



Response to the consultation document "Financial stability and depositor protection: strengthening the framework" issued by the Bank of England, HM Treasury and the Financial Services Authority (FSA) and dated January 2008

Introduction

We start our detailed response below by considering the proposed special insolvency procedure for banks set out in paragraphs 4.33 to 4.46 of the consultation document. Since it is proposed that the primary objective of the procedure would be to facilitate fast compensation payment by the Financial Services Compensation Scheme (FSCS), we go on to consider the proposals for compensation arrangements set out in Chapter 5 of the document and to respond to the questions set out in that chapter. We then go on to respond to other questions where we consider we can make a useful contribution. These include some questions relating to security set out in Chapter 3, and questions set out in Chapter 4 other than those directly relating to the proposed insolvency procedure. This means that our response does not follow the order of the document, but within each of those three sections it does.

We should like to give particular emphasis to the following points:

- We consider that the proposed bank insolvency procedure is a liquidation and should be referred to as such. Once compensation has been paid, it should be run like any other liquidation. We believe that no other insolvency procedure should be available to banks, other than a Members' Voluntary Liquidation for the purposes of reconstruction.
- We do not consider that the target of one week after closure of a bank for the payment of compensation to depositors is realistic.
- We believe that the proposed means of enabling the FSCS to have advanced details of deposits, so as to speed up the payment of compensation when the bank fails, is wholly unacceptable from the data protection point of view.
- We are convinced that the name "Special Resolution Regime" currently given to the proposed regime for resolving the problems of failing banks will inevitably cause confusion with Special Resolutions as passed by companies, in particular when entering voluntary liquidation. If the name were simplified to "Special Regime" it would be perfectly adequate, and the confusion would be completely avoided.

Paragraph references throughout are to the document.

Proposed bank insolvency procedure

Paragraph 4.34 states: "Current insolvency procedures appear to have significant weaknesses in relation to banks." We do not think this is actually true in relation to the winding up of a bank, if it is acceptable for the return to creditors to be determined in the normal way, depending on the realisation of assets and the determination of all claims. The weakness is rather that no insolvency rescue procedure will work, because no bank can trade in an insolvency procedure. It is worth considering why this is so.

Insolvency rescue procedures depend upon a stay of existing liabilities. Most businesses can trade under that stay; but not banks, since normal banking functions involve applying the credit of customers (itself a liability of the bank) in accordance with their instructions. (Obviously this is technically not true of overdrafts, but in practical terms the same applies. Access to an overdraft facility is as much part of the bank customer's liquidity as is a balance owing by the bank, and is as much truncated by the stay.) Payment out of deposits in accordance with their terms, including notice periods, is a particular case of normal banking functions.

Paragraph 4.4 emphasises that tools are needed to ensure "continued access to banking functions or rapid and orderly payments to depositors". The above paragraphs indicate why insolvency procedures cannot ensure "continued access to banking functions". A normal liquidation, without more, cannot ensure "rapid and orderly payments to depositors" either. In a winding up of the bank, and subject to any special rights or priorities, deposits will rank *pari passu* with other liabilities (and notice periods are most unlikely to be relevant). Delay in payment out is not, as such, a weakness of the insolvency procedure. But "rapid and orderly payments to depositors" funded externally, as under the FSCS, can certainly be grafted on to a winding up. Any insolvency practice has facilities for making large numbers of payments at once. The only condition is that any additional expense must also be met externally, in order not to prejudice other creditors of the bank not entitled to depositors' compensation (and indeed compensated depositors themselves in relation to any claim in excess of the maximum compensation).

The proposed "bank insolvency procedure" is in fact a liquidation, and should be referred to as such (the insolvency officeholder is already referred to as a "bank liquidator"). The difference is that the bank liquidator is given as a priority the "principal objective" set out in the first bullet point under paragraph 4.37. It is the additional cost of giving priority to that objective that must be met by the FSCS in order not to prejudice other creditors of the bank.

In the light of the above, we have the following comments on the specific questions posed in relation to the proposed bank insolvency procedure:

4.14) Should a new bank insolvency procedure be introduced for banks and building societies as an option for the Authorities instead of normal insolvency procedures?

Yes, but it should be called "bank liquidation procedure" or "bank winding-up procedure".

4.15) Do you think that there ought to be provision in the bank insolvency procedure for continued trading of some of the bank's business in the interests of depositors or other creditors? If so, how do you think this might work?

