from this provision. For example it would exclude information subject to legal professional privilege. This power is to reflect that his role may require him to examine fairly complex and detailed matters;
- **limit and control the use of information supplied to him in the course of the valuation process**. This will ensure that he can meet his public law duty of striking a fair balance between parties' interests (for example, issues of confidentiality and commercial sensitivity) while not restricting his ability to explain to the public the decisions he has made;

- **share information supplied to him with other public authorities without requiring the consent of the person who supplied the information**. It is proposed in the general public interest that the independent valuer should, in certain circumstances, be enabled to share information with various authorities without seeking the consent of party to whom the information relates. The Government proposes to take an enabling power so that the Treasury may specify by order the circumstances in which the independent valuer may be able to share information, for example, where he considers that it demonstrates evidence of a criminal offence or regulatory breach, such as money laundering or insider trading; and
- **refund a person's expenses reasonably incurred when supplying information to, attending, or otherwise in relation to, an investigation**.

Principles of valuation

3.143 It is also proposed that the primary and secondary legislation provide for principles of valuation. In accordance with the general protection of public finances it is proposed that the valuer must always disregard financial assistance provided to the bank in question by the Bank of England or the Treasury (apart from ordinary market assistance provided by the Bank of England) in determining the amount of compensation. Legislation would further require the valuer to assume that no further such financial assistance would be available to the bank at any point in the future. It is also proposed that additional discretionary principles could be included in specific cases.

Right of appeal

3.144 It is proposed that the Treasury have the power to provide for the reconsideration of the independent valuer's determination, and an onwards right of appeal to a court or tribunal.

3.145 The compensation mechanisms, including the status and powers of the independent valuer and the principles of valuation, are set out in draft clauses 24 to 32.

Compensation arrangements for a private sector purchase

3.146 For the private sector purchaser tool the Authorities believe that a price would normally need to be agreed in advance of the transfer between the purchaser and the Authorities. Uncertainty as to the price to be paid may deter potential private sector purchasers and limit the utility of the tool. The Authorities would aim to transfer the banking business at market value in the circumstances.[23] Those circumstances would include the fact that the sale would probably be taking place at short notice and following limited due diligence. Account would also need to be taken of the fact that the bank from which the transfer was made had met the general conditions of the SRR. The price paid for the banking business would (following the deduction of the costs of resolution) would represent the compensation payable either to the failing bank (in the case of the use of the property transfer powers) or its shareholders (in the case of the use of the share transfer powers).

3.147 However, the Authorities recognise that those who would receive compensation in these circumstances need to have some means through which to challenge the price agreed by the Authorities and to have this be determined by an independent body. The Authorities are considering whether it would be sufficient in these circumstances to allow someone who wished to challenge the decision of the Authorities as to the price to do so by way of an application for judicial review after the transfer, or whether the Authorities should put in place arrangements to provide for an independent assessment of the sufficiency of the purchase price.

[23] The Authorities are conscious that otherwise there is a risk that an indirect State aid may be granted to the purchaser.

3.148 A compensation order would also need to be put in place to assess such compensation, if any, as may be payable to third parties affected by the transfer (as noted above).

3.46) Do you agree with the mechanisms for compensation and appointing an independent valuer in the circumstances set out above?

3.47) Do you agree with the proposals to confer specific powers on an independent valuer, and the nature of the powers described above and provided for in draft clause 28?

3.48) Do you agree with the principles of valuation set out in draft clause 30?

3.49) Do you agree that the Treasury should have power to provide for the reconsideration of the independent valuer's determination and appeals from the valuer to a court or tribunal?

3.50) Do you agree that alternative compensation arrangements are needed for a private sector purchaser tool, that would not involve an independent valuer?

INDUSTRY CONTRIBUTION TO THE COST OF RESOLUTION

3.149 The July consultation confirmed that the Government intends to bring forward legislation so that, in addition to its role in ensuring payout to eligible claimants in the event of the failure of a deposit-taking firm, the Financial Services Compensation Scheme (FSCS) can also be called on to contribute to costs arising from the use of resolution tools.

3.150 The Authorities believe that a contribution to the costs of resolution, made by the FSCS, and ultimately borne by the financial services industry through FSCS levies, would be appropriate for a number of reasons. Intervention to resolve a failing bank by the Authorities would be undertaken on public interest grounds, including protecting financial stability and preserving confidence in the financial system, which directly benefit the financial services industry. Furthermore, it is anticipated that the cost of resolving a bank prior to insolvency and payout would, in most cases, be significantly less than the cost of payout of protected depositors which the industry would have had to bear had the Authorities not intervened. The Authorities will put in place a framework to ensure that the level of contribution made by the FSCS is capped, and independently assessed once the resolution is complete.

Principles

3.151 As set out in the July consultation, the extension of the role of the FSCS in this way would be underpinned by four main principles:

- the FSCS would only contribute up to the hypothetical net cost of depositor compensation payments (that is, after allowing for recoveries from winding-up);
- the FSCS would only contribute after resolution was complete and any shortfall in recoveries and other proceeds of resolution against the cost of intervention could be calculated accurately;
- should resolution result in a winding-up and compensation payments to covered depositors, the FSCS would not be called on to contribute to the costs of any other resolution tools; and
- there would be an independent process for assessing the cost of resolution.

Resolution costs

3.152 Under the proposals, therefore, levy payers would pay no more, and most probably less, than they would have done if the bank had been liquidated and protected depositors paid out. It is proposed that the FSCS would be responsible for calculating the hypothetical net cost of depositor compensation, to determine the maximum level up to which the FSCS could be required to contribute.

3.153 The Government intends to set out in secondary legislation a framework for determining the types of resolution cost towards which the FSCS would contribute. Such costs could include:

- the market value of any guarantees provided by the Authorities to the creditors of the bank in the SRR;
- financial assistance provided by the Authorities to support the operation of the bank in resolution, or to facilitate a transfer to the private sector;
- the cost of compensation claims arising from the SRR (as discussed above); and
- the administrative costs of the SRR – for example, the cost of advisory services procured by the Authorities in order to effect the resolution.

3.154 The Authorities are seeking views on whether these, or any other, costs should be included in the types of cost borne by the FSCS and its levy payers.

3.51) Should any of the costs described above not be covered by the FSCS, under the Authorities proposals? Please explain why.

3.52) Are there any additional costs of resolution which could be borne by the FSCS?

4 SRR TOOLS: BANK INSOLVENCY PROCEDURE

This chapter proposes legislative changes to introduce a new insolvency procedure for banks, based on existing liquidation provisions, to provide for the winding up of a failed bank and to facilitate rapid FSCS payments to eligible claimants.

OVERVIEW

4.1 As outlined in the January consultation paper, the Authorities propose to introduce a modified insolvency process for banks – the 'bank insolvency procedure' – to facilitate rapid FSCS payments. Draft clauses covering this new procedure are included at Annex A.

4.2 The proposed procedure would apply to those institutions which have a permission under Part 4 of FSMA to carry out the regulated activity of accepting deposits within the meaning of section 22 and Schedule 2 to that Act.

Consistency with existing insolvency law and practice

Stakeholder views

4.3 A summary of stakeholder responses to the January consultation paper, which first proposed the bank insolvency procedure, was included in the July consultation document (see *Financial stability and depositor protection: further consultation,* Annex B, paragraphs B48 to B54).

4.4 While stakeholders generally accepted that modifications to insolvency legislation would be required to facilitate prompt FSCS payments, it was also suggested that such changes should be kept to a minimum in designing the bank insolvency procedure. In preparing draft clauses on the bank insolvency procedure, the Government has therefore sought to avoid wholesale changes to existing winding up provisions.

Application of existing provisions

4.5 Consistent with this approach, a significant number of existing insolvency provisions will be applied to the bank insolvency procedure in full, or with only minor modifications. This reflects the Authorities' intention to adhere, where possible, to existing insolvency law and practice, so that the formal insolvency of a bank will be dealt with along similar lines to an ordinary liquidation. The table at draft clause 47 sets out the application of provisions from existing insolvency law to the bank insolvency procedure.

4.6 Other aspects of the bank insolvency procedure also closely follow existing insolvency law and practice and will be familiar to companies and their professional advisers. However, a number of additional new provisions are considered essential to enable the new procedure to achieve its objective of ensuring that eligible claimants under the FSCS receive appropriate treatment in terms of timely access to their insured deposits.

4.7 The provisions of the bank insolvency procedure are set out in detail below, highlighting areas of consistency with, or departures from, existing insolvency legislation.

DETAILED PROPOSALS AND DRAFT CLAUSES

Entry into the bank insolvency procedure

Grounds for application

4.8 Draft clauses 38 and 39 provide that, following a decision by the Bank of England to use the bank insolvency procedure tool of the SRR, an application for a bank insolvency order may be made to the court by the Bank of England or the FSA where a bank is unable, or is likely to become unable, to pay its debts or where such an application is considered to be fair (meaning just and equitable).

4.9 For consistency with ordinary compulsory liquidation, the Secretary of State will also have the right to apply for a bank insolvency order where it is considered fair and in the public interest to do so. As with existing insolvency legislation, such action may be initiated following investigations under the provisions of company law or FSMA.

Court hearing

4.10 The Authorities propose that an application for a bank insolvency order should be considered only by the higher courts. This is because of the size and complexity of many UK banks, and the general interest and publicity likely to be associated with a bank's failure.

14-day notice period

4.11 As with the provisions of existing special insolvency regimes (for example, those that apply to railways, water and protected energy companies) draft clauses 60 and 62 provide that normal insolvency procedures will not be allowed to commence unless adequate notice of such a petition, resolution or application has been served on the FSA. In keeping with existing special insolvency regimes, a 14-day notice period is provided for and a resolution for the voluntary winding up of a bank can have no effect without the approval of the court. These provisions are intended to give the Authorities an opportunity to trigger the SRR and make use of an appropriate resolution tool, where this is viewed as more appropriate than normal insolvency.

4.12 These provisions are also in line with existing provisions under FSMA which require that certain insolvency procedures cannot be initiated unless appropriate notice has been provided to the FSA and, in certain cases, that the FSA has consented to the desired course of action.

4.13 Given the high degree of regulatory involvement with banks by the FSA, it is unlikely that the Authorities would be unaware that a bank was in financial difficulties prior to notification of a proposed insolvency event from a third party. However, were a bank to collapse suddenly (for example due to large-scale fraudulent activity), the 14-day notice provision would ensure that the Authorities were notified and could either allow the proposed insolvency proceedings to go ahead or quickly initiate, if required, an alternative SRR tool. These alternatives would, of course, include the bank insolvency procedure, via substitution of the original insolvency application or petition by an application for the bank insolvency procedure.

Commencement date

4.14 In cases where the Authorities received notice of an insolvency application or petition from a third party, and an application for a bank insolvency order is instead submitted to and made by the court, the proceedings would be deemed to have commenced from the date of the presentation of the third party application or petition. Draft clause 41 is therefore designed to preserve the position in compulsory liquidation generally where such proceedings are deemed to have commenced from the date of the presentation of the winding-up petition.

4.15 Where the SRR is triggered without any notice being received of a third party application for insolvency and the Bank of England chooses the bank insolvency procedure as the most appropriate resolution tool, an urgent and without notice application would be made to the court for a bank insolvency order. Where the court makes such an order, the proceedings would, in keeping with ordinary liquidation, be deemed to have commenced from the time the application was made; but in practice it would generally be expected that an order would be made on the same date as the application.

> 4.1) Do you agree with the provisions for entry into the bank insolvency procedure, as set out in draft clauses 38-41, 60 and 62?

Bank liquidator – appointment and objectives

Appointment

4.16 Where the court makes a bank insolvency order, an appropriately qualified and suitably experienced insolvency practitioner (see draft clause 37), nominated by the body making the insolvency application and who had provided confirmation that they were willing to accept the position, would be appointed as the bank liquidator.

4.17 The insolvency practitioner would be an officer of the court (see draft clause 46) and the proceedings would therefore be subject to the general supervision of the court although, as outlined below, the Authorities and the FSCS would also have key roles in the proceedings. In addition, in keeping with general insolvency practice, the office-holder would be expected to adhere to all applicable general professional and ethical standards.

4.18 As is often useful in complex or high profile insolvencies, the application of section 231 of the Insolvency Act (through draft clause 47) provides that joint bank liquidators may be appointed, for example two or more insolvency practitioners from the same or different firms. This would ensure that the necessary expertise, experience, and resources were available to achieve the objectives of the proceedings and to protect the interests of creditors. In keeping with existing insolvency procedures, the appointment would need to specify which functions could be exercised by some or all of the office holders solely and which could only be executed jointly.

Objectives

4.19 As set out in draft clause 42, the bank liquidator would have two specific objectives. The first objective would be to engage with and assist the FSCS to ensure that depositors receive 'appropriate treatment', which may be defined as timely payout of the funds to which they are entitled under the compensation scheme. The second objective would be to wind up the affairs of the bank to achieve the best result for the bank's creditors as a whole.

