



HM TREASURY

Special resolution regime:

the Building Societies (Insolvency and Special Administration) Order 2009 and related insolvency rules, and financial assistance to building societies

July 2009



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1

Introduction

1.1 The recent period of sustained disruption in global financial markets has had a widespread impact across the world. In the UK, the most visible consequence of this has been the difficulties faced by a number of financial institutions. In response, the Government has taken steps to strengthen the financial sector, stabilise the banking systems, protect savers and taxpayers and support the wider economy.

The Banking Act 2009

1.2 A key measure was the introduction of the Banking Act 2009, which includes provisions to strengthen the statutory framework for financial stability and depositor protection. The Act received Royal Assent on 12 February 2009, and the key provisions came into force on 21 February 2009. The Act has a number of features:

- enhancing the ability of the Authorities (HM Treasury, the Financial Services Authority and the Bank of England) to respond to the failure of an individual bank or building society;
- enhancing the effectiveness of early regulatory intervention and liquidity assistance;
- providing the Authorities with permanent powers to deal with failing banks and building societies;
- strengthening depositor protection through the Financial Services Compensation Scheme (FSCS); and
- setting out a new statutory role for the Bank of England in relation to protecting and enhancing the UK's financial stability.

1.3 The centrepiece of the Act is the special resolution regime (SRR) established in Parts 1-3, which provides the Authorities with tools to deal with banks and building societies that are failing. The SRR has five high-level statutory objectives:

- to protect and enhance the stability of the financial systems of the UK (this includes the continuity of banking services);
- to protect and enhance public confidence in the stability of the banking systems of the UK;
- to protect depositors;
- to protect public funds; and
- to avoid interfering with property rights in contravention of a Convention right (within the meaning of the Human Rights Act 1998).

1.4 Part 1 of the Act establishes the objectives of the SRR, how it is triggered and the share and property transfer powers required to implement the different SRR tools. It also sets out the stabilisation options: a full or partial transfer to a private sector purchaser (by share or property

transfer) or to a bridge bank controlled by the Bank of England (by property transfer) or temporary public ownership (by share transfer).

1.5 Parts 2 and 3 of the Act establish two new insolvency procedures for banks: the bank insolvency procedure (BIP) and bank administration procedure (BAP). These new insolvency procedures require secondary legislation for their application to building societies.

Application of the SRR powers to building societies

1.6 The Government consulted on the creation of the SRR in January and July 2008. Respondents to these consultations agreed with the Government's view that building society members should receive similar protection to bank depositors, and that the SRR should therefore be applied to building societies as well as banks. Accordingly, the stabilisation options established in Part 1 of the Act were applied to building societies directly.

1.7 However, to allow time to consult fully on applying the new insolvency procedures to building societies, the procedures for building society insolvency and special administration were not set out on the face of the legislation. Instead, the Act gives the Treasury powers to make secondary legislation applying the BIP and BAP to building societies with modifications where necessary.¹

1.8 In line with normal practice, the Government committed to consult on this secondary legislation before it was made. However, it was recognised that it might be necessary to make secondary legislation urgently, without consultation (or before a consultation had finished), in the event that it was necessary to use the SRR powers to resolve a failing building society.²

1.9 The failure of Dunfermline building society in March 2009 (see **Box 1A**) meant that it was necessary to bring forward the secondary legislation applying the BIP and BAP to building societies on an urgent basis.³ Consequently, on 29 March 2009, the Government made the Building Societies (Insolvency and Special Administration) Order 2009 and the Building Society Special Administration (Scotland) Rules 2009.⁴ In the Explanatory Memorandum to the Order, the Treasury committed to consult fully on the order and if appropriate to lay an amending order in due course.⁵

¹ Sections 130 of the Act allows for the application of the BIP to building societies and section 158 allows for the application of the BAP to building societies

² Where the Banking Act provided for secondary legislation to be made using the draft affirmative procedure, the Act normally also provided for the first use of the relevant power to follow the made affirmative procedure. Under the draft affirmative procedure, statutory instruments must be laid in draft and approved by both Houses of Parliament before they are made. Under the made affirmative procedure, statutory instruments are made and laid before Parliament but will lapse unless they are approved by both Houses of Parliament within 28 sitting days of being made. (This procedure is also known as the 28-day affirmative procedure.) Some secondary legislation can also be made under the negative procedure.

³ Treasury press notice, *Dunfermline Building Society* (30 March 2009), www.hm-treasury.gov.uk

⁴ The order was made using the powers in sections 130 and 158 of the Banking Act to apply Parts 2 and 3 to building societies.

⁵ HM Treasury, *Explanatory Memorandum To The Building Societies (Insolvency And Special Administration) Order 2009 No. 805* (29 March 2009), paragraph 8.1

Box 1.A: The SRR in action: Dunfermline Building Society

At the beginning of 2009 the Dunfermline Building Society had 34 branches, employed around 500 people, and had around 300,000 members, making it the twelfth largest building society in Britain.

In the run up to March 2009, there was a significant deterioration in the Dunfermline's financial position. Its problems were caused by a range of circumstances, including substantial loss-making commercial property lending, the purchase of over £150m of high-risk mortgage portfolios and the need to write off £10m from the purchase of a £31m IT system. These factors contributed to the society making a significant loss in the context of the society's size and historic profitability.

On Saturday 28 March 2009, the FSA determined that Dunfermline was likely to fail to meet the threshold conditions necessary for it to remain open for business, and that it was not reasonably likely that action could be taken by the society to enable it to satisfy these conditions.

Following this decision, the authorities sought a long-term solution for the Dunfermline Building Society, consistent with the statutory resolution objectives including: protection of Dunfermline's depositors; protection of public funds; and preservation of financial stability. It was therefore decided, following an auction conducted by the Bank of England over the weekend of 28-29 March, that core parts of the Dunfermline would be transferred to the Nationwide Building Society.

In consultation with the Treasury and the FSA, the Bank of England therefore exercised its powers under the Banking Act 2009:

- Dunfermline's retail and wholesale deposits, its 34 branches, head office and originated residential mortgages (other than social housing loans and related deposits) were transferred to the Nationwide Building Society.
- Dunfermline's social housing portfolio was placed into a bridge bank wholly owned by the Bank of England. Since then, Nationwide has also acquired the assets and liabilities held by the bridge bank, following a competitive auction process.
- A court order was made to place the remainder of Dunfermline's business into the newly created Building Society Special Administration Procedure. This part of the business included commercial loans, acquired residential mortgages, subordinated debt and most of Dunfermline's treasury assets.

Dunfermline's deposit business continues to operate normally, branches and telephone banking continue to be open and customers can access their account in the usual way. Loan and mortgage customers can continue to contact the Dunfermline and to make repayments as normal. All of the Dunfermline Building Society's staff have been transferred to Nationwide.

Insolvency procedures for building societies

1.10 This consultation builds on the July 2008 consultation paper on the SRR, and asks for views on the Government's detailed proposals for applying the BIP and BAP to building societies.

1.11 This consultation refers to the two pieces of secondary legislation made on 29 March 2009 to enable the successful resolution of Dunfermline building society:

- the Building Societies (Insolvency and Special Administration) Order 2009; and

- the Building Society Special Administration (Scotland) Rules 2009.

1.12 This consultation also refers to proposed rules, which have not yet been made and which are published in draft:

- the Building Society Special Administration (England and Wales) Rules;
- the Building Society Insolvency (England and Wales) Rules; and
- the Building Society Insolvency (Scotland) Rules.

1.13 The secondary legislation and draft rules referred to in this consultation are available from the Banking Act section of the Treasury website.⁶

1.14 BSIP and BSSAP rules are also needed for Northern Ireland and these will be made separately by the Department of Enterprise, Trade and Investment Northern Ireland (DETINI). Northern Ireland stakeholders are invited to comment on the policy proposals in this consultation document, which are consistent UK-wide, and DETINI will run a separate targeted consultation on the detail of the rules.

1.15 In respect of the two instruments that have already been made, the Government will consider in the light of the responses to this consultation whether the instruments should be amended and will bring forward amending instruments in due course should they be needed. In respect of the instruments that are published in draft, the Government will consider in the light of the responses to this consultation whether the draft instruments should be revised and will make instruments incorporating those revisions in due course.

Financial assistance to building societies

1.16 Section 9B of the Building Societies Act 1986 prohibits building societies from creating floating charges on the whole or part of their undertaking or property. This may make it difficult for societies to offer appropriate security to the Bank of England, or any other provider of necessary financial assistance, in cases where insufficient unencumbered fixed collateral exists. This has the potential to create difficulties in the provision of necessary financial assistance to building societies, which is clearly undesirable.

1.17 An interim measure, made under the Banking (Special Provisions) Act 2008 enables societies to grant floating charges to the Bank of England in connection with the provision of financial assistance. Other provisions of the Building Societies Act, for example the funding limit, were modified in order to remove possible impediments to financial assistance in such cases.

1.18 The Government now intends to put in place a permanent replacement for the interim provision, which will be broader in scope. The Banking Act 2009 provides powers to make secondary legislation to address any remaining barriers to societies receiving financial assistance.

1.19 The Government's attention has been drawn also to particular difficulties pertaining to delivery by value (DBV) transactions that societies may need to undertake with market counterparties through the CREST system in order to turn Treasury bills or other financial assistance into cash.

1.20 This building societies consultation document therefore proposes an Order to permit building societies to grant floating charges in favour of settlement banks operating on the CREST system. In particular:

⁶ The Banking Act section of the Treasury website is www.hm-treasury.gov.uk/fin_banking_act2009.htm. The draft secondary legislation can be accessed by clicking on the 'Consultation' link.

- a building society will be able to grant a floating charge in favour of a participant in a designated system;
- the charge may be granted over realisable assets (including money); and
- the charge must be granted for the purpose of securing rights and obligations potentially arising in connection with that designated system.

1.21 The consultation document seeks views on the Treasury proposals contained in chapter 6 below and on the principle of making secondary legislation on this basis. A draft order is available from the Treasury website.

Stakeholders to be consulted

1.22 This consultation document will be sent to the Building Societies Association, all 53 building societies in the UK, and interested stakeholders in the financial services sector. The consultation will also be posted on the Treasury's public website and printed copies will be made available on request.

1.23 The Banking Liaison Panel (BLP), a statutory body established under the Banking Act 2009 to advise the Treasury on the development of secondary legislation under parts 1, 2 and 3 of the Act, will also consider the proposals, and have established a working group to do so. The BLP is made up of representatives from the banking sector, legal experts and representatives of the Authorities.⁷

⁷ Information about the Banking Liaison Panel is available from the Treasury website, www.hm-treasury.gov.uk/consult_banking_liaison.htm

2

Building societies and relevant legislation in the UK

Building Societies Act 1986 and Building Societies Act 1997

2.1 Building societies are mutual deposit-takers, regulated by the Financial Services Authority (FSA) and governed by the Building Societies Act 1986 as amended by the Building Societies Act 1997 and other legislation.

2.2 There are 53 building societies in the UK with total assets of around £395 billion. Around 15 million adults have building society savings accounts and around 3 million adults are currently buying their homes with the help of building society loans. Building societies have diversified in recent years and a number now also offer current accounts, credit cards, cash machines, travel money, unsecured loans, various types of insurance and estate agency services.