For the reasons given above, it is not possible to carry on the normal trade of a bank in an insolvency procedure. Accordingly no more is required than the usual power of a liquidator "to carry on the business of the company so far as may be necessary for its beneficial winding up" (Insolvency Act 1986, paragraph 5 of Schedule 4). For the avoidance of doubt, given that the proposed procedure would be initiated by a court order, the liquidator should be able to exercise this power without sanction, as in a voluntary winding up rather than one by the court.

4.16) Should the objectives of a bank liquidator be limited to assisting a rapid FSCS payout to eligible depositors and then winding up the affairs of a failed bank? Should the proceedings have any other statutory objectives?

The objectives of a bank liquidator should be so limited, and the proceedings should have no other statutory objectives. Such proceedings are very much the last resort, and to give them any other objectives would overcomplicate them.

4.17) Should a bank insolvency procedure be subject to the overall supervision of the Authorities?

Yes, but only until compensation has been paid to depositors. Thereafter regulation should be as for any other liquidation. Any additional cost resulting from the supervision of the Authorities should not fall on the liquidation.

4.18) Should a bank insolvency procedure be a stand-alone regime in which the bank liquidator has the combined powers of an administrator and liquidator? Are any other powers required?

For the reasons given above, we believe that the procedure would in fact be a liquidation and should be referred to as such. We are therefore not clear why the bank liquidator should require the powers of an administrator to the extent that they are not included in the powers of a liquidator. We do not believe that the bank liquidator requires any other powers. In particular, we can see no reason why a bank liquidator would need to proceed to a company voluntary arrangement as suggested in paragraph 4.40.

4.19) Should the FSCS cover any additional costs that a new bank insolvency procedure may incur?

Yes, for the reasons given above. Such additional costs would include: confirmation of money laundering identification checks for a customer opening a new account elsewhere as proposed in paragraph 5.62; assistance with such checks as proposed in paragraph 5.63; and exercising any delegated decision about compensation as proposed in the second bullet point in paragraph 5.80.

4.20) Should further consideration be given to the introduction of depositor preference?

We agree with the points made in paragraph 4.42, and do not believe that depositors should be given preferential status.

4.21) Do you agree that commencement into insolvency should be controlled by the Authorities, for example through requiring 14 days prior notice be given to the FSA? Should normal insolvency proceedings be retained alongside the bank insolvency procedure?

To answer the second of those questions first, we are not convinced of the need to retain normal insolvency proceedings alongside the proposed bank insolvency procedure. The first sentence of paragraph 4.45 refers to the FSA's taking the decision whether a bank which intends to enter a normal insolvency proceeding

should instead be placed in the SRR. We cannot conceive of circumstances in which such a bank should not be placed in the SRR, which of course includes the proposed bank insolvency procedure.

Members' voluntary liquidation is a special case. For a bank to wind itself up without more as a members' voluntary liquidation could cause problems, not least in terms of delay in repayment of deposits. But a members' liquidation may be required if a transfer under part VII of FSMA as referred to in paragraph 4.22 is part of a reorganisation such as under section 425 of the Companies Act 1985.

We therefore consider that members' voluntary liquidation should remain available to banks if the proposed bank insolvency procedure is introduced; subject to a requirement of 14 days' notice to the FSA. We cannot see, however, why it should be necessary in addition for the bank to obtain the permission of the court before entering such a liquidation. All that is needed is that the legislation requiring notice to the FSA should expressly render ineffective a Winding-up Resolution "passed" without that notice.

Paragraph 4.44 also proposes that the same notice should be required "where a secured creditor proposes any other step to enforce their security". Two points arise. In the first place, as with a bank which proposes to enter into an insolvency proceeding, we find it difficult to see how a bank against which security is sought to be enforced should not be in the SRR. In the second place, and given that we think that the only decision open to the FSA would be to place the bank in the SRR, we cannot see why the notice period required should be more than (say) five days.

Compensation arrangements

We set out below our responses to the questions posed in Chapter 5 of the document.

5.1) How would a higher compensation limit affect consumer confidence?

5.2) How would a higher compensation limit affect the responsibility consumers have for their financial choices?

5.3) How would a higher compensation limit for deposits affect consumer perception of other financial products?