4.20 The liquidator would work with the FSCS to ensure rapid payout of depositors via the scheme. This could, for example, include providing information on amounts due to depositors, ensuring IT systems and other infrastructure (for example branches) were kept operational, engaging sufficient staff to handle claims, and granting the FSCS access to appropriate information and systems. In certain circumstances, however, the first objective may best be achieved by transferring depositors' accounts, including funds up to the limit for protected deposits, into another appropriate financial firm.[1]

[1] This option bears some similarity to the use of the partial transfer tool to transfer the deposit book prior to insolvency. There are, however, significant differences. The bulk transfer option in the bank insolvency procedure is fundamentally a means to

4.21 As discussed in the July consultation, a large-scale payout may best be effected through a bank's existing distribution channels and the Authorities are working with the banking sector to consider the practicality of this payout route. If this approach to payout is adopted, the FSCS may require the liquidator to maintain the operation of the bank's systems for the purpose of payout.

Usual order of priority of creditors

4.22 While working with the FSCS to ensure that eligible claimants receive appropriate treatment in terms of timely payout would be the key objective, the bank liquidator would also, under their second objective, be obliged to wind up the affairs of the bank in the best interests of creditors as a whole. Despite the first objective taking precedence, it is expected that work in respect of both objectives would commence immediately and no changes are proposed to the current statutory order of priority of creditors for distribution purposes.

4.23 The protection of eligible claimants under the first objective would be funded through the FSCS (including through the use of liquidity provided by the Government, as discussed in the July consultation) rather than from the assets of the failed bank. As with current provisions, the FSCS would then take the place of eligible claimants within the insolvency and would therefore rank as an ordinary unsecured creditor in the proceedings alongside the claims of other equally creditors.

> 4.2) Do you agree with the provisions for the appointment and objectives of the bank liquidator, as set out in draft clauses 37, 42, 46 and 47?

Bank liquidator - powers and responsibilities

Bank Liquidator's powers

4.24 Draft clause 47 provides that a bank liquidator would have all the usual powers of a liquidator, including those set out in schedule 4 to the Insolvency Act 1986. For completeness, draft clause 48 confers additional powers drawn from schedule 1 to that Act (powers of an administrator or administrative receiver).

4.25 The bank insolvency procedure also draws from normal administration provisions at draft clause 61, which provides for the of dismissal of any pending winding-up petition on the making of a bank insolvency order; and also the introduction of a moratorium on the commencement of other insolvency procedures once the bank insolvency procedure was underway.

CDDA 1986

4.26 To ensure that the conduct of the directors of a failed bank would be subject to proper scrutiny, draft clause 63 provides that the bank insolvency procedure would fall within the provisions of the Company Directors Disqualification Act 1986. Therefore, a bank liquidator would be required to submit a return on the conduct of the failed bank's directors and, where action was considered appropriate in the public interest, the Secretary of State would be able to seek a disqualification order from the court in relation to any directors whose conduct was considered to have been unfit. As in normal insolvency proceedings, a disqualification undertaking could also be mutually agreed. The effect of a disqualification order or undertaking is that, without the specific permission of the court, a person is barred from acting as a company director, and from holding certain other offices, for a specified period of time (between two and fifteen years).

expedite payout of protected depositors from a failed bank, as opposed to a pre-insolvency tool for resolving a failing bank. This fundamental distinction can be seen in a number of differences between the two tools. For example, the bulk transfer of deposits in the bank insolvency procedure would be funded from the FSCS, rather than the assets of the failing bank.

Insolvency Services Account

4.27 In an ordinary compulsory liquidation, a liquidator in England and Wales, (although not in Scotland) would be obliged to pay funds from the realisation of assets into an Insolvency Services Account ("ISA"). This provision has been adopted for the bank insolvency procedure (see draft clause 66), principally because such an account is held with the Bank of England and would therefore offer security in the event of a general crisis in the banking industry. This would avoid any possibility that funds from the realisation of assets were held in another commercial bank which itself got into difficulty.

4.28 It is recognised that this would be a fairly significant change in Scotland, and discussions with the Scottish Executive on this point are ongoing. The Bank of England is reviewing its provision of banking services to the ISA as part of its general review of banking services and will reach a conclusion consistent with the role of this service in supporting financial stability.

> 4.3) Do you agree with the provisions for the powers and responsibilities of the bank liquidator, as set out in draft clauses 47, 48, 61, 63 and 66?

Liquidation committee

4.29 Draft clauses 44 and 45 provide that in the initial stages of the bank insolvency procedure, nominated individuals from the Authorities, namely the Bank of England and the FSA along with the FSCS, would form a liquidation committee to oversee the proceedings generally. That committee would also act to provide consent or otherwise, where appropriate, to certain proposed actions; and make a resolution that, as far as reasonably practicable, it considered that the first objective had been achieved.

Changes to committee membership

4.30 Due to first objective of the proceedings, there would initially be no scope for creditors generally to sit on the liquidation committee. However, once the liquidation committee had resolved that the first objective had been achieved, the proceedings would in effect become an ordinary liquidation; and a meeting of creditors would be called at which, among other matters, the creditors could resolve to form a new liquidation committee. At that stage, representatives from the Bank of England and the FSA would step down, although they would still be entitled to attend future meetings (as is already the case for the FSA in ordinary liquidation proceedings) and the meeting would elect those creditors who would sit on the newly formed committee.

4.31 Since the FSCS would be likely to be among the largest of the failed bank's creditors and would already be familiar with the conduct of the proceedings, it is proposed that the FSCS's representative should have the option of remaining on the committee.

> 4.4) Do you agree with the provisions for the liquidation committee, as set out in draft clauses 44 and 45?

End of the procedure

Distribution of assets

4.32 Once the first objective, to facilitate appropriate treatment of depositors, had been achieved, the proceedings would continue along the lines of any other winding up. The liquidator would realise all the available assets of the failed bank and make distributions to creditors, where possible, in the existing statutory order of priority.

Bank liquidator's release

4.33 Once the liquidation had been completed, the procedure would be brought to an end in much the same way as an ordinary winding up, with the bank liquidator obtaining his release and the company being dissolved; although there are certain additional requirements for the bank liquidator to follow, for example draft clause 57 provides that a final report on the proceedings must additionally be sent to the Bank of England, the FSA, the FSCS and the Treasury.

Alternative outcomes

4.34 On completion of the proceedings, the most likely outcome is that the failed bank would be formally dissolved. However, in keeping with existing insolvency legislation, to offer maximum flexibility and to ensure the best outcome for creditors, draft clauses 55 to 58 provide for alternative outcomes once the first objective has been substantially achieved. Hence, the failed bank could move from the bank insolvency procedure to an ordinary administration (under schedule B1 to the Insolvency Act 1986) where the court makes such an order on the application of the bank liquidator (this appears an unlikely outcome but is provided for in case it would be in the best interests of the creditors). In addition, provision is also made for a move to a company voluntary arrangement where such proposals were considered feasible and were acceptable to the requisite majority of the failed bank's creditors.

> 4.5) Do you agree with the provisions for the end of the bank insolvency procedure, as set out in draft clauses 50-58?

Secondary legislation

4.35 As with the current insolvency regime, the bank insolvency procedure would be supplemented by a set of specific rules in secondary legislation (see draft clause 49). These would include, for example, rules:

- to address procedural matters including court procedure and to facilitate the primary legislation;
- covering areas such as the content and timing of reports to creditors on the progress of the proceedings; and
- providing for any amendments necessary to statutory set-off to ensure compatibility with gross FSCS payments to eligible claimants (as discussed in the July consultation paper at paragraphs 5.35 - 5.37).

4.36 Where possible, existing insolvency rules will be applied (with any necessary modifications). The Authorities recognise, however, that new rules will also be required to accommodate the proposed bank insolvency procedure.

5 BUILDING SOCIETIES AND OTHER ISSUES OF SCOPE

This chapter discusses the scope of application of the SRR tools, with particular consideration of building societies. As mutual bodies, building societies have different ownership, governance and legal arrangements. There will therefore need to be special treatment in legislation for the SRR to be made applicable to building societies.

This chapter:

- proposes that the SRR tools should apply to building societies;
- proposes not to apply the SRR tools to credit unions at this stage (although proposes to take a power to make such an extension if appropriate in the future); and
- sets out some of the adaptations to the regime that will be required to make the SRR applicable to building societies.

The chapter also considers a number of other issues relating to the scope of the SRR. In particular, it:

- proposes that the SRR tools should apply only to UK-incorporated deposit taking banks, and discusses the implications for non-UK incorporated banks operating in the UK; and
- discusses appropriate means for resolving failing banks that are part of group structure and proposes that the Authorities place an obligation on former group companies to continue to provide services to a deposit-taker to which a resolution tool has been applied.

BUILDING SOCIETIES AND OTHER MUTUALS

5.1 In the January consultation, the Authorities asked whether the SRR tools should be applied to building societies. In line with respondents' views, the Government confirmed in the July consultation its intention to legislate so that building societies are subject to a special resolution regime, similar to that for banks.

5.2 As explained in the January consultation, individuals who have a savings account or mortgage with a building society are members,[1] and have certain rights to vote and receive information. Each member of a building society has one vote, regardless of how much money they have invested or borrowed, or how many accounts they hold with the society.

5.3 Historically, building societies facing difficulties have often been taken over by a larger society, at an early enough stage for such a takeover to remedy effectively the issues faced.[2] As is the case in relation to banks, the Authorities will continue to seek to find private sector solutions for resolving building societies wherever possible, and before using the SRR tools. However, while such voluntary mechanisms reduce the risk of building societies failing, they do not remove the possibility altogether. For this

[1] The members of the building society will be depositors or borrowers but not all depositors are members.

[2] It should be noted that the majority of inter society mergers take place for other reasons, primarily commercial, not related to such rescue measures.

reason, it is proposed that any failing building society could be placed into the SRR, on the same basis as would be the case for a failing bank.

5.4 As would be the case with banks, it is proposed that any tool within the SRR would only be used where the Authorities had concluded that:

- the conditions for entering the SRR had been satisfied; and
- the selected tool would be the most appropriate means for achieving the objectives of the SRR.

Objectives, roles and governance

5.5 This decision would be based on the same process that is set out in detail in Chapter 2. In particular, the Authorities believe that the objectives of the SRR, the roles of the Authorities in the SRR and the governance of the SRR should be identical for building societies as banks. The rationale for intervention and the overall outcomes the Authorities would be seeking to achieve would also be the same.

> 5.1) Do you agree that the objectives, roles of the Authorities and governance of the SRR should not differ for building societies and banks?

Application of tools

5.6 The SRR tools are set out in detail in Chapters 3 and 4. In general terms, the Authorities intend that the same tools be available for resolving building societies. However, these tools will need to be modified to take account of the different legal basis on which building societies are established. The next section details how the SRR tools will be applied to building societies.

Private sector purchaser

5.7 At present, a building society is able to choose, on the recommendation of its board, and subject to the approval of its members and confirmation by the FSA, to transfer all of its business to a company, a process known as ‘demutualisation’. Legislation – the Building Societies Act 1986 (hereafter referred to as ‘the Act’) – permits this, and specifies the process which must be followed.[3] The society must provide details about the proposed transfer to its members, who vote on whether to approve the transfer to proceed further. If the vote is passed by the required majority, the society must then apply to the FSA for confirmation. The FSA makes its decision to accept or reject the application after assessing any written or oral representations made by members and others about the transfer. The FSA's confirmation decision cannot be appealed under the Act, but can be subject to judicial review.

5.8 If the FSA considers it expedient to do so, to protect the investments of members (that is retail depositors) or other depositors, it has power under the Act to intervene to direct a society to transfer all of its business to a company, or to merge with one or more building societies (and to permit it to do so without a vote by its members). Only a transfer of the entire business can take place in this directed transfer regime. Even in the case of such a transfer, the society must still provide a notification of transfer statement to its members, containing a summary of information similar to what is required for a ‘normal’ transfer. Members and others can also make written and/or oral representations in respect of the transfer.

[3] The 1986 Act also sets out the procedures to be followed if one building society seeks to transfer all or part its engagements to (that is merge with) another society. These processes are similar, but simpler. The Act also permits the transfer of part of the engagements of one society to another.

5.9 The Authorities propose that these mechanisms remain in place. However, as may prove the case with a failing bank, there may be situations where these existing mechanisms for resolving difficulties faced by a building society would be too uncertain, take too long, or be unavailable in the absence of a willing (or able) merger partner. Therefore the Government will legislate to give the Bank of England the power to effect a transfer of all or part of a building society's business to willing a private sector third party, in circumstances where the conditions for entering the SRR have been met, and where there are sufficient public interest grounds for such an intervention.

5.10 As building societies are owned by members rather than shareholders, in the case of a failing society, the share transfer power, which could be used to effect a transfer in the case of failing bank, would not be relevant. The Bank of England would only be able to effect the private sector purchaser tool through using property transfer powers.

5.11 It is possible that the third party purchaser of the society in such a case may itself be a building society, but it is also possible that it is a bank incorporated as a company. The use of the private sector purchaser tool would, in the latter case, therefore result in the demutualisation of the business of the building society so transferred.

Bridge bank for building societies

5.12 The Authorities intend to provide a power enabling the Bank of England to take control of all or part of a building society through a bridge bank. As with banks, this tool would provide the Bank of England with an opportunity to stabilise the business of the building society, preserve franchise value and ensure consumers have continued access to banking services.