2.3 There are a number of differences between building societies and banks. The purpose or principal purpose of a building society must be to make loans that are secured on residential property and are funded substantially by its members. To this end, there are limits on building societies' lending and funding activities:

- building societies must ensure that loans secured on residential mortgages constitute at least 75% of their total assets and that funding from individual members of the society (from deposits) constitutes at least 50% of total funding;
- building societies are effectively owned and controlled by their customers, who are the only members: there is no separate body of shareholders. Deposits in a building society are held in the form of shares. There are some exceptions to this, such as current accounts and client or trustee accounts. A person who holds a share is a member of the society and enjoys voting and other rights. But shares are generally not transferable. Residential mortgage customers are also members with voting rights;
- a building society can only raise funds from a body corporate by the issue of deferred shares (which include Permanent Interest Bearing Shares or PIBS). Issue terms of deferred shares must include a term that prohibits the repayment of any principal to the shareholder, except in the event of winding up where all other creditors (including members with non-deferred shares) have been paid in full. So deferred shares cannot be withdrawn (except in exceptional circumstances) and rank behind all other shares and liabilities in a winding up. They may (depending on their terms of issue) be transferable; and
- a building society can amalgamate with, or transfer its engagements to another building society. It can also transfer all of its engagements to a commercial company. The procedures for transferring to a commercial company are more onerous than for a transfer from one building society to another. There have been some cases over the years of building societies running into financial difficulties,

and these have typically been dealt with by a transfer of engagements to another society.

2.4 Responsibility for building society legislation is not devolved, which means that legislation passed in Westminster applies UK-wide. The Treasury is responsible for policy relating to building societies, credit unions and the wider mutuals sector.

The Building Societies (Funding) and Mutual Societies (Transfers) Act 2007

2.5 The Building Societies (Funding) and Mutual Societies (Transfers) Act is part of a wider package of measures aimed at enhancing the efficiency of the mutuals sector. The Act received Royal Assent on 23 October 2007. It allows the Treasury to make orders to:

- change building society law to enable building societies to borrow a greater proportion (up to 75%) of their funding from the wholesale markets (section 1);
- change building society law so that, in the event of a building society insolvency, members' shares would rank equally with liabilities to creditors (section 2); and
- make it easier for a mutual society (building society, friendly society or industrial and provident society) to transfer its business to a subsidiary of another mutual society (sections 3 and 4).

2.6 The Government consulted on implementation of the Act in 2008 and published a response in January 2009. Sections 3 and 4 of the Act were implemented in relation to building societies earlier in 2009.¹ The power to change the ranking of shares in insolvency will not be used until after implementation of Parts 2 and 3 of the Banking Act 2009 for building societies. The proposals in this consultation document do not pre-empt use of that power, or change the ranking of members in relation to creditors.

2.7 Respondents to the Government's consultation *Financial stability and depositor protection: strengthening the framework* were unanimous that the Government should act to make members' funds rank equally with liabilities to creditors in the event of an insolvency. Respondents to the consultation on the Building Societies (Funding) and Mutual Societies (Transfers) Act were also in agreement in principle, but sought assurances that the current position of instruments entered into before the Act was implemented would be retained. The Government will therefore implement section 2 at an appropriate time having regard to implementation of the Banking Act 2009. The order implementing section 2 will include transitional provisions to protect liabilities of a limited duration entered into before implementation of the Act, and to protect liabilities with an indeterminate duration for a 12-month period. These liabilities will continue to have priority over liabilities to members during the transitional period.

UK insolvency law

2.8 The UK's framework for corporate insolvency and personal bankruptcy is established by the Insolvency Act 1986, as amended by the Insolvency Act 2000 and the Enterprise Act 2002, and equivalent legislation in Northern Ireland. An established feature of the UK system is the existence of 'special insolvency regimes' for industries where failure poses a unique set of issues: for example water, energy and rail. These special regimes are based on standard insolvency

¹ The Mutual Societies (Transfers) Order 2009, S.I. 2009/509, which came into force on 5th March 2009.

procedures established by the 1986 Act. The bank insolvency procedure and the bank administration procedure under the Banking Act 2009 are closely modelled on existing insolvency law.

The Banking Act 2009

2.9 Parts 2 and 3 of the Banking Act 2009 introduce two new insolvency procedures for banks. Both are based on existing insolvency processes under the Insolvency Act 1986:

- the **bank insolvency procedure (BIP)** in Part 2, which provides for the orderly winding up of a failed bank and for faster FSCS payments to eligible claimants or a transfer of such accounts to another financial institution; and
- the **bank administration procedure (BAP)** in Part 3, which is a procedure for the special administration of an insolvent 'residual bank' created by a partial transfer of a bank's property.

2.10 This consultation document makes proposals for applying the BIP and the BAP to building societies.

3

Principles of building society insolvency and special administration

Principles of the bank insolvency procedure and bank administration procedure

3.1 As outlined in Chapter 1, in 2008 the Government consulted on the creation of the special resolution regime (SRR) for banks, including a new bank insolvency procedure (BIP) designed to enable prompt payments to be made in a bank insolvency to depositors who are eligible claimants under the Financial Services Compensation Scheme (FSCS), or the rapid transfer of their accounts to another institution.

3.2 Stakeholders who commented on the proposals for the BIP welcomed the Government's proposed objectives for the procedure. Stakeholders were also of the view that the BIP should build on the strength of the UK's existing insolvency regime, rather than being designed as an entirely novel procedure. Accordingly, Part 2 and Part 3 of the Banking Act 2009 were designed to follow existing insolvency procedures closely, with modifications to enable the unique objectives of the procedures to be achieved.

3.3 The BIP set out in Part 2 of the Banking Act 2009 is based on the process of compulsory liquidation in Part 4 of the Insolvency Act 1986. To enable the achievement of the objectives of protecting depositors and winding up in the interests of creditors, the bank liquidator has statutory objectives:

- to work with the FSCS to ensure that the accounts of eligible depositors are transferred to another institution or that compensation payments are made quickly; and
- to wind up the affairs of the failed institution in the interests of creditors as a whole.

3.4 The bank administration procedure (BAP) established in Part 3 of the Banking Act 2009, is based on the UK's existing administration process as set out in Schedule B1 to the Insolvency Act 1986. The Banking Act 2009 allows the Bank of England to effect a partial transfer, transferring part of a failing bank's business, so that the failing bank's business is split between another institution (either a private sector purchaser or a Bank of England-controlled bridge bank) and the residual bank. The BAP is used to manage the insolvent residual bank. To enable the achievement of the objectives of supporting a partial transfer and winding up in the interests of creditors, the bank administrator has statutory objectives:

- to supply services on behalf of the residual bank to the private sector purchaser or bridge bank so that it may operate effectively; and
- to carry out a "normal" administration: that is to rescue the bank as a going concern, or achieve a better result for the society's creditors than would be achieved if it were just wound up.

Application to building societies

3.5 The Government proposes that the building society insolvency procedure (BSIP) and building society special administration procedure (BSSAP) should remain broadly similar to the bank insolvency and bank administration procedures, with modifications to reflect the legal differences between banks and building societies.

3.6 The principles behind the Government's approach are that:

- building society insolvency and special administration should work in a similar way to bank insolvency and bank administration;
- a building society liquidator should have the same statutory objectives as a bank liquidator: to work with the FSCS to ensure that the accounts of eligible depositors are transferred to another institution or that compensation payments are made quickly, and to wind up the affairs of the failed building society in the interests of creditors as a whole;
- a building society special administrator should have the same objectives as a bank administrator: first objective to supply services on behalf of the residual society to the private sector purchaser or bridge bank so that it may operate effectively, and then to effect a "normal" administration: that is to rescue the society as a going concern, or achieve a better result for the society's creditors and members than would be achieved if it were just wound up;
- the BSIP and BSSAP should be court-based procedures;
- like bank insolvency and administration, building society insolvency and special administration should not make changes to the statutory priority order of creditors, including the subordination of shareholding members of the society to general creditors; and
- the rules for the BSIP and BSSAP should be based on, and operate in the same way as, the rules for the BIP and BAP, with appropriate changes in light of the different legal principles governing banks and building societies.

3.7 The Government is seeking views on these broad principles, as well as the more specific detail, which is set out in Chapter 3 and Chapter 4.

Box 3.A: Questions on the principles of applying the bank insolvency procedure to building societies

- 1 What is your view of the proposal that the BSIP and BSSAP should closely follow the BIP and BAP?
- 2 What is your view of the principles set out in paragraph 3.6 for how the bank insolvency procedure and bank administration procedure should be applied to building societies?
- 3 What other comments do you have, if any, on the principles that should be taken into consideration in the establishment of new insolvency and administration procedures for building societies?

4

The Building Societies (Insolvency And Special Administration) Order

4.1 As outlined in Chapter 1, The Building Societies (Insolvency And Special Administration) Order 2009 (“the order”) applies the bank insolvency procedure and bank administration procedure to building societies. The order was made and came into force on 29 March 2009 and was laid before Parliament on 30 March 2009. It was the first use of the Treasury’s powers in sections 130 and 158 of the Banking Act 2009 to apply Parts 2 and 3 of the Act to building societies.

4.2 The Government is seeking views on the existing order. Although no changes are proposed in this document, a number of issues have been flagged for consultation, some arising from the questions put to the Treasury by the House of Lords Committee on the Merits of Statutory Instruments¹. These issues are set out below, and the Government welcomes views on any other matters in relation to the order that respondents may wish to bring to the Government’s attention.

Building society insolvency procedure (BSIP)

4.3 As set out in Chapter 3, the Government believes that in principle the BSIP should operate in the same way as the BIP. The order establishes that the BSIP is implemented by a combination of amendments to the Building Societies Act 1986 and modifications in secondary legislation of Parts 2 and 3 of the Banking Act 2009. As set out in articles 2 to 6 of the order, the relationship to existing insolvency procedures is the same as for bank insolvency.

Role of the Secretary of State and the FSA (Schedule 1, paragraphs 9 – 11)

4.4 The Secretary of State does not have a role in relation to building societies. The existing order reflects this, and does not give the Secretary of State a role in applying for building society insolvency. This is different to bank insolvency, in which the Secretary of State can apply for a bank insolvency order where winding up is considered to be in the public interest.

4.5 Under section 96 of the Banking Act 2009 as applied by the order, the Bank of England and the FSA may apply for building society insolvency on the ground either that the building society is unable, or is likely to become unable, to pay its debts (‘Ground A’);² or that winding up the building society would be fair (‘Ground C’).

4.6 The Government is seeking views on whether it is sufficient for the Bank of England or FSA to be able to make an application for insolvency on ‘Ground A’ and / or ‘Ground C’; or whether it should also be possible for the Secretary of State to apply for the BSIP on grounds of public interest (‘Ground B’).

¹ The Merits Committee commented on the Building Societies (Insolvency and Special Administration) Order and the Building Society Special Administration (Scotland) Rules in its 14th report of 2008-09, available from (www.publications.parliament.uk)

² This has the meaning given under section 123 of the Insolvency Act 1986 but also includes where a building society is in default on an obligation to pay a sum due and payable under an agreement if the agreement and the agreement in question is one for which its making and performance is part of a bank’s regulated activities under FSMA.

Offences, dissolution, and other matters

4.7 In the order as drafted the FSA rather than the Secretary of State performs the usual functions of the registrar in building society insolvency. This is because the FSA has the role of registrar of companies in relation to building societies. Under Schedule 1, paragraph 13(6) of the order as drafted, any suspected offences discovered during the insolvency must be reported to the Secretary of State, who may refer the matter to the FSA for further investigation. Whereas powers of investigation lie with the Secretary of State in relation to companies, for building societies the equivalent powers lie with the FSA.