Reasons for not increasing the limit are very succinctly summarised in paragraph 5.10. It cannot be apparent from the statistics discussed in the preceding paragraphs to what extent the concentration by number of deposits of less than £35,000 (see chart 5.2) is influenced by customers who are aware of the limit and who shop around to make sure they are covered. But the statistics of consumer awareness discussed in paragraph 5.67 suggest that any such influence must be very marginal indeed. Our response to the questions set out above is as follows:

5.1 Difficult to say, even if there were full consumer awareness of the limit.

5.2 The assurance of compensation justifies the responsible consumer in depositing money with whatever institution offers the best return, irrespective of its soundness. If the compensation limit goes up the responsible consumer with a lot of cash to deposit does not have to spread it around so far.

5.3 There should be an effect in pushing consumers towards deposits in preference to uncompensated or less well compensated products; but even if there were full consumer awareness it would be unsafe to predict such an effect.

5.4) Which of the solutions to cover balances above the compensation limit is the most practical, desirable and/or proportionate, and why?

5.5) What types of large balance should be subject to additional protection, and in what circumstances?

5.6) Are there other circumstances, apart from client accounts, where consumers have little influence on where accounts are opened? What are your views on how the issue of client accounts might be addressed in relation to compensation payments?

Reference is made in paragraph 5.14 to deposits held "for purely transactional purposes which greatly exceed the compensation limit". It is suggested that some of these balances may be long lasting, but it is unlikely that the instances quoted: "house sale, inheritance or receipt of a pension lump sum" would of themselves be long lasting if held by a responsible consumer. But there could be instances such as the holding of funds to meet nursing home fees for an elderly person where very large balances could understandably be long-lasting.

Our response to the questions set out above is as follows:

5.4 Relying on customers to spread their balances addresses the issue of higher balances by removing it, and the second sentence of the first bullet point under paragraph 5.14 makes it clear that this is not always possible. Private deposit insurance would be a solution if it were available, but would only be taken out by the customers who least need protection. So, if it were decided that higher balances should be protected, a higher limit would be needed.

5.5 It might be possible to compensate large balances which had not been held for more than, say, a week. But it would be much more difficult to establish criteria for large balances held for longer.

5.6 Whatever other instances there are, there would always be a third party who had influenced where the account was opened. Confirmation from that third party could be made a condition of the payment of compensation in respect of a second account held with the same bank.

5.7) What are your views on a one-week target for FSCS payment?

5.8) How feasible would it be for banks to provide instant access to the funds provided by FSCS cheques as soon as they are deposited?

5.9) Are there other means to ensure consumers have access to funds within one week, including alternative payment methods to cheques?

5.10) How effective would interim payments be in mitigating consumer detriment when a full payout is not possible within a week?

It is admitted in paragraph 5.19 that to aim to make compensation payments within one week of the closure of the bank is "an ambitious goal". It is admitted in paragraph 5.18 that "The FSCS normally processes deposit claims in relation to relatively small deposit-taking firms within one month of receiving a completed application form from claimants"; and that a complex failure involving a high volume of claims would need more time. Paragraph 5.19 admits that "a comprehensive package of reforms" is a precondition of payment within one week, and sets out some of the reforms. For reasons given below in answer to questions on individual reforms, we consider some of them cannot be achieved.

Our response to the questions set out above is as follows:

5.7 We believe this target to be wholly unrealistic. Even if all the reforms proposed could be achieved, we do not believe that the actual process of payment could be completed in the timeframe suggested.

5.8 The delay in access to funds following the deposit of a cheque is usually attributed to the bank's need to be sure the cheque has cleared. Since the FSCS is in essence a collective procedure whereby the banks provide compensation to depositors with a bank which has failed, it should be possible for the banks collectively to agree to give instant credit in respect of a FSCS cheque. Otherwise a guarantee would be needed, probably by the government.

5.9 Any such other means would also depend upon unprecedentedly rapid opening of new bank accounts; and any payment system more sophisticated than the posting of a cheque would be more vulnerable to system failure.

5.10 If in fact it is impracticable to make payment within one week, that would apply as much to interim payments as to full payment. If it is practicable to make payments within one week, but the problem referred to is that of lack of funds, interim payments could be helpful, but would require a further calculation and a complication which would increase the cost of the process. If a less demanding target than one week were aimed at, any need for interim payments would be reduced.

5.11) How quickly could banks make the changes to have the necessary information readily available on account balances of FSCS-eligible depositors, and what would be the cost to them?

5.12) Should banks follow a common data standard or format, and, if so, what would this entail?