5.13 The bridge bank tool would also enable the Bank of England to pursue a private sector solution, in cases where there was insufficient time to arrange such a solution, by allowing time for potential acquirers to carry out due diligence on the business. As explained in chapter 3, the expectation is that a bridge bank would not exist for a long period of time.

5.14 In moving the business of the building society into a bridge bank, demutualisation would occur. As would be the case in a bank resolution, the Authorities envisage that a bridge bank for a building society would be a Companies Act company limited by shares, with the Bank of England holding all of the shares, or at least a controlling interest. As with the private sector purchaser tool, it is possible that ultimately the entity ultimately ended up being sold on to another building society.

5.15 More details on how a bridge bank would operate – for both banks and building societies – are set out in Chapter 3. Compensation arrangements for members are discussed below.

Partial transfers

5.16 The tools outlined above – the private sector purchaser tool and the bridge bank tool – will be based on new powers for the Bank of England to transfer a failing building society's business. In both cases, this power could be exercised to transfer some, rather than all, of the building society's property, rights and liabilities. In the case of the private sector purchaser tool, a private sector third party would acquire some of the assets and liabilities on the building society's balance sheet; for the bridge bank tool,

the Bank of England would transfer some of a failing building society's assets and liabilities to a bridge bank. In either case the building society's business would be split between a 'newco'[4] – the third party purchaser or bridge bank – and the original entity, or 'residual society' in the case of a building society. More detail on the proposed framework, implementation and safeguards for partial transfers is set out in Chapter 3.

5.17 A partial transfer used in the context of a failing building society's business, may lead to demutualisation. In the case of the private sector purchaser tool, demutualisation would occur unless the transfer was made to another building society. And, as discussed above, a transfer to a bridge bank – partial or whole – of a building society's business, would result in demutualisation of the transferred members.

5.18 As is explained in Chapter 3, it is likely that the residual society resulting from a partial transfer would be insolvent and would in most circumstances be wound down over a period of time, under a proposed building society special insolvency procedure (see below). It is also expected that, following the transfer, the residual society would not meet the necessary principal purpose and funding and lending limit and other statutory requirements for building societies. However, even if wound down relatively quickly, it is likely that the residual society would still need to operate in some form for a period of time. To enable this to happen it will be necessary to provide the Authorities with powers to disapply on an interim basis the normal building society principal purpose and funding and lending limits and other statutory requirements.

> 5.2) Do you agree that the Authorities should have powers to disapply statutory requirements including the principal purpose and lending and funding limits, for the residual element of a building society following a partial transfer?

Partial transfers – special building society administration procedure

5.19 Chapter 3 explains that a special form of administration is required to facilitate the successful resolution of a bridge bank in the context of a partial transfer, providing for control over the residual company and its continued operations where it would be needed to support the operation of a bridge bank. It is proposed that a similar form of administration be developed for application to building societies in a similar position.

5.20 More detail on the proposed special bank administration procedure is set out in Chapter 3. It is envisaged that in the special administration procedure for building societies, the objectives of the office-holders and the processes followed would be very similar to those for banks, with only minor modifications required.

> 5.3) Do you agree that there should be a special building society administration procedure for building societies in the event that part of a building society's business is transferred to a bridge bank?

[4] The newco may in fact be an existing bank; for convenience the term newco is used for both a bridge bank and a private-sector third party to which part of a building society's business may be transferred.

Temporary public sector ownership

5.21 Temporary public sector ownership for banks would be effected using the share transfer powers. Given the ownership structure of building societies, it would not be possible to effect public ownership of a building society in the same way. As a result, the bridge bank and private sector purchaser tools, which may be effected using property transfer powers, are proposed as the main resolution tools for building societies.

5.22 However, the Authorities believe that in some limited circumstances, and as a last resort, there may be merit in having the flexibility to take a building society into temporary public ownership – for essentially the same reasons as the tool is required for banks. Therefore, the Authorities are exploring alternative ways of implementing the temporary public ownership tool, and seeking views from stakeholders on how this would most effectively be achieved.

> 5.4) Would temporary public ownership be a useful tool for resolving a failing building society in some circumstances?
>
> 5.5) How would this tool best be implemented in the case of a building society, given the lack of applicability of share transfer powers?

Compensation arrangements for members and other creditors

5.23 As explained in the previous consultation documents, and in more detail in Chapter 3, the SRR will provide for mechanisms to allow compensation to be provided to those whose property rights have been altered or removed as part of the implementation of the SRR tools. In the case of building societies this compensation will need to be made primarily in respect of creditors and members.

5.24 Chapter 3 explains the intention to establish a bank resolution fund to give effect to the principle that the Authorities should be able to obtain control of a failing bank without obtaining net economic benefits from the bank (beyond meeting the costs of the resolution process). It is proposed that the same principle would apply to the resolution of building societies; therefore a power to create a similar fund, in relation to building societies, will be provided for in legislation.

5.25 The resolution fund is described in Chapter 3. As with banks the Authorities propose that establishment of such a fund be mandatory when the bridge bank tool is used.

5.26 In terms of the operation of the fund, including setting up the fund, calculating the value of the fund, and the management duties of the Bank of England, the Authorities proposal would be the same for building societies as for banks.

Compensation mechanisms

5.27 It is also proposed that as would be the case for banks, the Treasury would have the power to make a compensation order requiring an independent valuer to be appointed to determine the amount of compensation, in the circumstances set out in chapter 3. The powers of the valuer and principles of valuation would be the same for building societies as for banks, as explained in detail in Chapter 3.

5.28 At present there are no established principles as to how building society members are to be compensated in the event of demutualisation, or how any bonus is

distributed. This is in contrast to companies, where the share of compensation can be related directly to the size and nature of the shareholding. The Authorities are interested in views on how to deal with this issue in future, where demutualisation is a consequence of their action. Should principles be set out in advance, and on what basis – for example, on the basis of the size of the deposit or mortgage, and/or how long the deposit/mortgage has been held?

5.6) Should a set of principles be established to determine how compensation is distributed between members of building societies? If so, what would be the most appropriate fair and equitable principles?

5.7) What are the risks in creating a pre-determined set of principles for distributing compensation?

5.8) Should the former members have a say in how compensation is distributed?

Building society insolvency procedure

5.29 The Authorities propose that a new building society insolvency procedure be put in place, based on the model outlined for the bank insolvency procedure in Chapter 4. This would have the primary purpose of facilitating rapid FSCS compensation payments.

5.30 This procedure would be implemented in a very similar way to that which is proposed for banks. Rules would set out the detail as to the insolvency procedure and, as it would apply, without exception, to all building societies, the new procedure would provide – where currently absent – a comprehensive, specialised insolvency package for building societies.

5.31 The Government also intends to bring forward legislation later this year to implement section 2 of the Building Societies (Funding) and Mutual Societies (Transfers) Act 2007 (known as the Butterfill Act) – giving depositor members equality with creditors in a winding up.

Application to credit unions

5.32 In the January consultation the Authorities proposed that the SRR should not apply to credit unions at this stage, but that a power would be taken to apply the SRR to credit unions should circumstances change in the future. The Government intends the forthcoming legislation to contain such a power.

5.33 Furthermore, as set out in the July consultation, the Treasury is currently undertaking a review of credit union and cooperative legislation. Any changes which are required in relation to the application of the special resolution regime to credit unions will form a part of the Government's legislative response to that review.

OTHER SCOPE ISSUES

UK deposit-takers

5.34 The July consultation proposed that, as is the case in other countries with a specialised regime for resolving failing banks, the SRR should only apply to UK incorporated deposit-takers. Therefore, it is proposed that the SRR tools would not be

applicable to a branch of a non-UK incorporated bank operating in the UK, but would apply to any UK incorporated bank subsidiaries of non-UK firms, and to any foreign branches of UK incorporated banks.

5.35 The July consultation document also outlined how the Authorities will continue to work with their international counterparts to put in place arrangements to deal more effectively with banks operating across borders and different legal jurisdictions. This international work includes proposals for supervisory colleges for the ongoing supervision of all large, complex, and internationally active cross-border groups and plans to set up small groups of supervisors and central banks to address cross-border crisis management and planning issues for the largest international financial firms.

Banks which are part of larger corporate groups

5.36 The July consultation also discussed the appropriate ways to deal with other relevant entities in financial groups with the aim of helping to maintain financial stability.

5.37 The Authorities recognise that many of the deposit-taking firms that are incorporated in the UK are part of larger (often cross-border) groups. The stabilisation powers used to effect the private sector purchaser, bridge bank and temporary public sector ownership resolution tools discussed in this document are intended to apply to the particular legal entity within such a group that accepts deposits. The Authorities have considered the position of deposit-takers in larger groups, particularly if the group is organised along business rather than legal entity lines, or the deposit-taker is heavily dependent on other group companies to carry out key functions.

5.38 The Authorities have considered the best way to apply the stabilisation tools of the special resolution regime to group companies and believe that any resolution action to a deposit-taker within a group should aim to:

- ensure the deposit-taker remain fully operational; and
- take steps to prevent the failure of the group it sits within, if it is in the public interest (for example, if the deposit-taker provided essential services – for example a treasury function or guarantees – to systemically important parts of the group).

5.39 As discussed in the July consultation, the Authorities believe that the most appropriate way to meet these objectives would be to place an obligation on former group companies to continue to provide services to the deposit-taker to which a stabilisation tool had been applied. The Government proposes to legislate for Treasury powers (such as the ones contained in the Banking (Special Provisions) Act 2008, to create, alter or nullify contracts between group companies, and to augment these powers with a statutory duty on group companies to co-operate in the use of those powers by the Authorities.

> 5.9) Do you agree that the Government should legislate to enable the Treasury to create, alter or nullify contracts between group companies, and introduce duties for group companies (where necessary) to cooperate with the use of those powers?

A DRAFT CLAUSES

A.1 This annex sets out the draft clauses for consultation.

A.2 The draft clauses do not provide for the whole scope of the SRR as described in the consultation document. Rather they make provision for key parts of the SRR, which were of particular interest to respondents to previous consultation documents. Occasionally references are made within these clauses to further provisions which will form part of the Bill when introduced, to draw out the overall architecture of the SRR (for example, the share transfer powers which can be used to implement the private sector purchaser and temporary public ownership tools[1] are referred to but not included in the draft clauses).

DESCRIPTION OF CLAUSES

A.3 The clauses are in four groups:

- introduction;
- property transfer powers;
- compensation arrangements; and
- bank insolvency procedure.

Group 1: introduction

A.4 Group 1 consists of clauses 1 to 13.

A.5 Included in Group 1 are:

- introductory provisions, including an overview of the SRR provisions other than the bank insolvency procedure and interpretative provisions;
- special resolution objectives and code of practice;
- provisions governing the exercise of powers: these include the various conditions which must be satisfied before the private sector purchaser, bridge bank and temporary public ownership tools may be exercised; provision is also made in respect of Treasury involvement; and
- the stabilisation options, which are namely the private sector purchaser, bridge bank and temporary public sector ownership tools.

A.6 Chapter 2 describes the policy underpinning these clauses.

Group 2: property transfer powers

A.7 Group 2 consists of clauses 14 to 23.

A.8 Group 2 sets out the property transfer powers, which are exercised by the Bank of England making property transfer instruments. The clauses provide for the procedure which governs the making of property transfer instruments and their effect.

[1] As noted in Chapter 3, the Authorities propose that the share transfer powers will be similar to those of the Banking (Special Provisions) Act 2008 (see sections 3 and 4 of, and Schedule 1 to, that Act).

Particular provision is made, for example, to ensure continuity in respect of property, rights and liabilities transferred, as to termination rights, in respect of foreign property and as to the making of subsequent property transfer instruments.

A.9 Chapter 3 describes the policy underpinning these clauses.

Group 3: compensation arrangements

A.10 Group 3 consists of clauses 24 to 32.

A.11 Group 3 sets out the provisions, which enable or require compensation arrangements to be put in place. These include the powers of the Treasury to establish bank resolution funds, and make compensation scheme orders. Provision is also made in respect of the independent valuer who will be appointed to determine such compensation, if any, as is payable under compensation scheme orders.

A.12 Chapter 3 describes to policy underpinning these clauses.

Group 4: the bank insolvency procedure

A.13 Group 4 covers clauses 33 to 69.

A.14 Group 4 sets out:

- the bank insolvency procedure including interpretation, appointing a bank liquidator, applying for a bank insolvency order, grounds for making an order and commencement;
- the process itself: the bank liquidator's objectives, the role of the FSCS, the liquidation committee, status of the bank liquidator, general powers, duties and effects through the application of certain provisions of the Insolvency Act 1986, the power to draft insolvency rules;
- terms of appointment of the bank liquidator, resignation, removal, disqualification and release;
- termination of the process: company voluntary arrangement, moving to administration, dissolution;
- substitution of bank insolvency as an alternative order, exclusion of other proceedings, notification to FSA of steps taken by a third party to bring insolvency procedures, the application of the Company Directors Disqualification Act 1986, a power to apply insolvency law with modification to bank insolvency; and
- miscellaneous provisions: the power to charge fees, the Insolvency Services Account, partnerships, the application of provisions of the Insolvency Act 1986 regarding cooperation between the courts and evidence.