4.8 Section 116 of the Banking Act 2009 deals with the dissolution of a company once the bank insolvency procedure has been completed, and allows for the dissolution of a company to be delayed for a period of time by the Secretary of State or the court in certain circumstances. In the order as drafted, this role is instead performed by the FSA (Schedule 1, paragraphs 16 and 17 of the order).

4.9 The order therefore establishes that suspected offences may be referred to the FSA for further investigation, and that in general the FSA, rather than the Secretary of State, performs the functions of the registrar in building society insolvency. In all other respects the Secretary of State retains his or her role.

Transfer of accounts (Schedule 1, paragraph 22)

4.10 Under Schedule 1, paragraph 22, arrangements under section 124 of the Act to transfer eligible depositors' accounts to another financial institution may contain appropriate provision to deal with building society shares, including cancelling them and imposing equivalent rights and liabilities. The Government proposes that the ability to transfer eligible depositors accounts is an important one to retain in respect of building society insolvency, and that the provisions for dealing with shares are necessary and appropriate because the majority of eligible depositors' accounts in building societies are held in the form of shares.

4.11 The order therefore establishes that the powers to transfer accounts are available in building society insolvency, as modified by Schedule 1 paragraph 22.

Box 4.A: Consultation questions on the BSIP

- 1 What is your view of the respective roles of the Secretary of State and the FSA as set out in paragraphs 4.4 – 4.9, and in particular the position that application for building society insolvency on public interest grounds ('Ground B') is not available?
- 2 Do you agree that the liquidator should have the facility to transfer accounts to another institution, and what is your view of the provisions for this set out in paragraphs 4.10 – 4.11?
- 3 If in your view further technical modifications to the insolvency provisions are needed to reflect the differences between banks and building societies, what are they and how should they be applied? What other recommendations do you have, if any, in relation to the application of the BIP to building societies?

Building society special administration (BSSAP)

4.12 As set out in Chapter 3, the Government believes that in principle the BSSAP should operate in the same way as the BAP. Part 3 of the Banking Act 2009 provides that where the Bank of England makes, or intends to make, a partial sale or transfer to a commercial purchaser or bridge bank under the powers in Part 1 of that Act, the residual bank may be placed into bank administration. The order applies this procedure to building societies.

4.13 As in the BAP, in order to facilitate the achievement of objective 1 of the BSSAP (see sections 137 and 138 of the Act), the Bank of England will have an important role to play in the process and will be responsible for agreeing the administrator's proposals. The Bank of England will also fulfil the sort of functions usually carried out by a creditors' committee. Once there is no requirement for the residual society to continue providing services or facilities to a commercial purchaser or a bridge bank, the process will continue in much the same way as an ordinary administration under Schedule B1 to the Insolvency Act 1986, with appropriate modifications for building societies.

4.14 The Government's view is that the BAP, and the underlying general provisions of administration, should apply to building societies with appropriate modifications, in the same way as normal administration under Schedule 15A to the Building Societies Act 1986. The order also applies to building societies provisions of Part 3 of the Banking Act 2009 in same way as they apply to banks, as set out in articles 2, 4, 5 and 6 of the order, which amend the Building Societies Act 1986; and applies legislation made under parts 2 and 3 of the Banking Act 2009, with appropriate modifications, as set out in Schedule 2 to the order.

4.15 In addition to these technical points, there are a number of policy issues on which the Government is seeking views, set out below.

Role of FSA

4.16 As outlined in paragraph 4.6 in relation to building society insolvency, the FSA fulfils the role of registrar of companies for building societies. The Government's view is that this should also apply in the BSSAP. For example, where a building society has no more property for distribution, notice is served on FSA not the registrar of companies (Schedule 1, paragraph 30).

Participation of shareholding members

4.17 In the second stage of the administration, the administrator will work towards the second objective, to rescue the society as a going concern or achieve a better result than would be the case if the society were wound up without first being in administration.

4.18 Shareholding members will, like creditors, be able to participate in a distribution, at the administrator's discretion. This goes beyond the position for banks, whose shareholders, as company shareholders, may not participate in a distribution. This is in recognition that any remaining shareholding members may still have a significant financial interest in the society.

4.19 However, after a partial transfer there may be few if any shareholding members left. Furthermore, any shareholding members left in the administration are likely to have received payment from the FSCS, and so will not have an comparable economic interest in the administration to general creditors.

4.20 The order does not therefore make provision for shareholding members to vote on the administrator's proposals in the second stage of the administration.

Box 4.B: Consultation questions on the BSSAP

- 4 What is your view of the respective roles of the Secretary of State and the FSA as set out in paragraph 4.16?
- 5 What is your view of the proposal in paragraphs 4.17 – 4.20 that shareholding members should be able to participate in a distribution but should not have the ability to vote in the second stage of the BSSAP?
- 6 If in your view further technical modifications to the administration provisions are needed to reflect the differences between banks and building societies, what are they and how should they be applied? What other recommendations do you have, if any, in relation to the application of the BAP to building societies?

5

The building society insolvency and special administration rules

Building society insolvency procedure rules

5.1 The building society insolvency procedure rules (the “BSIP rules”) are modelled on the bank insolvency rules (the “BIP rules”). There are a number of differences between the BIP rules and the proposed BSIP rules.¹ In addition to the matters of substantive policy that are set out below, there are minor and technical differences, reflecting the differences in terms and terminology applicable to banks and building societies. Annex B contains a summary of the significant technical differences between bank and BSIP rules for England and Wales, Scotland, and Northern Ireland.

FSCS

5.2 The FSCS pays compensation to building society customers who are eligible for compensation under FSCS rules. As in a bank insolvency, when the FSCS pays out to eligible claimants it takes over their right to reclaim monies from the insolvency. However, in building society insolvency, the FSCS will take over two types of claims. This arises because account-holders in a building society can hold their account in two ways: either as members of the society (in which case they are members, not creditors) or as non-members such as current account holders (in which case they are creditors). The FSCS will therefore be a creditor in respect of the monies it has paid out to non-members; and it will hold rights equivalent to a building society member in respect of monies that it has paid out to building society members. As discussed below, in receiving payment of dividends from the insolvent estate of a building society, members rank lower in priority for distribution than general creditors. The BSIP reflects this and contains provisions to enable the FSCS to make appropriate payments, to rank in the insolvency at the appropriate level to recover monies, and to perform necessary functions such as holding the liquidator to account.

Mutual credit and set-off

5.3 The BIP provides that in calculating payments to eligible claimants, the FSCS may set off any mutual dealings between the bank and the customer. The bank rules also allow set-off to be disapplied if FSCS rules change to allow it make gross rather than net payments to eligible depositors.² However, members’ deposits in a building society are held in the form of shares, which confer membership of the society, and building society members rank below general creditors in insolvency. Having paid out to eligible claimants and subrogated their rights to claim in the insolvency, the FSCS’s claim in the insolvency will rank below those of general creditors.

5.4 If the FSCS were to take advantage of set-off in connection with payments made to members, it would effectively elevate members’ claims above many normal creditors. This would have two undesirable effects. First, it would alter the statutory order of priority of creditors, contrary to stakeholders recommendations in response to the 2008 consultations for the design

¹ The rules and draft rules are available from the Treasury website.

² The FSA is currently consulting on whether the FSCS should move to gross payouts.

of the BIP; and second it would effectively pre-empt implementation of the Building Societies (Funding) and Mutual Societies (Transfers) Act 2007, which will give parity to building society members and other creditors.³ The Government believes that it would be inappropriate to pre-empt the implementation of primary legislation through the making of insolvency rules.

5.5 The proposed rules therefore are based on the legal assumption that set-off is available to the FSCS only in the case of payment by the FSCS to depositors who are not members of the society because, like bank depositors, they are general creditors. Furthermore, for the sake of legal certainty, the rules specify that set-off does not apply in respect of any mutual dealings between the society and a creditor who is also a shareholding member of the society in respect of shares held by that person in the society.

FSCS membership of the liquidation committee

5.6 Like the BIP, the BSIP will be a two-stage procedure. In the early stages of the insolvency, representatives from the Bank of England, the FSA and the FSCS will form a liquidation committee to oversee proceedings and to ensure that the first of the statutory objectives (payout by the FSCS to eligible depositors) is achieved as soon as reasonably practicable.

5.7 Once the first objective has been achieved, or has been substantially completed, the liquidation committee passes a “full payment resolution” and the FSA and the Bank of England step down from the committee. Liquidation then continues in much the same way as an ordinary winding up with the liquidator calling a meeting of creditors, who may elect representative creditors to join the liquidation committee. The FSCS may remain on the liquidation committee if it wishes.

5.8 As creditors are paid out, they will step down from the second stage Liquidation Committee, as they do in a normal compulsory liquidation. Because the FSCS’s claim in respect of members’ deposits is subordinate to the claims of general creditors (but not subordinated creditors), it may be the last member left on the Liquidation Committee if the society has no subordinated creditors. It is possible that the FSCS will still have significant amounts to claim from the insolvency when all other creditors have stepped down. It is therefore important the Liquidation Committee should continue to function.

5.9 The proposed rules therefore ensure that the Liquidation Committee can continue to operate where the FSCS is the sole member of the committee, and to ensure that the FSCS has voting rights in the liquidation committee. When the FSCS has been reimbursed, it may step down from the Liquidation Committee and the building society liquidator may apply to the court to make further distributions (including distribution of any surplus to shareholding members).

FSCS role in challenging excessive remuneration and other functions of the creditors’ committee

5.10 In a normal insolvency, the creditors’ committee performs a number of important functions (separate to the Liquidation Committee). For example, it has the right to challenge the liquidator’s remuneration package if remuneration is thought excessive. However, as noted above it is possible that the FSCS will still have significant amounts to claim from the insolvency when all other creditors have been paid in full, and the creditors committee will not be able perform these functions.

³ The Building Societies (Funding) and Mutual Societies (Transfers) Act 2007, which received Royal Assent on 23 October 2007, allows the Treasury to make an order to change building society law so that, in the event of building society insolvency, members’ shares would rank equally with liabilities to creditors. The Treasury recently finished its consultation on implementation of the parts of the Act.

5.11 The Government is therefore seeking views on whether the FSCS should be able to perform some of the functions of the creditors committee, such as consideration of remuneration matters, after all other creditors have been paid in full.

Role of contributories

5.12 Contributories in the insolvency of a company are members of the company who have liabilities in insolvency proceedings. Similarly, in the insolvency of a building society, members of the society are contributories. The contributories committee is one of the formal means by which the liquidator can engage with the members in building society insolvency.

5.13 The meetings of contributories of building societies differ from the meetings of contributories of banks. In a meeting of shareholders of a bank (or other company), voting rights are based on the value of shares held. Voting in meetings of members of building societies tends to be based on the principle of one member one vote. This would not be appropriate in the context of a building society insolvency, firstly because it would not be reasonable to give all members an equal vote regardless of their economic interest in the distribution of the surplus, and secondly because it would be impractical to hold a meeting for a large number of members (some of whom might be liable for small sums of money). Further, whereas the shareholding members have an ongoing economic interest in the distribution of any surplus in the insolvency, borrowing members (i.e. individuals who have a mortgage with the society) do not have a comparable economic interest.

5.14 The proposed rules therefore establish that only shareholding members (and not borrowing members) should be treated as contributories for the purposes of Part 6 ('Meetings of creditors and contributories'), and that voting rights at the contributories meeting should be apportioned by value of the member's shareholding.