5.13) What information should be included in a single customer view and what would be the implications for firms of different information requirements?

Lip service is paid in paragraph 5.34 to the data protection implications of what is proposed in order to enable the FSCS to have advance information. But the whole proposal rides roughshod over all principles of data protection, and cannot be seriously entertained. Let us consider what is proposed.

It is admitted in paragraph 5.24 that for the FSCS to obtain advance information on customer deposit accounts in a targeted way from a bank that is in trouble would risk only making matters worse; and therefore would be counter-productive, and so not practicable. So it is proposed that the FSA, as part of its supervision of deposit takers, should regularly collect such information in a way which is not so targeted (or the same suspicions would be aroused). The FSA would then hold the information generally, and if a bank was seen to be in trouble would pass it to the FSCS in respect of that bank.

The FSA would thus at all times be holding details potentially of the names and addresses of all depositors with every bank, where their accounts are held, and the nature and numbers of those accounts (in fact everything but the balances, which it is admitted in the second sentence of paragraph 5.31 would not be needed until compensation actually became payable). This would be to cover a remote contingency that a bank could fail, and that in consequence a small proportion of that enormous number of depositors would be entitled to compensation. All this would be not to achieve the payment of compensation as such, but to achieve it in the time scale of one week. It cannot seriously be contended that this holding by the FSA of personal data of enormous interest to identity thieves is remotely proportionate to the purpose.

Our response to the questions set out above is as follows:

5.11 For the reasons given above it must be impossible for the FSA to collect this information as part of its supervision of deposit takers, and then hold it pending the

need to pass any of it to the FSCS. This question must therefore be taken as referring to the ready availability of such information when a bank fails. There is a problem here in that organisations which fail usually do in several respects, so that it is likely that the more readily available the information is in respect of any particular bank, the less likely it is to be needed.

5.12 Any compulsion on banks to adopt a common data standard for this purpose would itself almost certainly be unacceptable from a data protection point of view.

5.13 The answer to this question must be "too much" from a data protection point of view.

5.14) How would banks place a 'flag' on accounts that are not eligible for FSCS payments?

5.15) Are there other classes of depositor that should be ineligible for FSCS compensation payments, and, if so, why?

Even if ineligible accounts were confined as suggested in paragraphs 5.37 and 5.38 to those excepted under the EC Deposit Guarantee Schemes Directive, plus those of directors and possibly senior management if responsible for the failure, it would not be possible to flag them all. It is understandable why the Directive excepts "deposits arising out of transactions in relation to money laundering"; but it is inconceivable that a bank would be able to flag such an account. That exception assumes that there is sufficient time before compensation is paid for some thorough investigation into accounts (much more than a week).

If the FSCS is designed to protect consumers, then it ought to exclude accounts of corporate bodies such as those listed in paragraph 5.40. By contrast with much of the rest of this chapter of the consultative document, which makes light of extreme difficulties, the suggestion that accounts of corporate bodies could not be readily identified as such and flagged sees a difficulty where there is none. Tax deduction requirements mean that all banks can readily identify those of their accounts which are held by individuals, and it should be easy to exclude all other accounts from the compensation provisions.

Our response to the questions set about above is as follows:

5.14 Banks could not be certain to "flag" all ineligible accounts.

5.15 No account held by a body corporate should be eligible for FSCS compensation payments. This is for two reasons: the compensation scheme is designed to protect consumers, in other words individual depositors; and, while compensation limited to £35,000 is a real protection for individuals, it is likely to be far less useful to a body corporate. Moreover, for the reasons given above, it should be easy to exclude them.

5.16) To what extent would gross payments help maintain depositor confidence and speed up payment?

Gross payments should certainly speed up payment, since less investigation and calculation would be required. If consumer awareness of the compensation scheme were raised, such a change should reduce any "churning" by consumers with the aim of ensuring that their deposits were not with those they owed money to.

5.17) To what extent are gross payments justified by maintaining depositors' access to liquidity as well as by accelerating payments by the FSCS?

The example cited in paragraph 5.43 of a consumer who has a mortgage and has also deposited with the lender funds that may be made needed at short notice is sufficient justification.

5.18) What are your views on the link between FSCS gross payment and set-off?