A.15 Chapter 4 describes the policy underpinning the clauses.

PART 1

SPECIAL RESOLUTION REGIME

Introduction

1 Overview

(1) The purpose of the special resolution regime for banks is to address the situation where all or part of the business of a bank has encountered, or is likely to encounter, financial difficulties.

(2) The special resolution regime consists of—
   (a) the three stabilisation options, and
   (b) the bank insolvency procedure (provided by Part 2).

(3) The three "stabilisation options" are—
   (a) transfer to a private sector purchaser (section 11),
   (b) transfer to a bridge bank (section 12), and
   (c) transfer to temporary public ownership (section 13).

(4) Each of the three stabilisation options is achieved through the exercise of one or more of the "stabilisation powers", which are—
   (a) the share transfer power (section []), and
   (b) the property transfer powers (sections 14 and 23).

(5) Each of the following has a role in the operation of the special resolution regime—
   (a) the Bank of England,
   (b) the Treasury, and
   (c) the Financial Services Authority.

(6) The Table describes the provisions of this Part.

Sections	*Topic*
Sections 1 to 3	Introduction
Sections 4 to 6	Objectives and code
Sections 7 to 10	Exercise of powers: general
Sections 11 to 13	The stabilisation options
Sections 14 to 23	Transfer of property
Sections 24 to 32	Compensation

2 Interpretation: "bank"

(1) In this Part "bank" means a UK institution which has permission under Part 4 of the Financial Services and Markets Act 2000 to carry on the regulated activity of accepting deposits (within the meaning of section 22 of that Act, taken with Schedule 2 and any order under section 22).

(2) But "bank" does not include—

(a) a building society within the meaning of section 119 of the Building Societies Act 1986, or

(b) a credit union within the meaning of section 31 of the Credit Unions Act 1979.

(3) In subsection (1) "UK institution" means an institution which is incorporated in, or formed under the law of any part of, the United Kingdom.

3 Interpretation: other expressions

In this Part—

"the FSA" means the Financial Services Authority, and

"financial assistance" includes giving guarantees or indemnities and any other kind of financial assistance (actual or contingent).

Objectives and code

4 Special resolution objectives

(1) This section sets out the special resolution objectives.

(2) The relevant authorities shall have regard to the special resolution objectives in using, or considering the use of, the stabilisation powers or the bank insolvency procedure.

(3) For the purpose of this section the relevant authorities are—

(a) the Treasury,

(b) the FSA, and

(c) the Bank of England.

(4) Objective 1 is to protect and enhance the stability of the financial systems of the United Kingdom.

(5) Objective 2 is to protect and enhance public confidence in the stability of the banking systems of the United Kingdom.

(6) Objective 3 is to protect depositors.

(7) Objective 4 is to protect public funds.

(8) Objective 5 is to avoid interfering with property rights in contravention of a Convention right (within the meaning of the Human Rights Act 1998).

(9) The order in which the objectives are listed in this section is not significant; they are to be balanced as appropriate in each case.

5 Code of practice

(1) The Treasury shall issue a code of practice about the use of—

(a) the stabilisation powers, and
(b) the bank insolvency procedure.

(2) The code must, in particular, provide guidance on—
(a) how to achieve the special resolution objectives,
(b) the information to be provided in the course of a consultation under this Part,
(c) the giving of advice by one relevant authority to another about whether, when and how the stabilisation powers are to be used,
(d) how to determine whether Condition 2 in section 7 is met, and
(e) how to determine whether the test for the use of stabilisation powers in section 8 is satisfied.

(3) The relevant authorities shall have regard to the code in using, or considering the use of, the stabilisation powers or the bank insolvency procedure.

(4) For the purpose of this section the relevant authorities are—
(a) the Treasury,
(b) the FSA, and
(c) the Bank of England.

6 Code of practice: procedure

(1) Before issuing the code of practice the Treasury must consult—
(a) the FSA,
(b) the Bank of England, and
(c) the scheme manager of the Financial Services Compensation Scheme (established under Part 15 of the Financial Services and Markets Act 2000).

(2) As soon as is reasonably practicable after issuing the code of practice the Treasury shall lay a copy before Parliament.

(3) The Treasury may revise and re-issue the code of practice.

(4) Subsections (1) and (2) apply to re-issue as to the first issue.

Exercise of powers: general

7 General conditions

(1) A stabilisation power may be exercised in respect of a bank only if the FSA is satisfied that the following conditions are met.

(2) Condition 1 is that the bank is failing, or is likely to fail, to satisfy the threshold conditions (within the meaning of section 41(1) of the Financial Services and Markets Act 2000 (permission to carry on regulated activities)).

(3) Condition 2 is that having regard to timing and other relevant circumstances it is not reasonably likely that (ignoring the stabilisation powers) action will be taken by or in respect of the bank that will enable the bank to satisfy the threshold conditions.

(4) The FSA shall treat Conditions 1 and 2 as met if satisfied that they would be met but for financial assistance provided by—

(a) the Treasury, or
(b) the Bank of England (disregarding ordinary market assistance offered by the Bank on its usual terms).

(5) Before determining whether or not Condition 2 is met the FSA must consult—
(a) the Bank of England, and
(b) the Treasury.

(6) The special resolution objectives are not relevant to Conditions 1 and 2.

(7) The conditions for applying for a bank insolvency order are set out in sections 39 and 40.

8 Specific conditions: private sector purchaser and bridge bank

(1) The Bank of England may exercise a stabilisation power in respect of a bank in accordance with section 11(2) or 12(2) only if satisfied that Condition A is met.

(2) Condition A is that the exercise of the power is necessary, having regard to the public interest in—
(a) the stability of the financial systems of the United Kingdom,
(b) the maintenance of public confidence in the stability of the banking systems of the United Kingdom, or
(c) the protection of depositors.

(3) Before determining whether Condition A is met, and if so how to react, the Bank of England must consult—
(a) the FSA, and
(b) the Treasury.

(4) Where the Treasury notifies the Bank of England that the Treasury has provided financial assistance in respect of a bank for the purpose of resolving or reducing a serious threat to the stability of the financial systems of the United Kingdom, the Bank of England may exercise a stabilisation power in respect of the bank in accordance with section 11(2) or 12(2) only if satisfied that Condition B is met (instead of Condition A).

(5) Condition B is that—
(a) the Treasury has recommended the Bank of England to exercise the stabilisation power on the grounds that it is necessary to protect the public interest, and
(b) in the Bank of England's opinion, exercise of the stabilisation power is an appropriate way to provide that protection.

(6) The conditions in this section are in addition to the conditions in section 7.

9 Treasury involvement

(1) The Bank of England may not exercise a stabilisation power in respect of a bank if the Treasury notifies the Bank that the exercise would be likely to contravene an international obligation of the United Kingdom.

(2) A notice under subsection (1)—
(a) must be in writing, and
(b) may be withdrawn (generally, partially or conditionally).

(3) The Bank of England may not exercise a stabilisation power in respect of a bank without the Treasury's consent if the exercise would be likely to have implications for public funds.

(4) In subsection (3)—
  (a) "public funds" means the Consolidated Fund and any other account or source of money which cannot be drawn or spent other than by, or with the authority of, the Treasury, and
  (b) action has implications for public funds if it would or might involve or lead to a need for the application of public funds.

(5) The Treasury may by order specify considerations which are to be, or not to be, taken into account in determining whether action has implications for public funds for the purpose of subsection (3).

(6) If the Treasury gives a notice under subsection (1) or refuses consent under subsection (3), the Bank of England must consider other exercises of the stabilisation powers with a view to—
  (a) pursuing the special resolution objectives, and
  (b) avoiding the objections on which the Treasury's notice or refusal was based.

(7) The Treasury may by notice to the Bank of England disapply subsection (6) in respect of a bank; and a notice may be revoked by further notice.

10 Specific conditions: temporary public ownership

(1) The Treasury may exercise a stabilisation power in respect of a bank in accordance with section 13(2) only if satisfied that one of the following conditions is met.

(2) Condition A is that the exercise of the power is necessary to resolve or reduce a serious threat to the stability of the financial systems of the United Kingdom.

(3) Condition B is that exercise of the power is necessary to protect the public interest, where the Treasury has provided financial assistance in respect of the bank for the purpose of resolving or reducing a serious threat to the stability of the financial systems of the United Kingdom.

(4) Before determining whether a condition is met the Treasury must consult—
  (a) the FSA, and
  (b) the Bank of England.

(5) The conditions in this section are in addition to the conditions in section 7.

The stabilisation options

11 Private sector purchaser

(1) The first stabilisation option is to sell all or part of the business of the bank to a commercial purchaser.

(2) For that purpose the Bank of England may make—
  (a) a share transfer instrument;
  (b) a property transfer instrument.

12 Bridge bank

(1) The second stabilisation option is to transfer all or part of the business of the bank to a bank established and controlled by the Bank of England in accordance with section [].

(2) For that purpose the Bank of England may make a property transfer instrument.

13 Temporary public ownership

(1) The third stabilisation option is to take the bank into temporary public ownership.

(2) For that purpose the Treasury may make a share transfer order.

Transfer of property

14 Property transfer instrument

(1) A property transfer instrument is an instrument which—
(a) provides for property, rights or liabilities of a specified bank to be transferred;
(b) makes other provision for the purposes of, or in connection with, the transfer of property, rights or liabilities of a specified bank (whether the transfer has been or is to be effected by that instrument, by another property transfer instrument or otherwise).

(2) A property transfer instrument may relate to—
(a) all property, rights and liabilities of the specified bank,
(b) all its property, rights and liabilities subject to specified exceptions,
(c) specified property, rights or liabilities, or
(d) property, rights or liabilities of a specified description.

15 Effect

(1) In this section "transfer" means a transfer provided for by a property transfer instrument.

(2) A transfer takes effect by virtue of the instrument (and in accordance with its provisions as to timing or other ancillary matters).

(3) A transfer takes effect despite any restriction arising by virtue of contract or legislation or in any other way.

(4) In subsection (3) "restriction" includes—
(a) any restriction, inability or incapacity affecting what the bank could assign or transfer, and
(b) a requirement for consent (by any name).

16 Transferable property

A property transfer instrument may transfer any property, rights or liabilities including, in particular—
(a) property, rights and liabilities acquired or arising between the making of the instrument and the transfer date,
(b) rights and liabilities arising on or after the transfer date in respect of matters occurring before that date,
(c) property outside the United Kingdom,
(d) rights and liabilities under the law of a place outside the United Kingdom, and
(e) rights and liabilities under an enactment (including legislation of the European Union).

17 Continuity

(1) A property transfer instrument may provide for a transferee to be treated for any purpose connected with the transfer as the same person as the transferor.

(2) A property transfer instrument may provide for agreements made or other things done by or in relation to a transferor to be treated as made or done by or in relation to the transferee.

(3) A property transfer instrument may provide for anything (including legal proceedings) that relates to anything transferred and is in the process of being done by or in relation to the transferor immediately before the transfer date, to be continued by or in relation to the transferee.

(4) A property transfer instrument which transfers or enables the transfer of a contract of employment may include provision about continuity of employment.

(5) A property transfer instrument may modify references (express or implied) in an instrument or document to a transferor.

(6) In so far as rights and liabilities in respect of anything transferred are enforceable after transfer, a property transfer instrument may provide for apportionment between transferor and transferee to a specified extent and in specified ways.

(7) A property transfer instrument may apportion liability to tax between transferor and transferee.

(8) A property transfer instrument may enable the transferor and transferee by agreement to modify a provision of the instrument; but a modification—
  (a) must achieve a result that could have been achieved by the instrument, and
  (b) may not transfer (or arrange for the transfer of) property, rights or liabilities.

(9) A property transfer instrument may require or permit—
  (a) a transferor to provide a transferee with information and assistance;
  (b) a transferee to provide a transferor with information and assistance.

18 Licences

(1) A licence in respect of anything transferred by property transfer instrument shall continue to have effect despite the transfer.

(2) A property transfer instrument may disapply subsection (1) to a specified extent.

(3) Where a licence imposes rights or obligations, a property transfer instrument may apportion responsibility for exercise or compliance between transferor and transferee.

(4) In this section "licence" includes permission and approval and any other permissive document in respect of anything transferred.

19 Termination rights, &c.

(1) In this section "default event provision" means a provision of a contract or other agreement that if a specified event occurs—
  (a) the agreement is terminated, modified or replaced,
  (b) rights or duties under the agreement are terminated, modified or replaced,

(c) a right accrues to terminate, modify or replace the agreement,
(d) a right accrues to terminate, modify or replace rights or duties under the agreement,
(e) a sum becomes payable or ceases to be payable,
(f) delivery of anything becomes due or ceases to be due,
(g) a right to claim a payment or delivery accrues, changes or lapses,
(h) any other right accrues, changes or lapses, or
(i) an interest is created, changes or lapses.

(2) A property transfer instrument may provide for subsection (3) or (4) to apply (but need not apply either).

(3) If this subsection applies, the property transfer instrument is to be disregarded in determining whether a default event provision applies.

