

Dear Sirs

Financial stability and depositor protection: strengthening the framework

Thank you for including the Insolvency Service in your consultation. Many of the questions contained within the consultation document do not have a bearing on insolvency law and practice and our response therefore only covers those questions that are related to this area, as follows –

General

1.3) The insolvency of a building society is governed by the Building Societies Act 1986. To date, no secondary legislation has been introduced to provide a framework for a building society's insolvency, so wider insolvency issues, such as set-off, are not currently catered for should a building society become insolvent. Any consideration of BIPs for a building society should bear in mind that modification of 'standard' rules of insolvency to facilitate a BIP are not necessarily rules that would otherwise apply to a building society.

Chapter 4

4.1) Any special regime for banks should ensure that it applies the Company Directors' Disqualification Act 1986, in order that the conduct of the directors (and shadow directors) of the failed bank is considered by the office-holder and reported to the Secretary of State. Building societies, although not companies, are also covered by this Act (see section 22A of the Act).

4.10) I note (para 4.32) that the passing of a bank into a bridge bank would be facilitated by a negative resolution statutory instrument. If such an instrument was prayed against (and therefore failed to pass into law) uncomfortable delays may be added to the process (possibly hastening a BIP or other insolvency procedure), to the detriment of depositors and creditors generally. Has an affirmative resolution SI been considered in this regard?

4.14) As stated above, there is currently no framework of secondary legislation applying normal insolvency procedures to building societies. A BIP may be the only option for such an institution, should it become insolvent.

4.15) Allowing the bank to continue trading some of its business while in a BIP would seem sensible and would also mirror standard insolvency procedures in this regard.

4.16) In addition to the proposed statutory objectives of the BIP in having a rapid FSCS payout and a winding up of the affairs of the bank, there should



also be a general objective to act in the best interests of all creditors, as in other special regimes (other than where that would conflict with the primary objective). For example, see section 220(1)(b) Greater London Authority Act 1999, in relation to PPP administration orders.

4.17) By overall supervision of the Authorities, is it meant at the exclusion of a role for the court? Existing special administration regimes (and normal administration for that matter) are under the general supervision of the court and I am unaware of a convincing argument for a divergence from this practice for a BIP.

4.19) If additional costs are incurred in relation to assisting the FSCS with the accelerated pay-out of eligible depositors within 7 days, these should not be borne by the general body of creditors as an expense of the procedure. The primary objective of a BIP, to aid the FSCS in this swift payout, is there for public policy reasons and creditors should not bear the costs of this. There is also a political risk if creditors consider they are, essentially, funding what they consider are the FSCS's costs.

We think that there would be additional costs attached to this acceleration, such as overtime payments to bank and office-holder staff, additional funding of IT support, rental costs of where the staff are located (if a site is being kept open solely for the additional staff needed to meet FSCS deadlines). Additional employment costs may be required to keep staff on during this period, to prevent key staff from leaving and finding employment elsewhere.

Such costs are difficult to quantify theoretically, as each banking failure would be different but the majority of the costs themselves should be distinguishable from other expenses of the procedure once the BIP is underway.

We think that negligible, if any, savings would be made by the office-holder subsequently only having to deal with the FSCS (rather than all the depositors) and their subrogated claim in the insolvency. Putting aside any 7-day payout deadline, in any banking insolvency the existence of the FSCS and the rights that depositors would have under it is likely to be very well publicised. An eligible depositor is unlikely to make a claim to the insolvency office-holder for amounts that are covered by the FSCS in its current form. An FSCS claim will result in full payment in a relatively short period of time (months, maybe); a claim in the insolvency will likely result in payment of a fraction of the claim at an indeterminate point in time, possibly far in the future. To illustrate this last point, the sixth dividend in BCCI was made in November 2007, nearly sixteen years after the company entered liquidation, and the 6 dividends now total 84% of the original claim. An informed depositor is therefore likely to go first to the FSCS even without the accelerated 7-day payment target (and then have no engagement with the office-holder) and part of the FSCS's payment process requires the assignment of the depositor's claim in the insolvency. There would therefore be unlikely to be any discrete saving to be made in this area from the action of a 7-day payout target.

4.20) Depositor preference would not be desirable for a BIP (or in a normal insolvency involving a bank). The FSCS already provides a protection that is

not available to ordinary unsecured creditors; giving them additional preference would not be warranted. As the FSCS would in any event step into the shoes of the depositor in any return from the procedure, all preference would do to the majority (in number) of depositor claims, would be take funds otherwise available for the general body of creditors in order to reduce the costs of administering the FSCS and those that fund it.

4.21) The 14-day notice period is sensible and mirrors the approach used in other special insolvency regimes.

Chapter 5

5.7) The one week payment target for FSCS payment would be challenging for the insolvency office-holder assisting the FSCS in this regard, particularly if insolvency set-off is to be applied to the depositors' claims. If set-off is to applied, much would depend on the quality of the bank's records for each individual customer and the products that he/she had obtained through the bank, if this deadline is to be met. The application of set-off in such a narrow window may have large cost implications for the BIP.

5.18) If FSCS made gross payments to depositors of failed banks out of the scheme, it should be appreciated that the entirety of such payments would not be provable debts in the insolvency should insolvency set-off subsequently apply to the FSCS's claim. To do otherwise would be to allow a greater debt in respect of depositors' claims in the insolvency than was actually the case at the relevant date. Even were subsequent realisations made from the depositor by the office-holder in relation to debit balances at the date of the insolvency, there is always likely to be a portion of the bank's debtors that will not be recovered. It would be inequitable to the general body of creditors to admit a proof of debt for a greater sum than was actually owed to eligible depositors at the date of the insolvency. In any event, this overpayment is unlikely to constitute a debt in the insolvency, as defined in the Insolvency Rules 1986 and neither would it be an expense of the procedure.

If the suspension of set-off in the insolvency itself (as opposed to just within the FSCS) is to be considered, care should be taken to avoid a two-tier system for creditors, with different rules applying to depositor creditors (who would not set-off) and 'ordinary' creditors' (who would). Such a system would likely be complicated to administer by the office-holder.

Elsewhere in the consultation document it envisages that the 'normal' insolvency routes would still be open for banks where a BIP was not thought desirable. This could lead to depositors' claims being treated differently (i.e. gross or net payments) depending on what insolvency procedure their bank had entered, which is unlikely to be desirable and could possibly carry a reputational risk for the FSCS/HMT.

We would be happy to assist with any discussions on the application of set-off in banking insolvencies. We are aware that this matter may be left until the secondary legislation is considered, which we think would be unwise. For example, if insolvency set-off were to be applied, this could cause problems

with any 7-day payout for depositors from the FSCS that was enshrined in the primary legislation, given the additional time this would take to calculate.

5.25) Para 5.63 of the consultation document states that “it is proposed that ID checks would be undertaken with the assistance of the failed bank”. It would not be desirable for an insolvency practitioner administering a failed bank to incur any expenses in this regard (this would also include the costs of those former bank employees being kept on to administer the orderly winding up of the bank’s affairs). To do so would not assist in meeting either of the objectives of a BIP (in which case he would have duty to *not* incur expenses in relation to a former customer opening a new account). There would be no benefit to the general body of creditors of such an action; rather it would increase the expenses and therefore diminish the monies available for creditors. This would be a particular issue if the former customer were requesting assistance during the early stages of the failure, when the office-holder’s primary objective would be in ensuring that the FSCS had sufficient information to enable a payout from its funds within 7 days.

Yours faithfully