Procedural issues

Appointment of a provisional building society liquidator

5.15 When an application for building society insolvency is made, there will be a short period before the court hearing to consider whether the order should be made. During this period, a provisional liquidator may be appointed. As in an ordinary insolvency, the provisional liquidator has powers specified by the court, which are generally to protect or preserve the assets of a company pending the appointment of a liquidator on the making of the winding-up order.

5.16 In the context of building society insolvency, it may be necessary to appoint a provisional liquidator over a weekend while the court office is closed.

5.17 The proposed rules therefore allow an application for a provisional liquidator to be made before the order for building society insolvency has been made. However, the provisional liquidator may not be actually appointed until the application for building society insolvency has been made.

Replacement of liquidator

5.18 Under Rule 106 of the BIP rules, where a building society liquidator has been removed by a meeting of creditors but one month has passed and no resolution has been passed by a meeting of creditors to appoint a new building society liquidator, the Bank of England shall appoint a new building society liquidator as soon as practicable. However, there is a risk in allowing a building society in liquidation to remain without a liquidator for an extended period of time.

The Government is therefore proposing that if the liquidator is removed and the creditors have not appointed another liquidator at the meeting that has removed the previous liquidator, the Bank of England should be able to appoint a new liquidator immediately.

Box 5.A: Consultation questions on BSIP rules

- 7 What is your view of the proposal that the FSCS should make gross payments to eligible building society members, while building society depositors (such as holders of current account and trustee or client accounts) would be treated the same as bank depositors under FSCS rules?
- 8 What is your view of the proposals around the role of the FSCS in relation to the liquidation committee?
- 9 What is your view on whether the FSCS should be able to perform some of the functions of the creditors committee and the creditors once the creditors have been paid out?
- 10 What is your view on the proposals concerning voting rights at contributories meetings?
- 11 What is your view of the aspects related to court procedure, including the proposal that an application for a provisional liquidator may be made before the application for building society insolvency has been made, and the appointment of a new liquidator?
- 12 What is your view on the general technical application of the insolvency rules? If in your view further technical modifications to the insolvency rules are needed to reflect the differences between banks and building societies, what are they and how should they be applied?

The building society special administration rules ('the BSSAP rules')

5.19 Part 3 of the Banking Act 2009 as applied to building societies provides that where the Bank of England makes, or intends to make, a partial sale or transfer to a commercial purchaser or bridge bank under the powers in Part 1 of the Act, the residual building society may be placed into special administration. That process is based on the procedure of administration set out in Schedule B1 to the Insolvency Act 1986. An overview of the building societies special administration procedure is given in chapter 4.

5.20 The draft BSSAP rules for England and Wales, and a link to the Building Societies Special Administration (Scotland) Rules, are available from the Treasury website. These rules, like the BAP rules, are based on the rules for administration set out in Part 2 of the Insolvency Rules 1986. Many of the existing rules for the process of administration have been applied with little or no modification. New rules and modifications to existing rules have been introduced, similar to the BAP rules, in order to facilitate the achievement of the unique objectives of the BSSAP and to reflect the role of the Bank of England in exercising a partial transfer.

5.21 In keeping with ordinary administration, only an insolvency practitioner may be appointed as building society special administrator. The objectives of a building society special administrator are to provide support services or facilities to a commercial purchaser or bridge bank and to administer the company in such a way to achieve the best result for creditors and shareholding members.

5.22 Because of its role within the Special Resolution Regime set out in Part 1 of the Act, only the Bank of England may apply to the court for a building society special administration order and the rules provide for a hearing to be held quickly. This will be essential to help ensure successful resolution through a partial transfer to a commercial purchaser or bridge bank. The rules also add detail to the appointment of a provisional building society special administrator in any period between the submission of an application for a building society special administration order and the court hearing for the making of such an order. This is to give

comfort to the transferee that the residual building society will be able to continue to provide essential services between the application and the making of the special administration order.

Differences to BAP rules

5.23 In addition to the technical changes (for example around terms and terminology appropriate for building societies), the BSSAP rules reflect the BSIP rules in relevant matters of substantive policy set out in Chapter 3. In particular:

- References to the registrar of companies. The FSA is the registrar for building societies: the registrar of companies has no role. Accordingly, references to the registrar of companies are either removed where there is already a reference to the FSA, or replaced with a reference to the FSA.
- Mutual credit and set-off. Set-off does not apply in respect of any mutual dealings between the society and a creditor who is also a shareholding member of the society in respect of shares held by that person in the society, because set-off does not apply generally in relation to rights arising from shares, as they rank lower than debts to creditors in the event of an insolvency.
- Further differences to the BAP rules are summarised in Annex A.

Box 5.B: Consultation questions on the BSSAP rules

- 13 What is your view on the general technical application of the administration rules? If in your view further technical modifications to the administration rules are needed to reflect the differences between banks and building societies, what are they and how should they be applied?
- 14 What other recommendations do you have, if any, in relation to the application of the administration rules to building societies?

6

Financial assistance to building societies

6.1 The Banking Act 2009 includes provisions that improve the ability of the Authorities to provide liquidity support and other financial assistance to institutions in difficulty. This is of particular relevance to building societies. The Government is of the view that societies should, wherever possible, have the same ease of access to financial assistance as banks. There are particular difficulties associated with this at present, due to the prohibition on the creation of floating charges in Section 9B of the Building Societies Act 1986.

Floating Charges

6.2 The prohibition on the creation of floating charges may make it difficult for societies to offer appropriate security to the Bank of England, or any other provider of necessary financial assistance, in cases where a society has insufficient unencumbered collateral that it can afford to be made subject to a fixed charge. In such cases, the Bank of England, another central bank, or the Government, may wish to take a floating charge over the society's assets in order to have some form of security for its lending while permitting the society to continue to trade in these assets in way that a fixed charge would prohibit. Should societies be unable to offer such a charge this has the potential to create difficulties in the provision of necessary financial assistance, which is clearly undesirable.

6.3 The Government addressed this issue through the Building Societies (Financial Assistance) order 2008, which was made under the Banking (Special Provisions Act) 2008 ("the BSPA"); the interim legislation made in response to the difficulties surrounding Northern Rock. The order enabled societies to grant floating charges to the Bank of England, or anyone acting on the Bank's behalf, in connection with the provision of financial assistance. Other provisions of the Building Societies Act 1986, for example the funding limit, were modified in such cases in order to remove possible impediments to financial assistance. The Building Societies Act 1986 was not amended and the modifications only applied to building societies receiving relevant financial assistance provided for the purposes of maintaining stability of the UK financial system. The Government has taken care not to alter any aspect of building societies law unless strictly necessary.

6.4 The Banking Act 2009 replaces the BSPA, which as emergency legislation was subject to a one-year sunset provision. It is important to note that the order made under the BSPA, and described above, has not lapsed and continues to have effect. However, the Government considers it necessary to make a new order in replacement of the interim provision, which will be slightly broader in scope. Accordingly, Section 251 of the Act provides powers for the Treasury to make appropriate secondary legislation to address any remaining barriers to societies receiving financial assistance from the Treasury or a central bank (the Bank of England, another central bank of a Member State of the European Economic Area, or the European Central Bank).

6.5 It is intended that the first part of this new order shall remain similar to the existing order, although the Government will widen slightly the range of qualifying institutions that may be regarded as providing financial assistance, and hence to which societies may issue a floating

charge. Also the concept of “financial assistance” is wider: the existing order only applies in relation to financial assistance provided for the purpose of maintaining the stability of the financial system in the United Kingdom, which is the definition of “relevant financial assistance” given in the BSPA. No such limitation applies to financial assistance under the Act¹.

Delivery by Value

6.6 In addition, the Government has become aware of particular difficulties pertaining to Delivery by Value transactions, which societies may need to operate in order to actualise financial assistance in cash terms.

6.7 Under existing financial assistance programmes, such as the Special Liquidity Scheme (SLS), the Bank of England provides recipients with Treasury Bills (“T-Bills”); in this case with a 9 month maturity. Societies can then enter into a sale and repurchase agreement in respect of these T-Bills in order to generate funding (i.e. “repo” the T-Bills). There are three ways in which the T-bills can be repo’ed – directly with market counterparties, directly with the Bank of England under its weekly Open Market Operations, or by utilising the Delivery By Value (‘DBV’) mechanics of the CREST Settlement System.

6.8 Under DBV the counterparties agree the cash amount of the repo and the CREST system automatically allocates assets from the borrower’s account to cover the value of the deal i.e. they are “delivered by value”, and marked to market based on the closing CREST market prices. DBV repos unwind automatically the following day reversing the cash and the security transfers within CREST.

6.9 The DBV mechanism offers particular advantages for this repo-ing activity, since it is both low-cost and low risk, participants are not subject to the same degree of counterparty risk as they would be in the open market for example.

6.10 In order to conduct the DBV transaction, participants need to be able to create charges in favour of their settlement bank, over their assets. This presents particular difficulties around recharacterisation risk, insofar as it is legally uncertain whether any given charge created for these purposes would be regarded as fixed or floating. A participant may believe that a charge is fixed (i.e. it pertains to a fixed set of collateral), but a court could subsequently determine that the charge was floating (particularly if the value of the underlying asset changed). The existence of this legal ambiguity is sufficient to call into question the ability of building societies to offer any form of charge in respect of DBV transactions.

6.11 This is unfortunate, since the DBV process may otherwise assist in enabling societies to make any financial assistance they receive fully liquid.

Proposed approach

6.12 The Government therefore proposes to exercise the power in section 251(7) of the Act. This allows HM Treasury, by order, to create exceptions to, or otherwise modify the effect of, section 9B of the Building Societies Act where to do so would assist societies in giving effect to financial assistance from the Treasury or a central bank.

¹ Section 257(1) of the Act provides that ““financial assistance” includes giving guarantees or indemnities and any other kind of financial assistance (actual or contingent)”.

6.13 The Government proposes to permit building societies to grant floating charges in favour of participants such as settlement banks operating on the CREST system. The order will therefore disapply Section 9B of the Building Societies Act 1986, in respect of charges made in favour of settlement banks participating in a designated system such as CREST.

6.14 The effect of disapplying section 9B will be that –

- a building society will be able to grant a floating charge in favour of a participant in a designated system;
- the charge may be granted over realisable assets (including money);
- the charge must be granted for the purpose of securing rights and obligations potentially arising in connection with that designated system.
- the terms “participant” and “designated system” will have the same meaning as in the Financial Markets and Insolvency (Settlement Finality) Regulations 1999.

6.15 The disapplication of section 9B will not be limited to charges made in relation to T-Bills or other securities received by a society from a central bank. Because of the fungible nature of T-Bills and other securities it would be impossible to ascertain whether a charge related to securities received from a central bank or other securities. However, the Treasury may only make the order if it is satisfied that the change will help some societies to use, give effect to or take advantage of financial assistance received from the Treasury or a central bank.

6.16 In addition the Government considers that it may be useful for the change to extend to both payment and securities. Whilst DBV has been identified as a particular issue, similar problems exist now (and new ones could arise in the future) in relation to granting charges in connection with payment systems (such as BACS). The Government’s view is that such a measure may have wider benefit and would place societies on the same footing as banks when accessing designated systems. The Government seeks views on whether this would help building societies to take advantage of financial assistance provided by a central bank.

6.17 Like the other proposed secondary legislation referred to in this consultation document, the order is available from the Treasury website.