Protection of creditors other than those entitled to compensation requires that the normal liquidation set-off rules should apply in the winding up of the bank once compensation has been paid. This will mean that the FSCS will not be able to prove in the liquidation of the bank for any sum by which a depositor's proof in the liquidation would have been diminished by reason of set-off; or at all if the compensated depositor owed more to the bank than the amount of the deposit. This is fair to the FSCS, because gross payment would be designed to improve the speed and effectiveness of compensation, but should not be carried out at the expense of those not entitled to compensation.

5.19) Are any other measures necessary to better align FSCS rules and the provisions of the proposed bank insolvency procedure?

Provided that the proposed bank insolvency procedure is regarded, as we believe it should be, as a liquidation with varied priorities and additional duties on the liquidator until compensation has been paid but not thereafter, little needs to be done.

5.20) What are your views on the removal of the formal claims process? What risks would be involved in the FSCS automatically sending out cheques and how can they be mitigated?

Removal of the formal claims process could speed payment up, as long as the bank's records are adequate as a basis for compensation payments. Given that an organisation that has failed generally fails in many areas, this will not always be the case. Risks arise from the probable higher incidence of mistaken payments. To be fair to other creditors of the bank, the FSCS must compensate the insolvent estate for any consequent loss.

5.21) What are your views on including an element of pre-funding in the FSCS?

This really is a decision for the banks that finance the FSCS. We suspect that the disadvantages outlined in paragraph 5.54, which reinforce one another, will render banks unwilling to contemplate this.

5.22) What steps would need to be taken to ensure that pre-funding would be compatible with other elements of the FSCS funding arrangements?

We have no views on this question.

5.23) What are your views on whether the FSCS should be permitted to borrow from the Government or the Bank of England?

This could help to spread over a period of several years the cost to contributing banks of compensation payments in respect of a large failure. Problems could then, however, arise if there were a second large failure in that period.

5.24) How soon could streamlined procedures for opening accounts be introduced so that the one-week target for opening a new account can be met?

It is misleading to refer to "the one-week target for opening a new account". The timetable given in paragraph 5.21 describes the opening of accounts with new banks on "Day one", the day of the closure of the first bank. From the point of view of the loss by customers of banking services as referred to in paragraph 5.59, the sooner a new account can be opened the better. We doubt, however, if it will ever be possible to do it that fast; even if the FSCS had the proposed access to advance information which we believe to be entirely precluded by data protection considerations. The one-week target refers to the date by which the new account must be open to be used to negotiate the FSCS compensation cheque. We think even that target will be very difficult to achieve.

5.25) Are there additional risks which need to be considered with this faster account opening method?

It is suggested in paragraphs 5.61 to 5.63 that Regulation 17 of the Money Laundering Regulations 2007 could be used to enable the new bank to rely on the failed bank's money-laundering checks. This would be subject to confirmation by the failed bank. If the failed bank was subject to the proposed bank insolvency procedure, and was therefore acting by its bank liquidator, then either the new bank would have to hold the bank liquidator harmless in respect of any such confirmation, or there would need to be a statutory immunity for the bank liquidator. Otherwise the bank liquidator could not reasonably be expected to give the confirmation.

The proposed solution to the money-laundering problem again ignores the fact that a failed organisation has generally failed in several respects. It is possible if not likely that the failed bank will not be in a position to give any confirmation. Moreover, history shows that a failed bank is not infrequently one whose activities were anyway questionable. That would reflect on its customers, and it might then be negligent for any other bank to accept confirmation by the failed bank of its money-laundering checks.

It is suggested in paragraph 5.64 and 5.65 that the process might be speeded up by a move to standardisation of bank account numbers. There is a problem with this in that it would be bound to make it easy for an outsider to establish from first principles what a bank account number was. This would facilitate identity theft, and is accordingly an extremely dubious proposition from the data protection point of view.

5.26) How else could the account opening process be sped up?

We have no suggestions.

5.27) What else would be needed to enable banks to provide instant access to funds following the deposit of a FSCS compensation payment?

See answer to question 5.8 above.

5.28) What notification requirements on compensation should apply to banks, and how can they be made less burdensome? Would these have an effect on market stability or depositor confidence?

Paragraph 5.68 lists four new requirements which could be placed on banks. All of these would be useful, and collectively even more so. They vary in the burden they would impose. Nevertheless, they should probably all be required. It is difficult to say what the effect on market stability or depositor confidence would be.

5.29) How should disclosure requirements be imposed?

This probably requires legislation.

5.30) What would be the best way for DWP and HMRC to make payments in the event that consumers did not have access to their bank accounts?