(4) If this subsection applies, the property transfer instrument is to be disregarded in determining whether a default event provision applies except in so far as the instrument provides otherwise.

(5) In subsections (3) and (4) a reference to the property transfer instrument is a reference to—
(a) the making of the instrument,
(b) anything that is to be, or may be, done under or by virtue of the instrument, and
(c) any action or decision taken or made under this or another enactment in so far as it resulted in, or was connected to, the making of the instrument.

(6) Provision under subsection (2) may apply subsection (3) or (4) generally or only for specified purposes.

20 Foreign property

(1) This section applies where a property transfer instrument transfers foreign property.

(2) In subsection (1) "foreign property" means—
(a) property outside the United Kingdom, and
(b) rights and liabilities under foreign law.

(3) The transferor and the transferee must each take any necessary steps to ensure that the transfer is effective as a matter of foreign law (if it is not wholly effective by virtue of the property transfer instrument).

(4) Until the transfer is effective as a matter of foreign law, the transferor must—
(a) hold the property or right for the benefit of the transferee (together with any additional property or right accruing by virtue of the original property or right), or
(b) discharge the liability on behalf of the transferee.

(5) The transferee must meet any expenses of the transferor in complying with this section.

(6) An obligation imposed by this section is enforceable as if created by contract between the transferor and transferee.

(7) The transferor must comply with any directions of the Bank of England in respect of the obligations under subsections (3) and (4); and—
(a) a direction may disapply subsections (3) and (4) to a specified extent, and
(b) obligations imposed by direction are enforceable as if created by contract between the transferor and the Bank of England.

(8) In this section "foreign law" means the law of a place outside the United Kingdom.

21 Incidental provision

(1) A property transfer instrument may include incidental, consequential or transitional provision.

(2) In relying on subsection (1) an instrument—
(a) may make provision generally or only for specified purposes, and
(b) may make different provision for different purposes.

22 Procedure

(1) As soon as is reasonably practicable after making a property transfer instrument in respect of a bank the Bank of England shall send a copy to—
(a) the bank,
(b) the Treasury,
(c) the FSA, and
(d) any other persons specified in the code of practice under section 5.

(2) As soon as is reasonably practicable after making a property transfer instrument the Bank of England shall publish a copy—
(a) on the Bank's internet website, and
(b) in two newspapers, chosen by the Bank of England to maximise the likelihood of the instrument coming to the attention of persons likely to be affected.

23 Subsequent instruments

(1) This section applies where the Bank of England has made a property transfer instrument in accordance with section 11(2) or 12(2).

(2) The Bank of England may make one or more further property transfer instruments.

(3) For the purpose of a further property transfer instrument—
(a) sections 7 and 8 do not apply,
(b) transfers may be made either from the transferor under the original instrument ("the original transferor") or to the original transferor from an original transferee, and
(c) the instrument may make incidental provision of a kind permitted by this group of sections, whether in connection with a transfer under the original instrument or in connection with a transfer under a further instrument.

(4) In the case of a property transfer instrument made in accordance with section 11(2), a further property transfer instrument may not transfer property, rights or liabilities.

(5) Before making a property transfer instrument in reliance on this section the Bank of England must consult—
   (a) the FSA, and
   (b) the Treasury.

Compensation

24 Orders

(1) This Part provides three methods of protecting the financial interests of transferors and others in connection with share transfer instruments and orders and property transfer instruments.

(2) A "compensation scheme order" is an order establishing a scheme for—
(a) determining whether transferors should be paid compensation, and
(b) paying any compensation.

(3) A "resolution fund order" is an order establishing a scheme under which transferors become entitled to the proceeds of the disposal of things transferred—
(a) in specified circumstances, and
(b) to a specified extent.

(4) A "third party compensation order" is an order establishing a scheme for paying compensation to persons other than a transferor.

25 Transfer to bridge bank

(1) This section applies if the Bank of England makes a property transfer instrument in accordance with section 12(2).

(2) The Treasury shall make a resolution fund order.

(3) An order made by virtue of subsection (2) may include—
(a) a compensation scheme order;
(b) a third party compensation order (which may, in particular, make provision, in respect of specified classes of creditor, for rights in addition to any rights they may have by virtue of the resolution fund order).

26 Transfer to temporary public ownership

(1) This section applies if the Treasury makes a share transfer order in accordance with section 13(2).

(2) The Treasury shall make either—
(a) a compensation scheme order, or
(b) a resolution fund order.

(3) An order made by virtue of subsection (2) may include a third party compensation order.

27 Independent valuer

(1) A compensation scheme order must provide for the amount of any compensation payable to be determined by a person appointed in accordance with the order (the "independent valuer").

(2) An order must provide for the independent valuer to be appointed by a person appointed by the Treasury ("the appointing person").

(3) An order may either—
  (a) require the Treasury to make arrangements to identify a number of possible independent valuers, one of whom is to be selected by the appointing person, or
  (b) require the appointing person to make arrangements to select the independent valuer, having regard to any criteria specified in the order.

(4) The independent valuer may be removed only—
  (a) on the grounds of incapacity or serious misconduct, and
  (b) by a person specified by the Treasury in accordance with the compensation scheme order.

(5) An order must include provision for resignation and replacement of the independent valuer (and subsections (2) and (3) apply to replacement as to the first appointment).

(6) This section applies to third party compensation orders as to compensation scheme orders.

28 Independent valuer: supplemental

(1) An independent valuer may do anything necessary or desirable for the purposes of or in connection with the performance of the functions of the office.

(2) The Treasury may by order confer specific functions on independent valuers; in particular, the order may—
  (a) enable independent valuers to require the provision of information or the giving of oral or written evidence;
  (b) enable or require independent valuers to publish, disclose or withhold information.

(3) Provision under subsection (2) may—
  (a) confer a discretion on independent valuers;
  (b) confer jurisdiction on a court or tribunal;
  (c) make provision about oaths, expenses and other procedural matters relating to the giving of evidence or the provision of information;
  (d) create a criminal offence;
  (e) make other provision about enforcement.

(4) An independent valuer may appoint staff.

(5) The Treasury may by order make provision about the procedure to be followed by independent valuers.

(6) The Treasury may by order make provision for—
  (a) reconsideration of a decision of an independent valuer;
  (b) appeal to a court or tribunal against the decision of an independent valuer.

(7) Independent valuers (and their staff) are neither servants nor agents of the Crown (and, in particular, are not civil servants).

(8) Records of an independent valuer are public records for the purposes of the Public Records Act 1958.

29 Independent valuer: money

(1) The Treasury may by order provide for the payment by the Treasury of remuneration and allowances to—
   (a) independent valuers,
   (b) staff of independent valuers, and
   (c) appointing persons.

(2) The order may—
   (a) provide for the appointment by the Treasury of a person to monitor the operation of the arrangements for remuneration and allowances for independent valuers;
   (b) require, or enable a compensation scheme order or third party compensation order to require, the monitor's approval before specified things may be done in the course of those arrangements;
   (c) include provision about records and accounts;
   (d) make provision about numbers of staff and the terms and conditions of their appointment (which may include provision requiring the approval of the Treasury or the monitor).

(3) In subsection (1) a reference to the payment of allowances to a person includes a reference to the payment to or in respect of the person of sums by way of or in respect of pension.

(4) Independent valuers (and their staff) are not liable for damages in respect of anything done in good faith for the purposes of or in connection with the functions of the office (subject to section 8 of the Human Rights Act 1998).

30 Valuation principles

(1) A compensation scheme order may specify principles ("valuation principles") to be applied in determining the amount of compensation.

(2) Valuation principles may, in particular, require an independent valuer—
   (a) to apply, or not to apply, specified methods of valuation;
   (b) to assess values or average values at specified dates or over specified periods;
   (c) to take specified matters into account in a specified manner;
   (d) not to take specified matters into account.

(3) In determining an amount of compensation (whether or not in accordance with valuation principles) an independent valuer must disregard actual or potential financial assistance provided by the Bank of England or the Treasury (disregarding ordinary market assistance offered by the Bank on its usual terms).

(4) Valuation principles may require or permit an independent valuer to assume that the bank—
   (a) has had a permission under Part IV of the Financial Services and Markets Act 2000 (regulated activities) varied or cancelled;
   (b) is unable to continue as a going concern;
   (c) is in administration;
   (d) is being wound up.

(5) There is nothing to prevent the application of the valuation principles in an order from resulting in no compensation being payable to a transferor.

(6) This section applies to a third party compensation order as to a compensation scheme order.

31 Resolution fund

(1) A resolution fund order must include provision for determining—
  (a) who will be entitled to a share of the proceeds on disposal of things transferred,
  (b) the way in which the proceeds will be calculated, and
  (c) the way in which shares will be calculated.

(2) Provision under subsection (1)(b) may, in particular, provide for proceeds to be calculated net of—
  (a) amounts required for the repayment of loans from public funds or for other payments in respect of public financial assistance;
  (b) some or all of the administrative or other expenses incurred in connection with the provisions of this Part.

(3) A resolution fund order may confer a discretionary function on—
  (a) a Minister of the Crown,
  (b) the Treasury,
  (c) the Bank of England, or
  (d) any other specified person.

(4) A resolution fund order may include provision for the determination of disputes about the application of its provisions (whether by conferring jurisdiction on a court or tribunal or otherwise).

32 Procedure

(1) This section applies to—
  (a) compensation scheme orders,
  (b) resolution fund orders,
  (c) third party compensation orders, and
  (d) other orders of the Treasury under this Part.

(2) An order—
  (a) may make provision generally or for specified purposes,
  (b) may make different provision for different purposes,
  (c) may include incidental, consequential or transitional provision, and
  (d) shall be made by statutory instrument.

(3) A compensation scheme order, resolution fund order or third party compensation order may not be made unless a draft has been laid before and approved by resolution of each House of Parliament.

(4) An order under section 9(5) shall be subject to annulment in pursuance of a resolution of the House of Commons.

(5) Any other order under this Part shall be subject to annulment in pursuance of a resolution of either House of Parliament.

PART 2

BANK INSOLVENCY

Introduction

33 Overview

(1) This Part provides for a procedure to be known as bank insolvency.

(2) The main features of bank insolvency are that—
  (a) a bank enters the process by court order,
  (b) the order appoints a bank liquidator,
  (c) the bank liquidator aims to arrange for the bank's eligible depositors to have their accounts transferred or to receive their compensation from the FSCS,
  (d) the bank liquidator then winds up the bank, and
  (e) for those purposes, the bank liquidator has powers and duties of liquidators, as applied and modified by the provisions of this Part.

(3) The Table describes the provisions of this Part.

Sections	*Topic*
Sections 33 to 36	Introduction
Sections 37 to 41	Bank insolvency order
Sections 42 to 49	Process of bank liquidation
Sections 50 to 53	Tenure of bank liquidator
Sections 55 to 58	Termination of process, &c.
Sections 59 to 64	Other processes
Sections 65 to 69	Miscellaneous

34 Interpretation: "bank"

(1) In this Part "bank" means an institution which has permission under Part 4 of the Financial Services and Markets Act 2000 to carry on the regulated activity of accepting deposits (within the meaning of section 22 of that Act, taken with Schedule 2 and any order under section 22).

(2) But "bank" does not include a credit union within the meaning of section 31 of the Credit Unions Act 1979.

35 Interpretation: "the court"

In this Part "the court" means—
  (a) in England and Wales, the High Court,
  (b) in Scotland, the Court of Session, and
  (c) in Northern Ireland, the High Court.

36 Interpretation: other expressions

(1) In this Part "the FSA" means the Financial Services Authority.

(2) In this Part a reference to "the FSCS" is a reference to—
   (a) the Financial Services Compensation Scheme (established under Part 15 of the Financial Services and Markets Act 2000), or
   (b) where appropriate, the scheme manager of that Scheme.

(3) A reference in this Part to "eligible depositors" means depositors eligible for compensation under the FSCS.

(4) For the purposes of a reference in this Part to inability to pay debts—
   (a) a bank that is in default on an obligation to pay a sum due and payable under an agreement, is to be treated as unable to pay its debts, and
   (b) section 123 of the Insolvency Act 1986 also applies; and

   for the purposes of paragraph (a) "agreement" means an agreement the making or performance of which constitutes or is part of a regulated activity carried on by the bank.

(5) Expressions used in this Part and in the Insolvency Act 1986 have the same meaning as in that Act.

(6) Expressions used in this Part and in the Companies Act 2006 have the same meaning as in that Act.

(7) The expression "fair" is used in this Part as a shorter modern equivalent of the expression "just and equitable" (and is not therefore intended to exclude the application of any judicial or other practice relating to the construction and application of that expression).

Bank insolvency order

37 The order

(1) A bank insolvency order is an order appointing a person as the bank liquidator of a bank.

(2) A person is eligible for appointment as a bank liquidator if qualified to act as an insolvency practitioner.

(3) An appointment may be made only if the person has consented to act.

(4) A bank insolvency order takes effect in accordance with section 41; and—
   (a) the process of a bank insolvency order having effect may be described as "bank insolvency" in relation to the bank, and
   (b) while the order has effect the bank may be described as being "in bank insolvency".