Box 6.A: Consultation questions on floating charges

- 15 Do you agree with the Treasury's proposal to replace the Building Societies (Financial Assistance) Order 2008 for the reasons set out in paragraphs 6.2 to 6.5?
- 16 Do you agree with the Treasury's proposals in relation to floating charges granted to settlement banks? Do you consider that the proposals should extend to payment systems as well as securities settlement systems or just securities settlement systems?
- 17 Do you see any unintended consequences or risks in extending the proposals to payment systems? If so how can these be mitigated?
- 18 Will the proposals in relation to (a) securities settlement systems and (b) payment systems, help some societies to use, give effect to or take advantage of financial assistance received from the Treasury or a central bank?
- 19 Do you consider that the wider proposals would have unintended consequences or risks? If so how can these be mitigated?
- 20 Do you have any comments on the draft order?

7

How to respond

7.1 This consultation will last until 30 October 2009. Please ensure that your response reaches us by the closing date. Please send responses to:

Chris Rusbridge
Financial Regulation Strategy team
International & Finance Directorate
HM Treasury
1 Horse Guards Road
London
SW1 2HQ
Email: christopher.rusbridge@hm-treasury.x.gsi.gov.uk

7.2 When responding please state if you are responding as an individual or representing the views of an organisation. In accordance with the code of practice on open Government comments will be made publicly available unless respondents specifically request otherwise.

7.3 Annex B to this consultation document includes an Impact Assessment for the proposals contained in this document. It refers to the consultation document to the Banking Bill which was published in October 2008.

CONFIDENTIALITY DISCLOSURES

7.4 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 (DPA) 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 with and which deals, amongst other things, with obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have 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 will be maintained in all circumstances.

7.5 An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department. Your personal data will be processed in accordance with the DPA, and in the majority of circumstances, this will mean that your personal data will not be disclosed to third parties.

FREEDOM OF INFORMATION CONTACT

7.6 Any Freedom of Information Act queries should be directed to:

Correspondence and Enquiry Unit
Freedom of Information Section
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ
Tel: (+44) (0) 20 7270 4558
Fax: (+44) (0) 20 7270 4681
Email: public.enquiries@hm-treasury.x.gsi.gov.uk

CABINET OFFICE CODE OF PRACTICE

7.7 This consultation is being conducted in line with the criteria in the Government's Code of Practice on Consultation.¹ The seven consultation criteria are:

- **When to consult** - formal consultation should take place at a stage when there is scope to influence the policy outcome.
- **Duration of consultation exercises** - consultations should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible.
- **Clarity of scope and impact** - consultation documents should be clear about the consultation process, what is being proposed, the scope to influence and the expected costs and benefits of the proposals.
- **Accessibility of consultation exercises** - consultation exercises should be designed to be accessible to, and clearly targeted at, those people the exercise is intended to reach.
- **The burden of consultation** - keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained.
- **Responsiveness of consultation exercises** - consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.
- **Capacity to consult** - officials running consultations should seek guidance in how to run an effective consultation exercise and share what they have learned from the experience.

7.8 If you feel this consultation does not fulfil these criteria, please contact:

Luke McInerney
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ
Email: luke.mcinerney@hm-treasury.x.gsi.gov.uk

¹ Available on the Department for Business, Innovation and Skills at <http://www.berr.gov.uk/whatwedo/bre/consultation-guidance/page44458.html>.

A

BSIP and BSSAP rules

A.1 Table 7.A sets out the significant changes that have been made to the bank insolvency rules in the drafting of the Building Society Insolvency (England and Wales) Rules. The changes also apply to the Building Society Insolvency (Scotland) Rules unless otherwise stated.

A.2 Table 7.B sets out the significant changes that have been made to the bank administration rules in the drafting of the Building Society Special Administration (England and Wales) Rules (and the Building Society Special Administration (Scotland) Rules. The changes also apply to the BSSAP (Scotland) Rules (S.I. 2009/806) unless otherwise stated.

A.3 All of the draft rules themselves, and a link to the BSSA (Scotland) Rules, are available from the Treasury website (www.hm-treasury.gov.uk). BSIP and BSSAP rules are also needed for Northern Ireland and these will be made separately by the Department of Enterprise, Trade and Investment Northern Ireland (DETINI). Northern Ireland stakeholders are invited to comment on the policy proposals in this consultation document, which are consistent UK-wide, and DETINI will run a separate targeted consultation on the detail of the rules.

Table 7.A: Summary differences between the draft Building Society Insolvency (England and Wales) Rules and the Bank Insolvency (England and Wales) Rules 2009 (S.I. 2009/356)

Rule(s)	Change	Explanation and detail
3	Changes have been made to reflect terms and terminology specific to building societies.	The rules include appropriate terms for building societies, for example "principal office" and "registered name" (rule 3(2)). They also include the appropriate terminology for building society insolvency ("building society insolvency", "building society liquidator", etc.) (rule 3(2)). Certain terms are given the same meaning as they have in the Building Societies Act, either expressly (e.g. "contributory" (rule 3(2)) or by virtue of rule 3(3)). There are other minor changes to rule 3, for example for consistency with the relevant provisions applying the Banking Act or the Insolvency Act to building societies (rule 3(4)).
Various	References to the registrar of companies	The FSA is the registrar for building societies: the registrar of companies has no role in connection with building societies. Accordingly, references to the registrar of companies are either removed (for example rules 16(5), 23(5), 90(4), 98(1)) where there is already a reference to the FSA, or replaced with a reference to the FSA (for example rules 88(4), 97(5), 98(3)).
15(1)	Witness statement in opposition (Rule 15(1))	The reference to the director is deleted, as it is redundant.

17, 22(2), 42(2)	Changes to notice provisions to reflect Insolvency (Amendment) Rules 2009	<p>The Insolvency (Amendment) Rules 2009 (S.I. 2009/642) came into force on 6th April 2009 and so were not in force at the time the BIP rules were made.</p> <p>The Insolvency (Amendment) Rules 2009 make some amendments to the Insolvency Rules 1986 upon which the BIP rules are modelled. A number of the amendments to the Insolvency Rules 1986 concern publicity of insolvency proceedings and are relevant to the rules. The policy approach being that building society insolvency should replicate, insofar as possible, normal insolvency proceedings, a number of changes have been made to the BIP rules precedent to reflect the recent amendments in connection with publicity.</p> <p>New Rule 17 (applicant to give notice of dismissal by the court of application for insolvency order) makes similar provision to new Rule 4.21B of the Insolvency Rules 1986. Appropriate changes are also made to rules 22(2) (notice of appointment of provisional liquidator), 42(2) (advertisement of first creditors' meeting) and 88(2) to reflect changes to equivalent provisions in the 1986 rules. Rule 210 of the BIP rules is omitted as Rule 7.32 of the 1986 rules no longer has effect.</p>
21	Appointment of provisional building society liquidator-The first and the fourth paragraph of the equivalent rule in the BIP rules have been amended.	<p>The amendments remove a restriction to the timing of the application for the appointment of a provisional building society liquidator: in building society insolvency, that application will be possible even before the application for an insolvency order has been filed, although, in line with section 135 of the Insolvency Act, the court will not be able actually to make the order until after the application for the insolvency order has been made. This will give increased flexibility as to timing.</p> <p>There is also a deletion of the reference (in the equivalent provision in the BIP rules), to the Secretary of State being able to apply for the appointment of the provisional liquidator. This arises from the fact that the Secretary of State does in have a role in applying for a building society insolvency order.</p>
35(3)(g)	Report by liquidator: building society shares	Rule 35(3)(g) (report by building society liquidator) requires separate details to be given of debts to creditors and shares, as most deposits in building societies are held in the form of shares (Building Societies Act 1986, section 8(1)).
41	Meaning of "contributories" in Part 6 and elsewhere	New Rule 41 provides that borrowing members of the society (i.e. individuals who have a mortgage with the society) are not contributories for the purposes of Part 6. This is because they are not considered to have an economic interest in the society comparable to the interest of shareholding members, so it would be inappropriate for them to attend and vote at meetings of contributories for the purposes of Part 6.
43(5)	FSCS entitlement to sit on the liquidation committee	Rule 43(5) provides that the FSCS can be a member of any liquidation committee formed under rule 43(4) or under sections 101(8) or (9) of the Banking Act. This is to ensure that, if a liquidation committee is not formed at the first meeting of creditors but is formed at a later date, the FSCS is still entitled to be a member of the committee.
46, 52	Voting rights of contributories	Rules 46 and 52 are changed to the effect that the votes of contributories (i.e. shareholding members of the society) reflect the value of their shares in the society. Shareholding members of building societies normally vote on a one-member, one-vote basis; however for insolvency purposes it is considered that voting should be in proportion to the value of shares held.

74, 75	Set-off	Rule 74 is changed by the addition of paragraph (2)(c), to the effect that set-off does not apply in respect of any mutual dealings between the society and a creditor who is also a shareholding member of the society in respect of shares held by that person in the society. This is a clarification for the purposes of legal certainty in the context of the general principle that set-off does not apply generally in relation to rights arising from shares, as they rank lower than debts to creditors. There are also changes to Rule 75 (disapplication of set-off in relation to eligible depositors) to make it clear that rule 75 does not in any event apply in relation to payment made by the FSCS to members, as there is no set-off to disapply.
108	Replacement building society liquidator	Where a building society liquidator has been removed by a meeting of creditors and no new liquidator has been appointed by the meeting that has removed the previous liquidator, the Bank of England shall appoint a new building society liquidator as soon as practicable, rather than waiting up to a month before appointing a new liquidator.
123	Quorum	The amendment ensures that the liquidation committee is duly constituted even if the FSCS is the only member (see also comments below on rule 135).
124	References to section 323 Companies Act 2006 (representation of corporations at company meetings)	References to this section are removed from Rule 124 (committee – members’ representatives), and there is no equivalent provision for Rule 240 of the BIP rules (company representation), as section 323 is not relevant to building societies in this context (and there is no equivalent provision in the Building Societies Act).
130	Voting rights and resolutions	Rule 130 applies rule 4.165 concerning voting rights and resolutions of the liquidation committee. The word “creditor” is removed at paragraph (1) to ensure that the FSCS has voting rights in the liquidation committee.
135	Composition of liquidation committee	Rule 135 applies rule 4.171(4), to ensure that, as creditors are paid off in full, they are automatically removed from the committee. This leaves the possibility that, as creditors leave the committee, the FSCS could be the sole member of the committee. Rule 135 inserts a new paragraph (6A) in rule 4.171, which provides that the liquidation committee continues to exist and can act so long as it consists of at least the FSCS.
181	FSA’s directions under section 116 of the Banking Act.	In Rule 181, the Secretary of State’s functions under section 116 of the Banking Act (direction to defer date of dissolution of bank) are conferred on the FSA by the Building Societies (Insolvency and Special Administration) Order, Schedule 1, paragraph 17.
-	Leave to act as director of bank with prohibited name.	Rules 181 to 187 of the BIP rules are not replicated, as they are not relevant to building societies. They concern company insolvency law on the restriction of re-use of a company name, which does not apply in relation to building societies (see paragraph 13(5) of Schedule 1 to the Building Societies (Insolvency and Special Administration) Order and paragraph 30 of Schedule 15 to the Building Societies Act 1986).
223	Restriction on concurrent proceedings and remedies	Building society rules reflect the fact that that it is the claimant in the proceedings to be stayed who needs to receive the order.