We have no view on this question.

5.31) What are your views on the proposed changes to increase FSCS management flexibility?

Paragraph 5.80 refers to the possibility that the FSCS might "delegate decision-making about compensation, for example, to an insolvency practitioner". If the insolvency practitioner instructed is not an insolvency officeholder of the failed bank, then the FSCS will clearly be responsible for his or her fees. But if the insolvency practitioner is, say, a bank liquidator acting in the bank insolvency procedure of the failed bank, it remains important that the FSCS should bear the proper remuneration for the time costs incurred by the bank liquidator on tasks which do not relate to the ordinary winding up of the bank.

5.32) Are there other possible changes which could increase management flexibility for the FSCS or enable it to process a large volume of claims quickly in the most cost-effective way?

The problem of having to process a large volume of claims is that it only occurs very occasionally. This means that it makes no sense to have a permanent establishment able to cope, but eminent sense to contract work out to those who have to perform analogous tasks on a more regular basis, such as insolvency practitioners. Rapid action may even require contracting out to more than one firm.

5.33) What are your views on the use of risk-based levies or on the introduction of behavioural factors into the calculation of the levies?

One problem not mentioned in paragraph 5.82 is that the bank most at risk is the bank least able to afford the levy. At the margin, particularly if there were a high levy because there had already been a large failure, this could even contribute to failure.

Responses to other questions

3.8) To what extent is the current provision to register charges at Companies House relevant to banks? Do you agree that it is appropriate to amend it?

3.9) Should any exemption for banks only apply to receipt of ELA, or should there be a more general exemption for all types of lending?

3.10) Would extending the 21-day period be a viable, alternative proposition?

To the extent that banks have existing exemptions from the registration requirements, the protection offered to those dealing with them is weakened. This is not a reason for weakening that protection still further by extending the exemptions. The reason given in this instance for exempting charges from the

registration requirement is that it is desirable to conceal, temporarily, that a bank is in receipt of emergency liquidity assistance. It is suggested in paragraph 3.42 that a bank could only have a legitimate interest in delaying disclosure of liquidity assistance "for a short period". In that case the maximum that can be required is a delay to the registration requirements rather than an exemption from them; and if "a short period" is seen as being less than three weeks no change should be needed (subject to any amendment in relation to entry in the bank's own register of charges). In the light of these considerations we should answer the questions set out above as follows:

3.8 The provision remains relevant to banks, and it is undesirable to extend the exemption beyond what exists, such as detailed in the EC Collateral Directive.

3.9 Any exemption should apply only to receipt of ELA.

3.10 If necessary, an extension to whatever is the definition of "a short period" should be all that is required.

3.13) Do you agree that it is appropriate to ensure that realisation of the Bank of England's security is fully effective whenever carried out?

Yes, if the only effect is to ensure that the Bank has priority over preferential creditors.

3.14) Do you agree that funds provided by the Bank of England should be exempted from calculation of building societies' wholesale funding?

3.15) What risks are there to building societies granting floating charges over their assets to the Bank of England?

Reference is made in paragraph 4.57 to the fact that, historically, building society depositors have been very well protected by the movement's arranging for a society in difficulties to be taken over by a larger solvent one. This also avoids insolvency and promotes financial stability. It is important that any step taken in contemplation of a possible failure in this protection should not weaken the protection itself. In the light of these considerations we should answer the questions set out above as follows:

3.14 Yes, provided there is no risk that it would encourage a building society in difficulties to "go it alone" rather than seeking assistance within the movement.

3.15 The risk identified in the answer given above.

4.1) Do you agree that there should be a special resolution regime for banks?

4.2) Do you agree that the trigger for a bank entering a special resolution regime should be based on a regulatory judgment exercised by the FSA after consultation with the Bank of England and HM Treasury?

4.3) Do you agree that the trigger should be linked to regulatory guidance material?

We appreciate that the term "special resolution regime" means a special regime for resolving the difficulties of a bank. But one outcome may always be insolvency, and indeed one of the tools within the regime is the proposed special bank insolvency procedure. In that context we consider the conjunction of the

words "special" and "resolution" to form the apparent phrase "special resolution" is unfortunate, since it is by passing a special resolution that a company winds itself up voluntarily. We believe this is bound to cause confusion, which it would be best to avoid by changing the name given to the regime. This is not a point made lightly. The difficulties of a bank will always arouse great public interest. Journalists covering the story will by no means always be expert, but if they have come across voluntary liquidation before they may well conclude that the "special resolution regime" has something to do with a special resolution.