38 Application

(1) An application for a bank insolvency order may be made to the court by—
   (a) the Bank of England,
   (b) the FSA, or
   (c) the Secretary of State.

(2) An application must nominate a person to be appointed as the bank liquidator.

(3) An application may be made without notice.

39 Grounds for applying

(1) In this section—
  (a) Ground A is that a bank is unable, or likely to become unable, to pay its debts,
  (b) Ground B is that the winding up of a bank would be in the public interest, and
  (c) Ground C is that the winding up of a bank would be fair.

(2) The Bank of England may apply for a bank insolvency order only if—
  (a) the FSA has informed the Bank of England that the FSA is satisfied that Conditions 1 and 2 of section 7 are met, and
  (b) the Bank of England is satisfied—
    (i) that the bank has eligible depositors, and
    (ii) that Ground A or C applies.

(3) The FSA may apply for a bank insolvency order only if—
  (a) the Bank of England consents, and
  (b) the FSA is satisfied—
    (i) that Conditions 1 and 2 of section 7 are met,
    (ii) that the bank has eligible depositors, and
    (iii) that Ground A or C applies.

(4) The Secretary of State may apply for a bank insolvency order only if satisfied—
  (a) that the bank has eligible depositors, and
  (b) that Ground B applies.

(5) The sources of information on the basis of which the Secretary of State may be satisfied of the matters specified in subsection (4) include those listed in section 124A(1) of the Insolvency Act 1986 (petition for winding up on grounds of public interest).

40 Grounds for making

(1) The court may make a bank insolvency order on the application of the Bank of England or the FSA if satisfied—
  (a) that the bank has eligible depositors, and
  (b) that Ground A or C of section 39 applies.

(2) The court may make a bank insolvency order on the application of the Secretary of State if satisfied—
  (a) that the bank has eligible depositors, and
  (b) that Grounds B and C of section 39 apply.

(3) On an application for a bank insolvency order the court may—
  (a) grant the application in accordance with subsection (1) or (2),
  (b) adjourn the application (generally or to a specified date), or
  (c) dismiss the application.

41 Commencement

(1) A bank insolvency order shall be treated as having taken effect in accordance with this section.

(2) In the case where—
  (a) notice has been given to the FSA under section 62 of an application for an administration order or a petition for a winding up order, and
  (b) the FSA or the Bank of England applies for a bank insolvency order in the period of 2 weeks specified in that section,

the bank insolvency order is treated as having taken effect when the application or petition was made or presented.

(3) In any other case, the bank insolvency order is treated as having taken effect when the application for the order is made.

(4) Unless the court directs otherwise on proof of fraud or mistake, proceedings taken in the bank insolvency, during the period for which it is treated as having had effect, are treated as having been taken validly.

Process of bank liquidation

42 Objectives

(1) A bank liquidator has two objectives.

(2) Objective 1 is to work with the FSCS so as to ensure that as soon as is reasonably practicable each eligible depositor receives appropriate treatment.

(3) For the purposes of Objective 1 the appropriate treatment for an eligible depositor is to have the relevant account transferred to another financial institution.

(4) But if the transfer would prejudice the interests of the bank's creditors as a whole, the appropriate treatment for an eligible depositor is to receive payment from (or on behalf of) the FSCS.

(5) Objective 2 is to wind up the affairs of the bank so as to achieve the best result for the bank's creditors as a whole.

(6) Objective 1 takes precedence over Objective 2 (but the bank liquidator is obliged to begin work towards both objectives immediately upon appointment).

43 Role of FSCS

(1) For the purpose of co-operating in the pursuit of Objective 1 of section 42 the FSCS—
  (a) may make or arrange for payments to or in respect of eligible depositors of the bank, and
  (b) may make money available to facilitate the transfer of accounts of eligible depositors of the bank.

(2) The FSCS may include provision about expenditure under this section (and, in particular, levies may be imposed in connection with that expenditure as if it were compensation under the scheme).

(3) In section 220(3)(a) of the Financial Services and Markets Act 2000 (Compensation Scheme: information) after "liquidator" insert ", bank liquidator".

(4) The FSCS is entitled to participate in proceedings for or in respect of a bank insolvency order.

(5) A bank liquidator may provide information to the FSCS.

44 Liquidation committee

(1) Following a bank insolvency order a liquidation committee must be established, for the purpose of ensuring that the bank liquidator properly exercises the functions under this Part.

(2) The liquidation committee shall consist initially of 3 individuals, one nominated by each of—
  (a) the Bank of England,
  (b) the FSA, and
  (c) the FSCS.

(3) The bank liquidator must report to the liquidation committee about any matter—
  (a) on request, or
  (b) which the bank liquidator thinks is likely to be of interest to the liquidation committee.

(4) In particular, the bank liquidator—
  (a) must keep the liquidation committee informed of progress towards Objective 1 of section 42, and
  (b) must notify the liquidation committee when in the bank liquidator's opinion Objective 1 of section 42 has been achieved entirely or so far as is reasonably practicable.

(5) As soon as is reasonably practicable after receiving notice under subsection (4)(b) the liquidation committee must either—
  (a) resolve that Objective 1 of section 42 has been achieved entirely or so far as is reasonably practicable (a "full payment resolution"), or
  (b) apply to the court under section 168(5) of the Insolvency Act 1986 (as applied by section 47 below).

(6) Where a liquidation committee passes a full payment resolution—
  (a) the bank liquidator must summon a meeting of creditors,
  (b) the meeting may elect 2 or 4 individuals as new members of the liquidation committee,
  (c) those individuals replace the members nominated by the Bank of England and the FSA,
  (d) the FSCS may resign from the liquidation committee (in which case 3 or 5 new members may be elected under paragraph (b)), and
  (e) if no individuals are elected under paragraph (b), or the resulting committee would have fewer than 3 members or an even number of members, the liquidation committee ceases to exist at the end of the meeting.

(7) Subject to provisions of this section, rules under section 411 of the Insolvency Act 1986 (as amended by section 49 below) may make provision about—
 (a) the establishment of liquidation committees,
 (b) the membership of liquidation committees,
 (c) the functions of liquidation committees, and
 (d) the proceedings of liquidation committees.

45 Liquidation committee: supplemental

(1) A meeting of the liquidation committee may be summoned—
 (a) by any of the members, or
 (b) by the bank liquidator.

(2) While the liquidation committee consists of the initial members (or their nominated replacements) a meeting is quorate only if all the members are present.

(3) A person aggrieved by any action of the liquidation committee may apply to the court, which may make any order (including an order for the repayment of money).

(4) The court may (whether on an application under subsection (3), on the application of a bank liquidator or otherwise) make an order that the liquidation committee is to be treated as having passed a full payment resolution.

(5) If a liquidation committee fails to comply with section 44(5) the bank liquidator must apply to the court—
 (a) for an order under subsection (4) above, or
 (b) for directions under or by virtue of section 168(3) or 169(2) of the Insolvency Act 1986 as applied by section 47 below.

(6) A nominating body under section 44(2) may replace its nominee at any time.

(7) After the removal of the nominated members under section 44(6)(c) the FSA and the Bank of England—
 (a) may attend meetings of the liquidation committee,
 (b) are entitled to copies of documents relating to the liquidation committee's business,
 (c) may make representations to the liquidation committee, and
 (d) may participate in legal proceedings relating to the bank insolvency.

(8) Where a liquidation committee ceases to exist by virtue of section 44(6)(e)—
 (a) ignore a reference in this Part to the liquidation committee,
 (b) for section 55(2) to (4) substitute requirements for the bank liquidator, before making a proposal—
  (i) to produce a final report,
  (ii) to send copies in accordance with section 55(2)(b),
  (iii) to make it available in accordance with section 55(2)(c), and
  (iv) to be satisfied as specified in section 55(4)(b),
 (c) ignore Condition 2 of section 56, and
 (d) for section 57(1) to (5) substitute a power for the bank liquidator to apply to the Secretary of State or Accountant of Court for release and

requirements that before making an application the bank liquidator must—
(i) produce a final report,
(ii) send copies in accordance with section 57(2)(b),
(iii) make it available in accordance with section 57(2)(c), and
(iv) notify the court and the registrar of companies of the intention to vacate office and to apply for release.

46 Status of liquidator

A bank liquidator is an officer of the court.

47 General powers, duties and effect

(1) A bank liquidator may do anything necessary or expedient for the pursuit of the Objectives in section 42.

(2) The following provisions of this section provide for—
(a) general powers and duties of bank liquidators (by application of provisions about liquidators), and
(b) the general process and effects of bank insolvency (by application of provisions about winding up).

(3) The provisions set out in the Table apply in relation to bank insolvency as in relation to winding up, with—
(a) the modifications set out in subsection (4),
(b) any other modification specified in the Table, and
(c) any other necessary modification.

(4) The modifications are that—
(a) a reference to the liquidator is a reference to the bank liquidator,
(b) a reference to winding up is a reference to bank insolvency,
(c) a reference to winding up by the court is a reference to the imposition of bank insolvency by order of the court,
(d) a reference to being wound up under Part IV or V of the Insolvency Act 1986 is a reference to being made the subject of a bank insolvency order,
(e) a reference to the commencement of winding up is a reference to the commencement of bank insolvency,
(f) a reference to going into liquidation is a reference to entering bank insolvency,
(g) a reference to a winding-up order is a reference to a bank insolvency order, and
(h) a reference to a company is a reference to the bank.

(5) Powers conferred by this Act, by the Insolvency Act 1986 (as applied) and the Companies Acts are in addition to, and not in restriction of, any existing powers of instituting proceedings against a contributory or debtor of a bank, or the estate of any contributory or debtor, for the recovery of any call or other sum.

(6) A reference in an enactment or other document to anything done under a provision applied by this Part includes a reference to the provision as applied.

TABLE OF APPLIED PROVISIONS

Provision of Insolvency Act 1986	*Subject*	*Modification or comment*
Section 127	Avoidance of property dispositions	Ignore section 127(2).
Section 128	Avoidance of attachment, &c.	
Section 130	Consequences of winding-up order	Ignore section 130(4).
Section 131	Company's statement of affairs	(a) Treat references to the official receiver as references to the bank liquidator. (b) A creditor or contributory of the bank is entitled to receive a copy of a statement under section 131 on request to the bank liquidator.
Section 143	General functions of liquidator	(a) Section 143(1) is subject to Objective 1 of section 42 above. (b) Ignore section 143(2).
Section 144	Custody of property	
Section 145	Vesting of property	
Section 146	*Duty to summon final meeting*	*Section 146 is not applied - but section 57 below makes similar provision.*
Section 147	Power to stay or sist proceedings	An application may be made only by— (a) the bank liquidator, (b) the FSA, (c) the Bank of England, (d) the FSCS, (e) a creditor or contributory (but only if the liquidation committee has passed a full payment resolution).
Section 148	List of contributories and application of assets	*By virtue of the Insolvency Rules the functions under this section are largely delegated to the liquidator - rules by virtue of section 49 will achieve a similar delegation to the bank liquidator.*
Section 149	Debts due from contributories	
Section 150	Power to make calls	
Section 152	Order on contributory: evidence	
Section 153	Exclusion of creditors	
Section 154	Adjustment of rights of contributories	
Section 155	Inspection of books by creditors	In making or considering whether to make an order under section 155 the court shall have regard to Objective 1 of section 42.
Section 156	Payment of expenses of winding up	
Section 157	Attendance at company meetings (Scotland)	

Provision of Insolvency Act 1986	*Subject*	*Modification or comment*
Section 158	Power to arrest absconding contributory	
Section 159	*Powers to be cumulative*	*Section 159 is not applied - but subsection (4) above makes similar provision.*
Section 160	Delegation of powers to liquidator (England and Wales)	
Section 161	Orders for calls on contributories (Scotland)	
Section 162	Appeals from orders (Scotland)	An appeal may be brought only if the liquidation committee has passed a full payment resolution.
Section 167 and Schedule 4	General powers of liquidator	(a) An application to the court may not be made under section 167(3) unless the liquidation committee has passed a full payment resolution (although a creditor or contributory may apply to the court with respect to any action (or inaction) of the liquidation committee, under section 45(3) above). (b) In exercising or considering whether to exercise a power under Schedule 4 the bank liquidator shall have regard to Objective 1 of section 42. (c) A reference to the liquidation committee is to the liquidation committee established by section 44. (d) The power in paragraph 4 of Schedule 4 includes the power to submit matters to arbitration. (e) *Some additional general powers are conferred by section 48 below.*
Section 168	Supplementary powers of liquidator	(a) A direction or request under section 168(2) has no effect unless the liquidation committee has passed a full payment resolution. (b) An application to the court may not be made under section 168(5) unless the liquidation committee has passed a full payment resolution (except as provided in section 44 above).
Section 169	Supplementary powers (Scotland)	(a) Ignore section 169(1). (b) Powers of the bank liquidator by virtue of section 169(2) are subject to Objective 1 of section 42 above.
Section 170	Liquidator's duty to make returns	The liquidation committee is added to the list of persons able to apply under section 170(2).
Section 172	*Removal of liquidator*	*Section 172 is not applied - but section 52 makes similar provision.*
Section 174	*Release of liquidator*	*Section 174 is not applied - but section 57 makes similar provision.*
Section 175	Preferential debts	