Table 7.B: Summary of differences between the draft Building Society Special Administration (England and Wales) Rules and the Bank Administration (England and Wales) Rules (S.I. 2009/357)

Rules	Change	Explanation and detail
various	Terms and terminology appropriate for building societies	The rules include appropriate terms, for example “principal office” (rule 4(1)(e)), “registered name” (rule 4(1)(f)). They also include the appropriate terminology for building society special administration (“building society special administration”, “building society special administrator”, etc.) and abbreviations of these terms (rule 4(1)(c) and g)). Certain terms are given the same meaning as they have in the Building Societies Act, either expressly (e.g. “contributory” (rule 4(1)(d))) or by virtue of rule 4(2). There are other minor changes to rule 4, e.g. for consistency with the relevant provisions applying the Banking Act to building societies (rule 4(1)(i) and (j)). Building society terminology is used as appropriate in other rules, e.g. “registered name” and “principal office” in Rule 9. Similarly Rule 60, which precedes the table, makes general modifications in paragraphs (a) to (s), using the appropriate building society terminology.
4, 15, 22	References to provisions of the Building Societies Act inserted by the order	The rules contain references to provisions of the Building Societies Act inserted by the Building Societies (Insolvency and Special Administration) Order 2009. Rules 4(j), 15(d) and 22(f) refer to sections 90C and 90D of the Building Societies Act 1986, which were inserted by that order. Section 90C applies Parts 2 and 3 of the Banking Act to building societies. Section 90D requires a person commencing an insolvency procedure to give notice to the Financial Services Authority (FSA) (it makes provision identical to section 120 of the Banking Act 2009).
28, 29	Details of the administrator’s proposals.	Rule 28(2)(b) uses appropriate building societies terminology. Rule 28(2)(e) includes the chief executive of the society: by law building societies are required to have a chief executive (Building Societies Act 1986, section 59(1)); it was considered appropriate to include the chief executive here as a statutory officer of the society. Rule 28(i) and (j) require separate details to be provided of details of the society’s debts and of the shares issued by the society, as most deposits in building societies are held in the form of shares (Building Societies Act 1986, section 8(1)). Similar provision is made in Rule 29.
37, 45, 48, 49, 60	References to the registrar of companies	The FSA is the registrar for building societies: the registrar of companies has no role. Accordingly, references to the registrar of companies are either removed (e.g. rules 37(1), 45(1), 48(4)) where there is already a reference to the FSA, or replaced with a reference to the FSA (e.g. Rule 49(4) and (5), Rule 60(p)).
48	Changes to notice provisions to reflect Insolvency (Amendment) Rules 2009	Rule 48(6) reflects the equivalent provision in the Insolvency Rules 1986 (rule 2.113) as amended by the Insolvency (Amendment) Rules 2009 (S.I. 2009/642). Where the 1986 rules applied by the table have been amended by the Insolvency Amendment Rules, those amendments apply automatically. The Insolvency Amendment Rules came into force on 6th April 2009 and so were not in force at the time the BAP rules were made. This is not relevant to the Scotland rules.
49	End of administration: dissolution	Rule 49 reflects that the relevant provisions are contained in paragraph 30 of Schedule 1 to the Building Societies (Insolvency and Special Administration) Order 2009, rather than in paragraph 84 of Schedule B1 to the Insolvency Act 1986.

61	Shareholding members	In the table in Rule 61, various provisions of the Insolvency Rules 1986 (including Rule 2.68, 2.95, 2.97, 2.98, 2.99 and 2.100) are modified to include shareholding members. This is to reflect that, under the Building Societies (Insolvency and Special Administration) Order, the administrator can make a distribution to shareholding members (i.e. depositors) of the society (see Schedule 1, paragraph 27, which modifies paragraph 65 of Schedule B1 to the Insolvency Act to that effect).
61	Mutual credit and set-off	In the table, Rule 2.85 is modified to the effect that set-off does not apply in respect of any mutual dealings between the society and a creditor who is also a shareholding member of the society in respect of shares held by that person in the society. This is because set-off does not apply generally in relation to rights arising from shares, as they rank lower than debts to creditors. There is no equivalent provision in the Scotland rules as there is no equivalent to Rule 2.85 in Scotland.
61	Part 11 of the 1986 Rules	This Part is not applied by the table in Rule 61, as it largely repeats rules 2.95 to 2.105. As Part 11 relates to winding up, but Part 2 relates to administration, it was considered appropriate to apply the relevant rules from Part 2 only. This is not relevant to the Scotland rules.

B

Impact assessment

B.1 This annex contains the impact assessment of proposals for building society insolvency and special administration, and floating charges.

Summary: Intervention & Options

Department /Agency: HM Treasury	Title: Impact Assessment of proposals for building society insolvency and special administration, and floating charges	
Stage: Consultation	Version: 1	Date: 21 July 2009
Related Publications: Impact assessment of the Banking Bill		

Available to view or download at:

http://www.hm-treasury.gov.uk/fin_banking_act2009.htm

Contact for enquiries: Chris Rusbridge

Telephone: 020 7270 4552

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

The Banking Act 2009 is a key part of the Government's wider programme to strengthen the financial sector, stabilise the financial system, protect savers and taxpayers and support the wider economy. First, the consultation document proposes two new insolvency procedures to enable failing building societies to be successfully resolved and their customers and the wider economy protected. Second, it proposes to allow building societies to offer floating charges in return for liquidity assistance, which is currently not possible under building society legislation.

What are the policy objectives and the intended effects?

The proposed new insolvency procedures will provide building society members with similar protections to bank depositors, and allow the SRR to be applied in essentially similar ways to building societies as it is to banks. The second set of proposals will allow liquidity assistance to be offered to building societies in a timely and effective manner: as such it should improve both depositor confidence and market confidence. It seeks to protect taxpayers' interests by liquidity assistance being secured by an effective charge against assets.

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

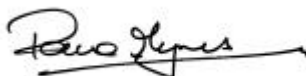
Treasury has considered not providing new insolvency procedures for buildings societies. However, these proposals fulfil commitments that were consulted on extensively during 2008, and which have the support of stakeholders; further, they have already been partly implemented to enable resolution of Dunfermline building society. In respect of the financial assistance provisions, an alternative would be to leave in place the temporary arrangements made under the Banking (Special Provisions) Act. However the Government considers that it is appropriate to consult on a permanent replacment.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? The building society insolvency provisions will be monitored by the Banking Liaison Panel, a statutory body under section 10 of the Act. Other provisions will be reviewed as and when necessary.

Ministerial Sign-off For consultation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister:



..... Date: 20 July 2009

Summary: Analysis & Evidence

Policy Option:	Description:
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COSTS	ANNUAL COSTS	Description and scale of key monetised costs by 'main affected groups' There are no significant ongoing or one-off direct costs associated with these measures
	One-off (Transition) Yrs	
	£	
	Average Annual Cost (excluding one-off)	
	£	
Total Cost (PV)		£
Other key non-monetised costs by 'main affected groups'		

BENEFITS	ANNUAL BENEFITS	Description and scale of key monetised benefits by 'main affected groups' It is not feasible to quantify the benefits of these measures. However, there are significant benefits of preventing a bank failure, and in ensuring that if a building society does fail, it is wound down in an orderly fashion. These are set out in "Costs of building society failure", in the evidence base.
	One-off Yrs	
	£	
	Average Annual Benefit (excluding one-off)	
	£	
Total Benefit (PV)		£
Other key non-monetised benefits by 'main affected groups' The key benefits relate to the reducing the likelihood of building society failure, and minimising the impact on building society members, other depositors, and the wider economy if failure does occur. This is set out in detail in the evidence base.		

Key Assumptions/Sensitivities/Risks

Price Base Year	Time Period Years	Net Benefit Range (NPV) £	NET BENEFIT (NPV Best estimate) £
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What is the geographic coverage of the policy/option?	UK				
On what date will the policy be implemented?	Immediate				
Which organisation(s) will enforce the policy?	HMT, BoE, FSA, MoJ				
What is the total annual cost of enforcement for these organisations?	£ not known				
Does enforcement comply with Hampton principles?	Yes				
Will implementation go beyond minimum EU requirements?	No				
What is the value of the proposed offsetting measure per year?	£ N/A				
What is the value of changes in greenhouse gas emissions?	£ N/A				
Will the proposal have a significant impact on competition?	No				
Annual cost (£-£) per organisation (excluding one-off)	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 25%;">Micro N/A</td> <td style="width: 25%;">Small N/A</td> <td style="width: 25%;">Medium N/A</td> <td style="width: 25%;">Large N/A</td> </tr> </table>	Micro N/A	Small N/A	Medium N/A	Large N/A
Micro N/A	Small N/A	Medium N/A	Large N/A		
Are any of these organisations exempt?	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 25%;">No</td> <td style="width: 25%;">No</td> <td style="width: 25%;">N/A</td> <td style="width: 25%;">N/A</td> </tr> </table>	No	No	N/A	N/A
No	No	N/A	N/A		

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)
Increase of £	Decrease of £	Net Impact £

Key:

Annual costs and benefits: Constant Prices

(Net) Present Value

Evidence Base (for summary sheets)

Introduction

This impact assessment considers some of the statutory instruments needed to apply the SRR to building societies. In this respect, this is not new policy: rather, it builds on provisions in the Banking Act 2009. The evidence base for the bank insolvency procedure (BIP) and bank administration procedure (BAP) is set out in the evidence base in *Banking Bill: Impact Assessment* (HM Treasury, October 2008, available from www.hm-treasury.gov.uk).

The BSIP and BSSAP apply these procedures to building societies, and are broadly comparable. There are, however, some additional areas of substantive policy, arising from the differences between the structure of banks and building societies (and in particular, differences in the hierarchy of creditors), which should be given particular consideration in respect of the BSIP and BSSAP. Although there are some additional risks associated with these differences, the Treasury does not believe that they will result in significant additional costs.

The evidence base for the proposals for financial assistance for building societies is also set out in *Banking Bill: Impact Assessment*. The text below sets out the relevant information from the original impact assessment and adds further information around the more detailed policy proposals that are put forward in this consultation document.

Consultation

The Government consulted on the creation of the SRR during January and July 2008. Respondents to these consultations agreed with the Government's view that building society members should receive similar protection to bank depositors, and that the SRR should therefore be applied to building societies as well as banks. Accordingly, the stabilisation options established in Part 1 of the Act were applied to building societies directly.

However, to allow time to consult fully on applying the new insolvency procedures for building societies, the procedures for building society insolvency and special administration were not set out on the face of the legislation. Instead, the Banking Act gives the Treasury powers to make secondary legislation applying the BIP and BAP to building societies with modifications where necessary.

In line with normal practice, the Government committed to consult on this secondary legislation before it was made. However, it was recognised that it might be necessary to make secondary legislation urgently, without consultation (or before a consultation had finished), in the event that it was necessary to do so in order to use the SRR powers to resolve a failing building society.

The failure of Dunfermline building society in March 2009 meant that it was necessary to bring forward the secondary legislation applying the BIP and BAP to building societies on an urgent basis. Consequently, on 29 March 2009 the Government made the Building Societies (Insolvency And Special Administration) Order 2009 and the Building Society Special Administration (Scotland) Rules 2009. In the explanatory memorandum which accompanied the Order, the Treasury committed to consult fully on the order and to lay a revised order in due course.

Costs of building society failure

The costs of bank failure are set out in detail in *Banking Bill: Impact Assessment* (see in particular the section on "Costs of financial instability and bank failure", p.7). Comparable remarks apply to the potential costs of the failure of building societies, as set out below.