We should answer the questions set out above as follows:

4.1 Yes, but it should not have that name. "Special regime" should be perfectly adequate, and would avoid the problem completely.

4.2 Yes.

4.3 Yes.

4.4) Do you agree with the special resolution regime process as outlined?

Yes, provided a change is made to the name (see above).

4.5) Do you agree that the potential abridgement of property rights in the special resolution regime can, in principle, be justified with a suitable public interest test?

Yes; in view of the considerations set out in paragraph 4.17.

4.6) What safeguards and appeal processes would be needed to support a public interest test for the special resolution regime?

In paragraph 4.24 there is reference to "appropriate mechanisms, as mentioned above, for challenge to the use of the power"; but we cannot find the reference. We think that existing court protection, including by way of judicial review, should be sufficient.

4.7) Do you agree that the Authorities should have the power to direct a sale of all or part of a bank's business, possibly against the wishes of the directors or shareholders?

4.8) Is judicial review the correct mechanism for challenging a decision to institute the directed transfer?

4.9) Is the Financial Services Markets Tribunal the right forum for resolution of transactional issues such as valuation or distribution of proceeds among stakeholders?

The point is made in paragraph 4.21 that transfer of all or part of the business may "provide better returns to creditors and uninsured depositors than piecemeal liquidation". But, at least in the case of a transfer of part of the business, it may produce a worse return to those left behind if the rump of the bank then goes into insolvent liquidation. This would be particularly true if any damages claim arising out of a challenge to the exercise of the power were provable in the liquidation. Bearing this in mind, we should answer the questions set out above as follows:

4.7 Yes.

4.8 Probably.

4.9 We have no relevant expertise.

4.10) Do you agree that, in tightly defined circumstances, the Authorities should be able to take control of a failing bank through effecting a transfer of some or all of its assets and liabilities to a bridge bank? Do you agree that that some flexibility in the description of these circumstances is also desirable?

4.11) Do you agree with the removal of shareholders' and directors' rights and temporary suspension of creditors' rights under this bridge bank proposal?

4.12) Is judicial review the correct mechanism for challenging a decision to transfer to a bridge bank?

4.13) Is the Financial Services Markets Tribunal the right forum for resolution of transactional issues such as valuation or distribution of proceeds among stakeholders?

The proposal envisages the establishment of a company in the role of the bridge bank every time one is needed. After its functions are completed, it would presumably be wound up or dissolved, since it is overwhelmingly likely that any purchaser of the business would wish to buy the undertaking from the bridge bank rather than the shares of the bridge bank itself. Consideration should perhaps be given to whether a continuing corporation should not be established to carry out the role of bridge bank on each occasion. This could help with costs, and the establishment of such contracts as suggested in the first bullet point in paragraph A.123 of the Impact Assessment. Subject to this point, our response to the question set out above is as follows:

4.10 There is an obvious conflict between "in tightly defined circumstances" and "some flexibility in the description of these circumstances". Neither paragraphs 4.25 to 4.32 nor paragraphs A.119 to A.128 of the Impact Assessment cast any light on the resolution of this conflict. Subject thereto, we consider that a bridge bank would be a useful tool.

4.11 Yes.

4.12 Probably.

4.13 We have no relevant expertise.

4.22) What should the governance arrangements for the SRR be?

Since it is the FSA that would initiate SRR, albeit in consultation with the Bank of England and HM Treasury (paragraph 4.9), we consider that it should be overseen by the FSA. We consider that oversight by the FSCS would be especially inappropriate, given that it is only involved when the regime has proceeded to the point where compensation has to be paid to depositors; and that it would remain inappropriate for the FSCS to supervise the SRR even if it were to contribute to funding it as suggested in paragraph 4.70.

4.23) Do you consider that introducing the office of the restructuring officer as part of the SRR would be a helpful and necessary development?

Yes. We consider that on occasion it would be appropriate for an insolvency practitioner with turnaround expertise to be appointed, as long as that did not

increase the risk identified in paragraph A.150 of the Impact Assessment that the appointment might itself cause a crisis of confidence.

4.24) Do you have any comments on the specific implications for shareholders, creditors or directors from the appointment of the restructuring officer over and above those already raised by the other resolution tools?