Provision of Insolvency Act 1986	*Subject*	*Modification or comment*
Section 176	Preferential charge on goods restrained	
Section 176ZA	Expenses of winding up	
Section 176A	Share of assets for unsecured creditors	
Section 177	Appointment of special manager	
Section 178	Power to disclaim onerous property	
Section 179	Disclaimer of leaseholds	
Section 180	Land subject to rentcharge	
Section 181	Disclaimer: powers of court	
Section 182	Leaseholds	
Section 183	Effect of execution or attachment (England and Wales)	
Section 184	Execution of writs (England and Wales)	
Section 185	Effect of diligence (Scotland)	In the application of section 37(1) of the Bankruptcy (Scotland) Act 1985 the reference to an order of the court awarding winding up is a reference to the making of the bank insolvency order.
Section 186	Rescission of contracts by court	
Section 187	Transfer of assets to employees	
Section 188	Publicity	
Section 189	Interest on debts	
Section 190	Exemption from stamp duty	
Section 191	Company’s books as evidence	
Section 192	Information about pending liquidations	
Section 193	Unclaimed dividends (Scotland)	
Section 194	Resolutions passed at adjourned meetings	
Section 195	Meetings to ascertain wishes of creditors or contributories	The power to have regard to the wishes of creditors and contributories is subject to Objective 1 of section 42.
Section 196	Judicial notice of court documents	
Section 197	Commission for receiving evidence	

Provision of Insolvency Act 1986	*Subject*	*Modification or comment*
Section 198	Court order for examination of persons (Scotland)	
Section 199	Costs of application for leave to proceed (Scotland)	
Section 200	Affidavits	
Section 206	Fraud in anticipation of winding up	
Section 207	Transactions in fraud of creditors	
Section 208	Misconduct in course of winding up	
Section 209	Falsification of company's books	
Section 210	Material omissions	
Section 211	False representations to creditors	
Section 212	Summary remedy against directors, &c.	
Section 213	Fraudulent trading	
Section 214	Wrongful trading	
Section 215	Sections 213 & 214: procedure	
Section 216	Restriction on re-use of company names	
Section 217	Personal liability for debts	
Section 218	Prosecution of officers and members of company	(a) Ignore subsections (4) and (6). (b) In subsection (3), treat the second reference to the official receiver as a reference to the Secretary of State. (c) In subsection (5) treat the reference to subsection (4) as a reference to subsection (3). (d) [Scotland.]
Section 219	Obligations under section 218	
Section 231	Appointment of 2 or more persons	
Section 232	Validity of acts	
Section 233	Utilities	
Section 234	Getting in company's property	
Section 235	Co-operation with liquidator	Ignore references to the official receiver
Section 236	Inquiry into company's dealings	Ignore references to the official receiver
Section 237	Section 236: enforcement by court	

Provision of Insolvency Act 1986	*Subject*	*Modification or comment*
Section 238	Transactions at undervalue (England and Wales)	
Section 239	Preferences (England and Wales)	Action taken in pursuance of or for the purposes of Objective 1 of section 42 is not giving a preference for the purpose of section 239.
Section 240	Sections 238 & 239: relevant time	
Section 241	Orders under sections 238 & 239	Having notice of the relevant proceedings means having notice of— (a) an application by the Bank of England, the FSA or the Secretary of State for a bank insolvency order, or (b) notice under section 62 below.
Section 242	Gratuitous alienations (Scotland)	
Section 243	Unfair preferences (Scotland)	
Section 244	Extortionate credit transactions	
Section 245	Avoidance of floating charges	
Section 246	Unenforceability of liens	
Sections 386 & 387, and Schedule 6 (and Schedule 4 to the Pension Schemes Act 1993)	Preferential debts	
Section 389	Offence of acting without being qualified	Treat references to acting as an insolvency practitioner as references to acting as a bank liquidator.
Section 390	Persons not qualified to act	Treat references to acting as an insolvency practitioner as references to acting as a bank liquidator.
Section 391	Recognised professional bodies	An order under section 391 has effect in relation to any provision applied for the purposes of bank insolvency.
Sections 423 - 425	Transactions defrauding creditors	
Section 433	Statements: admissibility	For section 433(1)(a) and (b) substitute a reference to a statement prepared for the purposes of a provision of this Part.

48 Additional general powers

(1) A bank liquidator has the following powers.

(2) Power to effect and maintain insurances in respect of the business and property of the bank.

(3) Power to do all such things (including the carrying out of works) as may be necessary for the realisation of the property of the bank.

(4) Power to make any payment which is necessary or incidental to the performance of the bank liquidator's functions.

49 Rules

(1) Section 411 of the Insolvency Act 1986 (company insolvency rules) is amended as follows.

(2) In subsection (1) after "Parts I to VII of this Act" insert ", Part 2 of the Banking Act 2008 (bank insolvency orders)".

(3) After subsection (2B) insert—

"(2C) For the purposes of subsection (2), a reference in Schedule 8 to this Act to doing anything under or for the purposes of a provision of this Act includes a reference to doing anything under or for the purposes of Part 2 of the Banking Act 2008."

(4) In subsection (3)—

(a) after "provisional liquidator" insert "or bank liquidator", and

(b) after "Parts I to VII of this Act" insert "or Part 2 of the Banking Act 2008".

Tenure of bank liquidator

50 Terms of appointment

A bank liquidator appointed by bank insolvency order remains in office until—

(a) resignation under section 51,

(b) removal under section 52,

(c) disqualification under section 53,

(d) the appointment by the court of a replacement, or

(e) vacation of office under section 57.

51 Resignation of bank liquidator

(1) A bank liquidator may resign by notice to the court.

(2) Rules under section 411 of the Insolvency Act 1986 (as amended by section 49 above) may restrict a bank liquidator's power to resign.

(3) Resignation shall take effect in accordance with those rules (which shall include provision about release).

52 Removal of bank liquidator

(1) A bank liquidator may be removed by order of the court on the application of—

(a) the liquidation committee,

(b) the FSA, or

(c) the Bank of England.

(2) Before making an application the FSA must consult the Bank of England.

(3) Before making an application the Bank of England must consult the FSA.

(4) A bank liquidator removed by order has release with effect from a time determined by—
  (a) the Secretary of State, or
  (b) in the case of a bank liquidator in Scotland, the Accountant of Court.

53 Disqualification

(1) If a bank liquidator ceases to be qualified to act as an insolvency practitioner, the appointment lapses.

(2) A bank liquidator whose appointment lapses under subsection (1) has release with effect from a time determined by—
  (a) the Secretary of State, or
  (b) in the case of a bank liquidator in Scotland, the Accountant of Court.

54 Release

A bank liquidator who is released is discharged from all liability in respect of acts or omissions in the bank insolvency and otherwise in relation to conduct as bank liquidator (but without prejudice to the effect of section 212 of the Insolvency Act 1986 as applied by section 47 above).

Termination of process, &c.

55 Company voluntary arrangement

(1) A bank liquidator may make a proposal in accordance with section 1 of the Insolvency Act 1986 (company voluntary arrangement).

(2) Before making a proposal the bank liquidator—
  (a) shall present a final report on the bank liquidation to the liquidation committee,
  (b) shall send a copy of the report to—
    (i) the FSA,
    (ii) the FSCS,
    (iii) the Bank of England,
    (iv) the Treasury, and
    (v) the registrar of companies, and
  (c) shall make the report available to members, creditors and contributories on request.

(3) A proposal may be made only with the consent of the liquidation committee.

(4) The liquidation committee may consent only if—
  (a) it has passed a full payment resolution, and
  (b) the bank liquidator is satisfied, as a result of arrangements made with the FSCS, that any depositor still eligible for compensation under the scheme will receive appropriate treatment within the meaning of section 42(3) and (4).

(5) The bank liquidator must be the nominee (see section 1(2) of the 1986 Act).

(6) Part 1 of the 1986 Act shall apply to a proposal made by a bank liquidator, with the following modifications.

(7) In section 3 (summoning of meetings) subsection (2) (and not (1)) applies.

(8) The action that may be taken by the court under section 5(3) (effect of approval) includes suspension of the bank insolvency order.

(9) On the termination of a company voluntary arrangement the bank liquidator may apply to the court to lift the suspension of the bank insolvency order.

56 Administration

(1) A bank liquidator who thinks that administration would achieve a better result for the bank's creditors as a whole than bank insolvency may apply to the court for an administration order (under paragraph 38 of Schedule B1 to the Insolvency Act 1986).

(2) An application may be made only if the following conditions are satisfied.

(3) Condition 1 is that the liquidation committee has passed a full payment resolution.

(4) Condition 2 is that the liquidation committee has resolved that moving to administration might enable the rescue of the bank as a going concern.

(5) Condition 3 is that the bank liquidator is satisfied, as a result of arrangements made with the FSCS, that any depositors still eligible for compensation under the scheme will receive their payments during administration.

57 Dissolution

(1) A bank liquidator who thinks that the winding up of the bank is for practical purposes complete shall summon a final meeting of the liquidation committee.

(2) The bank liquidator—
- (a) shall present a final report on the bank insolvency to the meeting,
- (b) shall send a copy of the report to—
  - (i) the FSA,
  - (ii) the FSCS,
  - (iii) the Bank of England,
  - (iv) the Treasury, and
  - (v) the registrar of companies, and
- (c) shall make the report available to members, creditors and contributories on request.

(3) At the meeting the liquidation committee shall—
- (a) consider the report, and
- (b) decide whether to release the bank liquidator.

(4) If the liquidation committee decides to release the bank liquidator, the bank liquidator—
- (a) shall notify the court and the registrar of companies, and
- (b) vacates office, and has release, when the court is notified.

(5) If the liquidation committee decides not to release the bank liquidator, the bank liquidator may apply to the Secretary of State for release; if the application is granted, the bank liquidator—
(a) vacates office when the application is granted, and
(b) has release from a time determined by the Secretary of State.

(6) In the case of a bank liquidator in Scotland, a reference in subsection (5) to the Secretary of State is a reference to the Accountant of Court.

(7) On receipt of a notice under subsection (4)(a) the registrar of companies shall register it.

(8) At the end of the period of 3 months beginning with the day of the registration of the notice, the bank is dissolved (subject to deferral under section 58).

58 Dissolution: supplemental

(1) The Secretary of State may by direction defer the date of dissolution under section 57, on the application of a person who appears to the Secretary of State to be interested.

(2) An appeal to the court lies from any decision of the Secretary of State on an application for a direction under subsection (1).

(3) Subsection (1) does not apply where the bank insolvency order was made by the court in Scotland; but the court may by direction defer the date of dissolution on an application by a person appearing to the court to have an interest.

(4) A person who obtains deferral under subsection (1) or (3) shall, within 7 days after the giving of the deferral direction, deliver a copy of the direction to the registrar of companies for registration.

(5) A person who without reasonable excuse fails to comply with subsection (4) is liable to a fine and, for continued contravention, to a daily default fine, in each case of the same amount as for a contravention of section 205(6) of the Insolvency Act 1986 (dissolution).

(6) The bank liquidator may give the notice summoning the final meeting at the same time as giving notice of any final distribution of the bank's property; but, if summoned for an earlier date the meeting shall be adjourned (and, if necessary, further adjourned) until a date on which the bank liquidator is able to report to the meeting that the winding up of the bank is for practical purposes complete.

(7) A bank liquidator must retain sufficient sums to cover the expenses of the final meeting.

Other processes

59 Bank insolvency as alternative order

(1) On a petition for a winding up order or an application for an administration order in respect of a bank the court may, instead, make a bank insolvency order.

(2) A bank insolvency order may be made under subsection (1) only—

(a) on the application of the FSA made with the consent of the Bank of England, or
(b) on the application of the Bank of England.

60 Voluntary winding-up

A resolution for voluntary winding up of a bank under section 84 of the Insolvency Act 1986 shall have no effect without the prior approval of the court.

61 Exclusion of other procedures

(1) The following paragraphs of Schedule B1 to the Insolvency Act 1986 (administration) apply to a bank liquidation order as to an administration order.

(2) Those paragraphs are—
(a) paragraph 40 (dismissal of pending winding-up petition), and
(b) paragraph 42 (moratorium on insolvency proceedings).

(3) For that purpose—
(a) a reference to an administration order is a reference to a bank insolvency order,
(b) a reference to a company being in administration is a reference to a bank being in bank insolvency, and
(c) a reference to an administrator is a reference to a bank liquidator.

62 Notice to FSA of preliminary steps

(1) An application for an administration order in respect of a bank may not be determined unless the conditions below are satisfied.

(2) A petition for a winding up order in respect of a bank may not be determined unless the conditions below are satisfied.

(3) A resolution for voluntary winding up of a bank may not be made unless the conditions below are satisfied.

(4) An administrator of a bank may not be appointed unless the conditions below are satisfied.

(5) Condition 1 is that the FSA has been notified—
(a) by the applicant for the administration order, that the application has been made,
(b) by the petitioner for a winding up order, that the petition has been presented,
(c) by the bank, that a resolution for voluntary winding up may be made, or
(d) by the person proposing to appoint an administrator, of the proposed appointment.