There are 53 building societies in the UK with total assets of around £395 billion. Around 15 million adults have building society savings accounts and around 3 million adults are currently buying their homes with the help of building society loans. Building societies have diversified in recent years and a number now offer current accounts, credit cards, cash machines, travel money, unsecured loans, various types of insurance and estate agency services as well as the facilities traditionally offered by building societies.

There have been some cases over the years of building societies running into financial difficulties, and these have typically been dealt with by the society in questions amalgamating with or transferring its engagements to another building society. A building society can also transfer all of its engagements to a commercial company if necessary.

However, in an environment of financial uncertainty, it is possible that a building society that ran into difficulties would not be able to resolve itself in this way. If this were to happen, there is the potential for negative consequences for depositors, borrowers, the Exchequer, and the economy as a whole:

- members and other depositors would suffer through loss of liquidity, and there is also the scope for the loss of wealth, where current and savings accounts (including notice accounts) are used as a form of investment (to the extent that the depositor's balance exceeds the FSCS compensation limit and the depositor does not recover these additional funds through the insolvency process);
- individual borrowers would suffer, in particular with difficulties connected to repayment of mortgages; and borrowers in general would suffer from a reduced capacity for mortgage lending from the financial sector as a whole;
- the Government may incur costs if it chooses to intervene in an attempt to resolve or alleviate the crisis. Unless these costs are offset by proceeds from the resolution (for example the sale of a state-owned bank) or recharged to another party (for example, FSCS levy payers), this loss will, ultimately, be borne by the taxpayer; and
- all of the types of cost discussed above – costs to depositors, borrowers, the Exchequer and the financial sector – will feed through in some form to the wider economy. This will be through a range of transmission mechanisms, which are discussed in detail in *Banking Bill: Impact Assessment*.

For more detailed relevant analysis of the potential costs of failure and the systemic risks, see *Banking Bill: Impact Assessment*, “Costs of financial instability and bank failure”, page 7. The consultation document therefore includes proposals to mitigate these risks:

- proposals for liquidity assistance to help prevent the failure of building societies;
- proposals that will support a partial transfer of a building societies assets, potentially protecting the building society members, depositors and borrowers in the event that a building society does fail
- proposals that will enable a failing building society to be wound down in an orderly fashion and for fast payout to be made by the FSCS to eligible claimants.

The building society insolvency procedure (BSIP)

The Banking Act introduces a new insolvency procedure for banks – the bank insolvency procedure (BIP) – to ensure that depositors who are eligible for compensation under the FSCS receive prompt payment or have their accounts transferred to another financial institution while also providing for the winding up of the affairs of a failed bank in the interests of its creditors as a whole. The building society insolvency procedure (BSIP) makes similar provision in relation to building societies.

There is currently no special insolvency regime for building societies. Like the BIP, the BSIP is based on the existing compulsory liquidation regime provided for by the Insolvency Act 1986 with additional clauses and modifications where required. Those changes generally reflect and support the achievement of the unique objectives of the BSIP which provide for a building society liquidator to work with the Financial Services Compensation Scheme (FSCS) in the early stages of the process to ensure that eligible claimants either receive prompt payment from the FSCS or alternatively have their accounts transferred to another financial institution to ensure continuity in access to funds and banking services (collectively, ‘Objective 1’).

After Objective 1 has been achieved, the building society liquidator (an insolvency practitioner appointed by the Court), will be obliged to undertake the usual practices associated with a

liquidation to ensure that the winding up proceeds in the best interests of creditors as a whole ('Objective 2').

The procedure is based on the BIP, with the following significant modifications:

- As in a bank insolvency, when the FSCS pays out to eligible claimants it takes over their right to reclaim monies from the insolvency. However, in building society insolvency, the FSCS will take over two types of claims. This arises because account-holders in a building society can hold their account in two ways: either as members of the society (in which case they are members, not creditors) or as non-members such as current account holders (in which case they are creditors). The FSCS will therefore be a creditor in respect of the monies it has paid out to non-members; and it will hold rights equivalent to a building society member in respect of monies that it has paid out to building society members. As discussed below, in receiving payment of dividends from the insolvent estate of a building society, members rank lower in priority for distribution than ordinary creditors. The BSIP reflects this and contains provisions to enable the FSCS to make appropriate payments, to rank in the insolvency at the appropriate level to recover monies, and to perform necessary functions such as holding the liquidator to account.
- The proposed BSIP Rules are based on the legal assumption that set-off is available to the FSCS only in the case of payment by the FSCS to depositors who are not members of the society because, like bank depositors, they are ordinary creditors. Furthermore, for the sake of legal certainty, the rules specify that set-off does not apply in respect of any mutual dealings between the society and a creditor who is also a shareholding member of the society in respect of shares held by that person in the society. Building society depositors (such as holders of current account and trustee or client accounts) on the other hand will be treated the same as bank depositors under FSCS rules because, like bank depositors, they are ordinary creditors. If the FSCS were to take advantage of set-off, it would effectively elevate members' claims above many normal creditors. This would have two undesirable effects. First, it would alter the statutory order of priority of creditors, contrary to stakeholders recommendations in response to the 2008 consultations for the design of the BIP; and second it would effectively pre-empt implementation of the Building Societies (Funding) and Mutual Societies (Transfers) Act, which will give parity to building society members and other creditors. The Government believes that it would be inappropriate to pre-empt the implementation of primary legislation through the making of insolvency rules.
- The proposed Rules therefore ensure that the Liquidation Committee can continue to operate where the FSCS is the sole member of the committee, and to ensure that the FSCS has voting rights in the liquidation committee. When the FSCS has been reimbursed, it may step down from the Liquidation Committee and the building society liquidator may apply to the court to make further distributions (including distribution of any surplus to shareholding members).
- The meetings of contributories of building societies differ from the meetings of contributories of banks. In a meeting of shareholders of a bank (or other company), voting rights are based on the value of shares held. Voting in meetings of members of building societies tends to be based on the principle of one member one vote. This would not be appropriate in the context of a building society insolvency, firstly because it would not be reasonable to give all members an equal vote regardless of their economic interest in the distribution of the surplus, and secondly because it would be impractical to hold a meeting for a large number of members (some of whom might be liable for small sums of money). Further, whereas the shareholding members have an ongoing economic interest in the distribution of any surplus in the insolvency, borrowing members (i.e. individuals who have a mortgage with the society) do not have a comparable economic interest. The proposed Rules therefore establish that only shareholding members (and not borrowing members) should be treated as contributories for the purposes of Part 6 ('Meetings of creditors and contributories'), and that voting rights at the contributories meeting should be apportioned by value of the member's shareholding.

- It may be necessary to appoint a provisional liquidator over a weekend while the court office is closed. As it is not possible for the Bank of England to make the application for building society insolvency while the court office is closed, it is necessary to ensure that the provisional liquidator can be appointed as quickly as possible. When an application for building society insolvency is made, there will be a short period before the court hearing to consider whether the order should be made. During this period, a provisional liquidator may be appointed. As in an ordinary insolvency, the provisional liquidator has powers specified by the court, which are generally to protect or preserve the assets of a company pending the appointment of a liquidator on the making of the winding-up order.

Benefits of the BSIP

There are no significant ongoing or one-off direct benefits associated with this measure. Should the new procedure be used, the control the Authorities would have over insolvency proceedings would yield benefits in two main ways:

- Speed of process – the Authorities would have the power to initiate proceedings quickly and nominate their preferred insolvency practitioner. Furthermore, there would not be a requirement to hold meetings with creditors, or seek their views before any action is taken; this should help facilitate a prompt transfer of accounts or quick FSCS payout.
- Specific objectives – as creditors' rights are somewhat restricted in the early stages of the proceedings (subject to the procedure being subject to the overall control of the court), this will enable the liquidator to act promptly towards achieving his or her objectives.

A prompt transfer of accounts or faster FSCS compensation payments will enable building society customers to access to their funds more quickly, decreasing potential costs to building society customers and reducing the period of time during which liquidity is lost or reduced. The new process will also avoid or at least reduce the burden of processing individual claims. The BSIP also provides a credible regime under which a building society could be allowed to fail, with a reduced impact on depositors and financial stability generally. The existence of a credible possibility that a building society may be allowed to fail reduces the risk of 'moral hazard' in respect of building societies.

It is not feasible to quantify these benefits. However, the 'Costs of building society failure' section above sets out the benefits of quick FSCS payments to depositors, and further information about the benefits to financial stability and the financial sector as a whole is set out in *Banking Bill: Impact Assessment* in the section on 'Costs of financial instability and bank failure'.

Costs of the BSIP

It is unlikely that there will be any material one-off or ongoing direct costs of a new insolvency procedure: it is not anticipated that existing contracts between a building society and its creditors would require rewriting or renegotiation. Part of the rationale for modelling the BIP and BSIP on existing insolvency procedures is simplicity and reduction of costs. Like the BIP, the BSIP has been designed to ensure that it closely follows existing insolvency procedures: it will be familiar to building societies and their professional advisers. For example, the BSIP will require forms to be filled in by the Bank of England and FSA. However, because the procedure is similar to normal insolvency, and these forms will only need to be used occasionally, the BSIP repeats the provision of the BIP that unique forms for building societies are not required, and existing forms may be used with modifications where necessary. It is not anticipated that there will be any additional ongoing compliance burden arising from these proposals.

There will be an additional direct cost where a building society wishes to wind itself up voluntarily since those proceedings cannot now take effect without the permission of the court, however it is not possible to quantify this additional cost.

Groups affected

Parties who are directly affected by the BSIP will be: creditors of any building society taken into the BSIP by the Authorities; FSCS levy-payers and building society customers generally.

Competition assessment

As this measure is only an alternative set of proceedings, it is not expected that it will affect competition. Arguably, this measure will have a beneficial impact on competition, as it will ensure that insolvency is a viable option, assisting in the efficient working of the market.

Risks

The most significant risk of this proposal is that it might not be in the best interests of all creditors of the building society, because the building society liquidator's primary objective in the early stages of the proceedings will be to work with the FSCS to ensure that eligible claimants receive payment from the FSCS or their accounts are transferred. However, this initial stage in the procedure should be short-lived. During this period, the building society liquidator is also required to carry out actions normally associated with a liquidation (for example identifying, protecting and realising assets, dealing with queries from creditors), and in this, the liquidator is expected to act in the interests of creditors generally. It should be noted that compensation payments will be made by the FSCS rather than from the assets of the failed building society and the FSCS will stand in the shoes of building society members and other FSCS-eligible claimants in respect of those claims that it pays.

A further risk arises from the fact that in the BSIP, like the BIP, no changes are proposed to the existing priority order of creditors. This is important to avoid pre-emption of section 2 of the Building Societies (Funding) and Mutual Societies (Transfers) Act, which will give parity to building society members and other creditors. However, while this may work to the advantage of other creditors (for example wholesale funders), it has the potential to disadvantage FSCS levy-payers relative to a comparable payout in the event of bank insolvency, as the FSCS may recover less money from the insolvency than it would in a bank insolvency.

The final significant risk is that the proposed rules provide that only shareholding members (and not borrowing members) are contributories and that voting rights at the contributories meeting should be apportioned by value of the member's shareholding. For the reasons set out above, the Government believes that this approach is fair, and indeed that it is the only practical way of engaging with members in the context of insolvency. In particular, having to hold meetings at short notice for large numbers of members could place a significant additional burden on the insolvency, reducing the monies available for distribution. However, there is a risk that some members of a building society that has failed may feel disenfranchised apportioning of votes at meetings by value of shares held, rather than according to the insolvent building societies' voting rules.