A useful parallel may be the restrictions imposed on officers and shareholders of a company in administration under Schedule B1 of the Insolvency Act 1986, for instance:

- the prohibition of the passing of a winding-up resolution under paragraph 42(3) of the Schedule;
- the power of an administrator to remove and appoint directors under paragraph 61;
- the requirement under paragraph 64 that the exercise of management powers should have the consent of the administrator.

4.25) Should the Government have the power to take temporary ownership of a failing bank, in order to facilitate a more orderly resolution? Under what circumstances would it be appropriate for this power to be exercised?

If there were a power to transfer the undertaking to a bridge bank, we are not clear that this power would be needed in addition. We should regard the bridge bank as preferable.

4.26) Do you agree that the special resolution regime should be extended to building societies but not other mutuals?

4.27) Do you agree with the proposals for a new accelerated directed transfer procedure for building societies, similar to that proposed for banks?

4.28) Do you believe a form of temporary public sector control through a bridge bank should be provided for building societies?

4.29) Do you agree that a building society insolvency procedure should exist for building societies along a similar model for banks?

We should repeat the warning given in our response to questions 3.14 and 3.15 that care should be taken not to prejudice the ability of the building society movement to look after the interests of depositors. Subject thereto, our responses to the question set out above are as follows:

4.26 Yes; but the trigger should take account of the actions of the building society movement.

4.27 Yes, because by that stage a building society would be beyond rescue.

4.28 Yes; and, for the reasons given in answer to the preceding question, demutualisation should no longer be an issue.

4.29 Yes, but (as with banks) only to the extent that it is necessary to assist the reconstruction of solvent building societies. The winding up of insolvent building societies should be dealt with only by the proposed building society insolvency procedure.

4.30) Do you agree that the Treasury should make an Order under the 2007 Act to ensure that, on the winding up or dissolution of a building society, any assets available to satisfy the society's liabilities are applied equally to creditors and members?

Yes; provided that (as with banks) care is taken to ensure that the operation of depositor compensation does not prejudice the interests of creditors not eligible for compensation.

4.31) Should the industry contribute to the costs of an SRR?

4.32) Would mechanisms other than the FSCS be appropriate for addressing such cost issues?

How might such mechanisms work?

The reasons given in paragraph 4.72, including the international comparisons, appear to justify requiring the industry to contribute to the costs of an SRR. But, given the dual purpose of an SRR, to ensure "continued access to banking functions or rapid and orderly payments to depositors" (paragraph 4.4), the fact that there might be a saving in compensation payments is not in itself a reason for using the FSCS, as at present constituted, as a vehicle. The FSCS is concerned with payments to depositors, whereas continued access to banking functions is an end in itself. In the light of these considerations, our response to the questions set out above is as follows:

4.31 Yes.

4.32 To use the FSCS would involve extending its purposes beyond its being a vehicle for the payment of compensation, and it would probably have to be given a different name. Moreover, in so far as its finance relates to deposits on which compensation may be payable, a change in the criteria for calculating levies would probably be necessary.

4.33) Are there any other mechanisms available to secure access to payment systems for agency banks in the event of a settlement bank failure?

Robust contingency arrangements agreed with one other settlement bank should be sufficient. The contingency of the failure of the first settlement bank is remote enough, and it would be unreasonable to expect arrangements to cover failure of the alternative.

4.34) Are there any contingency measures that banks could adopt to ensure that their organisation and structure are compatible with the tools proposed in the special resolution regime?

It is difficult to see how there could be contingency arrangements, apart from the normal obligation to keep proper records, to ensure compatibility with such tools as:

- accelerated transfer of banking business;
- transfer of all or part of the undertaking to a bridge bank;
- the appointment of a "restructuring officer";
- the proposed bank insolvency procedure.

4.35) Do you agree that the Government should take a power to enable it to make secondary legislation in relation to financial collateral arrangements, and with the proposed definitional scope? If not, why, and what would you suggest?

4.36) Do you have any suggestions as to future revisions to the financial collateral regime that should be considered?

Financial collateral, like any other security, protects the secured creditor at the expense of the unsecured (because security only matters if the debtor is insolvent). Restrictions, such as registration requirements, are there to protect the unsecured. Calls from the secured to make it easier to damage that protection are special pleading and should be treated as such. Primary legislation should always be required. Our response to the questions set out above is as follows:

4.35 Certainly not.

4.36 No.

Insolvency Practitioners Association
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