(6) Condition 2 is that a copy of the notice complying with Condition 1 has been filed with the court (and made available for public inspection by the court).

(7) Condition 3 is that the period of 2 weeks, beginning with the day on which the notice is received, has ended.

(8) Condition 4 is that no application for a bank insolvency order is pending.

(9) Arranging for the giving of notice in order to satisfy Condition 1 can be a step with a view to minimising the potential loss to a bank's creditors for the purpose of section 214 of the Insolvency Act 1986 (wrongful trading).

(10) Where the FSA receives notice under Condition 1—
(a) the FSA shall inform the Bank of England,
(b) the FSA shall inform the person who gave the notice, within the period in Condition 3, whether it intends to apply for a bank insolvency order, and
(c) if the Bank of England decides to apply for a bank insolvency order or to exercise a stabilisation power under Part 1, the Bank shall inform the person who gave the notice, within the period in Condition 3.

63 Disqualification of directors

(1) In this section "the Disqualification Act" means the Company Directors Disqualification Act 1986.

(2) In the Disqualification Act—
(a) a reference to liquidation includes a reference to bank insolvency,
(b) a reference to winding up includes a reference to making or being subject to a bank insolvency order,
(c) a reference to becoming insolvent includes a reference to becoming subject to a bank insolvency order, and
(d) a reference to a liquidator includes a reference to a bank liquidator.

(3) For the purposes of the application of section 7(3) of the Disqualification Act (disqualification order or undertaking) to a bank which is subject to a bank insolvency order, the responsible office-holder is the bank liquidator.

(4) After section 21 of the Disqualification Act (interaction with Insolvency Act) insert—

"21A Bank insolvency

Section 63 of the Banking Act 2008 provides for this Act to apply in relation to bank insolvency as it applies in relation to liquidation."

64 Application of insolvency law

(1) The Secretary of State may by order—
(a) provide for an enactment about insolvency to apply to bank insolvency (with or without specified modifications);
(b) amend, or modify the application of, an enactment about insolvency in consequence of, or in connection with, this Part.

(2) An order under subsection (1)—
(a) shall be made by statutory instrument, and
(b) may not be made unless a draft has been laid before, and approved by resolution of, each House of Parliament.

Miscellaneous

65 Fees

After section 414(8) of the Insolvency Act 1986 (fees orders) insert—

"(8A) This section applies in relation to Part 2 of the Banking Act 2008 (bank insolvency) as in relation to Parts I to VII of this Act."

66 Insolvency Services Account

A bank liquidator who obtains money by realising assets in the course of the bank insolvency must pay it into the Insolvency Services Account (kept by the Secretary of State with the Bank of England).

67 Partnerships

(1) The Lord Chancellor may, by order made with the concurrence of the Secretary of State and the Lord Chief Justice, modify provisions of this Part in their application to partnerships.

(2) For procedural purposes an order under subsection (1) shall be treated in the same way as an order under section 420 of the Insolvency Act 1986 (partnerships).

(3) This section does not apply in relation to partnerships under the law of Scotland.

68 Co-operation between courts

(1) Provisions of or by virtue of this Part are "insolvency law" for the purposes of section 426 of the Insolvency Act 1986 (co-operation between courts).

(2) At the end of that section insert—

"(12) Section 68 of the Banking Act 2008 provides for provisions of that Act to be "insolvency law" for the purposes of this section."

69 Evidence

In section 433(1) of the Insolvency Act 1986 (admissibility of statements of affairs) after paragraph (a) insert (before the "and")—

"(aa) a statement made in pursuance of a requirement imposed by or under Part 2 of the Banking Act 2008,".

B LIST OF QUESTIONS FOR CONSULTATION

B.1 The Authorities welcome responses to the following questions. Please feel free to provide other information, as appropriate, particularly in relation to comments on the draft clauses.

SRR objectives, roles and governance

2.1) Do you agree with the SRR objectives, as set out in draft clause 4?

2.2) Do you agree with the role of the FSA in determining the conditions for entering the SRR?

2.3) Do you agree with the conditions for entering the SRR as set out in draft clause 7?

2.4) Do you agree with the role of the Bank of England in operating the SRR in the public interest as set out in draft clause 8?

2.5) Do you agree with the roles of the Treasury as set out in draft clauses 8(4), 8(5), 9 and 10?

2.6) Do you agree that the SRR objectives should be supplemented by a code of practice?

2.7)Do you agree with the proposed areas to be covered in a code of practice?

SRR tools: stabilisation powers and compensation

3.1) What are your views on the breadth of the property transfer powers in clauses 14 to 23? Are there particular powers that are lacking?

3.2) What are your views on the nature of these powers?

3.3)Do you consider that a company limited by shares, with the Bank of England as the sole or controlling shareholder, would be the most appropriate governance structure?

3.4) Do you agree that the lifespan of a bridge bank should be limited? What do you think is an appropriate length of time?

3.5) Do you think that the extension of a bridge bank's lifetime should be subject to certain conditions? If so, what?

3.6) Do you think that partial transfers increase the chances of the successful operation and sale of a bridge bank and the chances of a private sector purchase?

3.7) Do you agree that guidelines, setting out when partial transfers might be used, should be provided in the code of practice?

3.8) Would these guidelines provide reassurances about how the Authorities might use partial transfers?

3.9) Do you agree with the situations in which it is proposed that the partial transfer powers could be exercised?

3.10) What is the appropriate level of flexibility for the situations in which these powers can be used?

3.11) Do you think the Bank of England should have the flexibility to make subsequent transfers between a bridge bank and a residual company?

3.12) Do you think the Bank of England should have the power to make subsequent transfers using the stabilisation powers?

3.13) Do you agree with the restrictions the Authorities propose for subsequent transfers (that they should only occur between a bridge bank and a residual company and not involve moving liabilities from the bridge bank to the residual company)? Should there be additional restrictions?

3.14) Do you think that the bank resolution fund is an appropriate means for compensating creditors left in the residual company?

3.15) Do you agree that an explicit safeguard to protect set-off and netting arrangements is required?

3.16) Do you agree with the risks of adopting a complete master netting arrangement safeguard?

3.17) Should the qualifying financial contracts approach be adopted, what do you think should be defined as qualifying financial contracts?

3.18) Can you suggest any alternative options for how the safeguard might be framed in a sufficiently wide but workable way?

3.19) Do you agree that an explicit safeguard to protect structured finance arrangements is required?

3. 20) Do you have any workable suggestions for how the safeguard might be framed in a sufficiently wide but workable way?

3.21) Do you agree that a safeguard to protect all security interests could make a partial transfer practically difficult?

3.22) Which security interests should not be covered by this safeguard?

3.23) Do you consider that where part of a failing bank's business is transferred to a bridge bank, a special bank administration procedure may be required to deal with the residual company?

3.24) Do you think that this special bank administration procedure should be confined to the residual company where a partial transfer is effected to a bridge bank or should it also apply, with any necessary modifications, where a partial transfer is effected to a private sector institution?

3.35) Do you agree that the special bank administration procedure should have specific objectives?

3.26) Do you agree with the objectives and their priorities as proposed above? In particular, do you agree that the objective of supporting the bridge bank should take priority?

3.27) Should the grounds for commencing or applying for special bank administration be linked to the partial transfer of assets and liabilities to a bridge bank?

3.28) Should any other grounds be included in the legislation?

3.29) Should the special bank administration procedure be commenced by an order of the court or initiated automatically by the direct appointment of a special bank administrator by the Bank of England?

3.30) Should the special bank administrator be an officer of the court, or in the interest of promoting the objectives of the SRR should he or she be subject to overall direction by the Bank of England, with the court ruling on any disputes arising in the resolution?

3.31) Are the moratorium provisions outlined above sufficient for the purposes of a special bank administration procedure? If not, what additional measures would be required?

3.32) Do you think that the existing powers of an administrator would be sufficient for the purposes of special bank administration?

3.33) Should the special bank administrator be given any additional powers, including some or all of the powers of a liquidator outlined above? If so, what extra powers do you consider would be appropriate?

3.34) Do you agree that the Bank of England should have a key role to play in the special bank administration procedure to facilitate the successful resolution of a bridge bank and to assist in the winding up of the residual company in the interests of its creditors generally?

3.35) Should the Bank of England rather than an initial meeting of creditors be responsible for considering and agreeing to, with or without modification, the special bank administrator's proposals?

3.36) Should the Bank of England rather than creditors fulfil the functions of a creditors' committee?

3.37) Should the rights of creditors to challenge the conduct of the procedure be subject to restrictions to ensure that the principal objectives are not jeopardised?

3.38) Do you agree that there should not be any substantial change to the ordinary statutory order of priority of creditors in the special bank administration procedure?

3.39) Should any special provisions relating to statutory set-off be introduced within a special bank administration procedure?

3.40) Do you agree that the procedure should only be terminated where the Bank of England provides consent?

3.41) Do you think that provisions should be made for a variety of ways to bring the procedure to a close, including conversion to ordinary insolvency procedures?

3.42) Do you agree that temporary public ownership should be subject to similar public interest tests as the Banking (Special Provisions) Act 2008?

3.43) Do you agree that the Authorities should have the power to put in place a bank resolution fund for a bridge bank and temporary public sector ownership?

3.44) Do you agree that the bank resolution fund should be mandatory in the case of the bridge bank tool, but optional in the case of temporary public ownership?

3.45) Do you agree that the bank resolution fund should comprise only the net proceeds of resolution (that is, less the costs of resolution)?

3.46) Do you agree with the mechanisms for compensation and appointing an independent valuer in the circumstances set out above?

3.47) Do you agree with the proposals to confer specific powers on an independent valuer, and the nature of the powers described above and provided for in draft clause 28?

3.48) Do you agree with the principles of valuation set out in draft clause 30?

3.49) Do you agree that the Treasury should have power to provide for the reconsideration of the independent valuer's determination and appeals from the valuer to a court or tribunal?

3.50) Do you agree that alternative compensation arrangements are needed for a private sector purchaser tool, that would not involve an independent valuer?

3.51) Should any of the costs described above not be covered by the FSCS, under the Authorities proposals? Please explain why.

3.52) Are there any additional costs of resolution which could be borne by the FSCS?

SRR tools: bank insolvency procedure

4.1) Do you agree with the provisions for entry into the bank insolvency procedure, as set out in draft clauses 38-41, 60 and 62?

4.2) Do you agree with the provisions for the appointment and objectives of the bank liquidator, as set out in draft clauses 37, 42, 46 and 47?

4.3) Do you agree with the provisions for the powers and responsibilities of the bank liquidator, as set out in draft clauses 47, 48, 61, 63 and 66?

4.4) Do you agree with the provisions for the liquidation committee, as set out in draft clauses 44 and 45?

4.5) Do you agree with the provisions for the end of the bank insolvency procedure, as set out in draft clauses 50-58?

Building societies and other issues of scope

5.1) Do you agree that the objectives, roles of the Authorities and governance of the SRR should not differ for building societies and banks?

5.2) Do you agree that the Authorities should have powers to disapply statutory requirements including the principal purpose and lending and funding limits, for the residual element of a building society following a partial transfer?

5.3) Do you agree that there should be a special building society administration procedure for building societies in the event that part of a building society's business is transferred to a bridge bank?

5.4) Would temporary public ownership be a useful tool for resolving a failing building society in some circumstances?

5.5) How would this tool best be implemented in the case of a building society, given the lack of applicability of the share transfer power?

5.6) Should a set of principles be established to determine how compensation is distributed between members of building societies? If so, what would be the most appropriate fair and equitable principles?

5.7) What are the risks in creating a pre-determined set of principles for distributing compensation?

5.8) Should the former members have a say in how compensation is distributed?

5.9) Do you agree that the Government should legislate to enable the Treasury to create, alter or nullify contracts between group companies, and introduce duties for group companies (where necessary) to cooperate with the use of these powers?

How to respond

C.1 This consultation document is available on the HM Treasury website at www.hm-treasury.gov.uk. For hard copies, please use the contact details below.

C.2 The Authorities invite responses to the issues raised and the proposals in this consultation document. **Responses are requested by 15 September 2008**, during which time the Authorities will engage with relevant stakeholders. Respondents are invited to submit their response to this document either as a standalone response, or as part of their response to the July consultation, which includes high-level questions on the SRR.

C.3 Please ensure that responses to the consultation document are sent in before the closing date. The Authorities cannot guarantee to consider responses that arrive after that date.

C.4 Responses should be sent by email to:

banking.reform@hm-treasury.gov.uk

C.5 Alternatively, they could be posted to:

Banking Reform consultation responses
Banking Reform Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

C.6 When responding, please state whether you are responding as an individual or on behalf of an organisation.

Confidentiality

C.7 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 and the Environmental Information Regulations 2004). 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.

C.8 In the case of electronic responses, general confidentiality disclaimers that often appear at the bottom of emails will be disregarded unless and explicit request for confidentiality is made in the body of the response.

Code of practice for written consultation

C.9 This consultation process is being conducted in line with the Code of Practice for written consultation (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 at 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.

C.10 If you feel that this consultation does not fulfil these criteria, please contact:

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