Building society special administration procedure (BSSAP)

The Banking Act allows the Bank of England to effect a partial transfer, transferring part of a failing building societies business, so that the business is split between a new company (either a private sector purchaser or a Bank of England-controlled bridge bank) and the residual bank.

The Banking Act introduces a unique insolvency process – the bank administration procedure (BAP) – to facilitate partial transfers. The bank administration procedure could only be invoked where part of a failing bank's business is sold to a private sector purchaser or transferred to a bridge bank and it is considered necessary for the residual banking company to continue to provide ongoing services or facilities to the bridge bank or the commercial purchaser for the parts of the business transferred.

The second part of the secondary legislation under consultation applies the BAP to building societies UK-wide, a procedure to be known as the building society special administration procedure (BSSAP). The procedure was implemented on an urgent basis without consultation in order to enable the resolution of Dunfermline building society. BSSAP rules were also made for Scotland, but as yet there are no equivalent rules for England and Wales, or Northern Ireland.

Like the BAP, the BSSAP may only be commenced by an order of the court on an application made by the Bank of England. The procedure is based largely on the existing administration

provisions of Schedule B1 to the Insolvency Act 1986 but has an additional unique objective requiring the building society administrator (an insolvency practitioner) to provide support for the commercial purchaser or bridge bank. The Banking Act contains provisions to ensure that this objective can be achieved in respect of banks, and the BSSAP applies these the building societies with necessary modifications.

The building society special administrator will also be obliged to carry on the ordinary process of an administration but this will be subject to certain restrictions, for example prior to completion of the 'support objective' certain assets may only be realised and certain actions taken only with the agreement of the Bank of England. The length of time that the residual building society may need to be kept alive to provide support will vary on a case-by-case basis. As soon as it is no longer necessary for continued support to be provided by the residual building society to the commercial purchaser or bridge bank, the proceedings will continue in much the same way as an ordinary administration.

To ensure that the building society administration procedure is a flexible and stand-alone regime the bank administrator will have all the existing powers of an administrator and will also have certain powers normally only available to a liquidator; for example to disclaim onerous property, bring actions before the court for wrongful or fraudulent trading and to be able to make distributions to creditors without requiring the express permission of the court. This means that once the 'support objective' has been achieved, the administrator will have all the tools available that he requires to either attempt a company rescue or to fully wind up the affairs of the building society.

Benefits

The wider benefits of the SRR and the private sector purchaser and bridge bank tools are discussed extensively in *Banking Bill: Impact Assessment*. The BSSAP will ensure partial transfers can be used in respect of building societies.

The particular benefit of the BSSAP is that it is designed to ensure that where there is a partial transfer, essential services and facilities continue to be provided to the commercial purchaser or bridge bank. The procedure also facilitates, where necessary, further property transfers between the residual building society and the commercial purchaser or bridge bank. This will assist the successful resolution of the bridge bank and should make a partial purchase of a failing building society's business by a private sector purchaser a more attractive option. The building society special administrator will also have additional powers normally only available to a liquidator which will ensure that the objectives of the proceedings can be achieved and reduce the costs associated with conversion from administration to a liquidation.

It is not feasible to quantify these benefits. However, the 'Costs of building society bank failure' section sets out the benefits enabling a building society to be successfully resolved, and the advantages of avoiding loss of continuity of service to depositors. Further information about the benefits to financial stability and the financial sector as a whole is set out in *Banking Bill: Impact Assessment* in the section on 'Costs of financial instability and bank failure'.

Costs

If a partial transfer is undertaken to a private sector purchaser or bridge bank then additional costs may be incurred. The Government has put in place safeguards in secondary legislation to provide compensation for those creditors left in the residual building society following the partial transfer. The amount of compensation is equal to the difference between what the creditors would hypothetically have received had the Authorities not intervened (and the whole of the bank had gone into insolvency) and the realisations of those creditors from the insolvency of the residual building society. This safeguard to creditors may increase the costs of the resolution.

Groups affected

Groups affected directly will be: creditors of any building society taken into the BSSAP.

Risks

The most significant risk of this proposal is that it might not be in the best interests of all creditors of the building society, for example there may be a delay before any distribution to creditors can be made and the dividend prospects may be worse than in an immediate insolvency because the assets of the building society may have been used in achieving the 'support objective'. To mitigate these risks safeguards including compensation, as outlined above, are proposed in relation to the exercise of the SRR tools.

An additional risk relates to the proposals for disapplying set-off in relation around FSCS payout, which is described in above in relation to the BSIP rules. This will also apply to the BSSAP rules. This does not require a change to the Scotland rules to bring them into line with the England and Wales rules, due to the different legal system in Scotland. The risk is mitigated by the fact that it is unlikely that FSCS payout would be necessary in relation to the BSSAP, as FSCS eligible depositors would typically be transferred to another institution in a partial transfer scenario.

The final significant risk relates to the second stage of the administration, during which the administrator will work towards his second objective, to rescue the society as a going concern or achieve a better result than would be the case if the society were wound up without first being in administration. In this stage, shareholding members will, like creditors, be able to participate in a distribution, at the administrator's discretion. This goes beyond the position for banks, whose shareholders, as company shareholders, may not participate in a distribution. This is in recognition that any remaining shareholding members have an interest in the society that is similar to a debt. However, under the BSSAP, building society members are not given the right to vote on the administrator's proposals in the second stage of the administration. The reason for this is that after a partial transfer there may be few if any shareholding members left. Furthermore, any shareholding members left in the administration are likely to have received payment from the FSCS, and will not have an comparable economic interest in the administration to ordinary creditors.

Liquidity Support for Building Societies

The Banking Act 2009 includes provisions that improve the ability of the Authorities to provide liquidity support and other financial assistance to institutions in difficulty. This is of particular relevance to building societies. The Government is of the view that societies should, wherever possible, have the same ease of access to financial assistance as banks. There are particular difficulties associated with this at present, due to the prohibition on the creation of floating charges in Section 9B of the Building Societies Act 1986.

Floating charges

In order to grant financial assistance to a building society, the Bank of England, another central bank, or the Government, may wish to take a floating charge over the society's assets in order to have some form of security for its lending while permitting the society to continue to trade in these assets in way that a fixed charge would prohibit. Building societies are generally prohibited from granting floating charges by section 9B of the Building Societies Act 1986. The Government made temporary provision to address this issue through the Building Societies (Financial Assistance) Order 2008.

The consultation document sets out proposals for permanent replacement to the temporary provision, to be made by order under section 251 of the Banking Act. Section 251 provides powers for the Treasury to make appropriate secondary legislation to address any remaining barriers to societies receiving financial assistance from the Treasury or a central bank (the Bank of England, another central bank of a Member State of the European Economic Area, or the European Central Bank). The proposed order would enable societies to grant floating charges to one of those bodies, or any person acting on their behalf, in connection with the provision of

financial assistance. It is similar to the temporary measure: however it has a wider definition of qualifying institutions that may be regarded as providing financial assistance, and a wider concept of “financial assistance”.

Delivery by Value

In addition, the Government has become aware of particular difficulties pertaining to Delivery by Value transactions, which societies may need to operate in order to actualise financial assistance in cash terms.

Under existing financial assistance programmes, such as the Special Liquidity Scheme (SLS), the Bank of England provides recipients with Treasury Bills (“T-Bills”); in this case with a 9 month maturity. Societies can then enter into a sale and repurchase agreement in respect of these T-Bills in order to generate funding (i.e. “repo” the T-Bills). There are three ways in which the T-bills can be repo’ed – directly with market counterparties, directly with the Bank of England under its weekly Open Market Operations, or by utilising the Delivery By Value (‘DBV’) mechanics of the CREST Settlement System.

Under DBV the counterparties agree the cash amount of the repo and the CREST system automatically allocates assets from the borrower’s account to cover the value of the deal i.e. they are “delivered by value”, and marked to market based on the closing CREST market prices. DBV repos unwind automatically the following day reversing the cash and the security transfers within CREST.

The DBV mechanism offers particular advantages for this repo-ing activity, since it is both low-cost and low risk, participants are not subject to the same degree of counterparty risk as they would be in the open market for example.

In order to conduct the DBV transaction, participants need to be able to create charges in favour of their settlement bank, over their assets. This presents particular difficulties around recharacterisation risk, insofar as it is legally uncertain whether any given charge created for these purposes would be regarded as fixed or floating. A participant may believe that a charge is fixed (i.e. it pertains to a fixed set of collateral), but a court could subsequently determine that the charge was floating (particularly if the value of the underlying asset changed). The existence of this legal ambiguity is sufficient to call into question the ability of building societies to offer any form of charge in respect of DBV transactions. This is unfortunate, since the DBV process may otherwise assist in enabling societies to make any financial assistance they receive fully liquid.

The consultation document therefore makes two proposals:

- to permit building societies to grant floating charges in favour of settlement banks and other participants operating on the CREST system. The order will therefore disapply Section 9B of the Building Societies Act 1986, in respect of charges made in favour of participants in a designated system such as CREST; and
- to make similar provision for payment systems. DBV has been identified as a particular issue, however similar problems exist now (and new ones could arise in the future) in relation to granting charges in connection with payment systems (such as BACS).

Benefits

Liquidity assistance is an important tool available to the Authorities to assist a firm in difficulties. This change will allow the Treasury, the Bank of England or another European central bank to grant liquidity support to a building society in exchange for security in the form of a floating charge, and in a timely and effective manner, providing building societies with the ability to convert securities into cash, with legal certainty. As such, it should improve both depositor confidence and market confidence. It seeks to protect taxpayers’ interests by liquidity assistance being secured by an effective charge against assets.

Secondly, it is possible that some potential providers of finance may have systems that enable charges to be granted. It is likely that such systems would need to be bespoke, and developed at considerable cost; and it is probable that such systems will not be widely in place in the

foreseeable future. Lifting the restriction established by section 9B, would remove a legal impediment to institutions who do not have such systems, and who would otherwise would not require such a system. Enabling a wider range of institutions to act as providers of financial assistance will enable building societies to identify the most appropriate partner for the provision of liquidity.

The Government's preliminary view is that DVB is likely to be the most cost effective method for accessing to liquidity assistance, and that lack of access to DBV means that building societies will face higher financing costs for. However, extending the change to payment systems would have the clear benefit of placing societies on the same footing as banks when accessing those systems. The consultation paper seeks views on how extensive these benefits may be, and they will be quantified in due course.

Costs

There are no significant ongoing or one-off direct costs associated with this measure.

Groups affected

Directly: building societies receiving liquidity support from the Bank of England, the Treasury or another central bank.

Building societies dealing with participants in a securities settlement system or payment system.

Indirectly: members of the building society, who may benefit if this action prevents a failure and from lower costs incurred by the society in relation to settlement and payment systems.

Creditors of the building society who may similarly benefit.

Competition assessment

These proposals should have a positive impact on competition, as they level the playing field between banks and building societies who may require liquidity assistance.

Risks

There is a risk that this proposal could be considered adversely to affect the position of building society members and unsecured creditors in an insolvency, as the creation of a floating charge would effectively give priority to the holder of the floating charge and reduce the pool of assets available to satisfy claims of creditors and members.

Specific Impact Tests: Checklist

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

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

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

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