

Response from the Insolvency Service, Department of Enterprise, Trade and Investment, Northern Ireland

Financial stability and depositor protection: strengthening the framework (issued January 2008)

Questions and Answers:

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

We would question the value of a special regime for banks as a means of preserving customer confidence. Is it not inevitable that the moment they hear that a bank or building society has entered a special resolution regime, depositors who have money in the bank in excess of the limit for compensation if the bank fails (currently £35,000) will rush to withdraw their money, leaving the bank a shell?

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

We have doubts about any proposal to about any proposal to transfer assets and liabilities to a “bridge bank”. Human nature being what it is, people who have money on deposit above the ceiling for compensation will be afraid of losing their money and are likely to arrive on a first come first serve basis to withdraw it. A “bridge bank” could work in the sense of allowing realisation of assets which it was possible to realise over a 12 month period and an orderly payout to depositors. However for this to happen there would have to be a means in place to ensure that depositors were paid pari-passu and in an orderly manner over the 12 months. The aim would be to avoid a queue of depositors outside the bridge bank with those at the head of the queue getting all their money and nothing left for the rest.

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 procedure?

We would question whether what is being proposed can correctly be described as an alternative to normal insolvency procedures. We cannot see that anything radically different from existing insolvency procedures such as liquidation and administration is being proposed in the case of banks. We agree that means should be in place to ensure that rapid payout under FSCS occurs, for example, if a bank is wound up.

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

We would question whether any continued trading should be allowed. If people are for example allowed to continue using bank cards the result could be that some of them are able to recover their savings while others are not. The better option would be to block or return any money coming into accounts after the date of the insolvency and let whoever sent it hold it until the intended recipient could open an account with a different bank.

It would be important to sort out who would have responsibility for which aspects of a bank's liquidation. Insolvency practitioners are subject to standards set by their professional bodies. It appears that if they were conducting a bank liquidation, they would in addition be answerable to Financial Services type authorities.

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 there any other powers required?

We would question how a bank liquidator could have the combined powers of an administrator and liquidator. He could however be given the right to act as an administrator or a liquidator depending on the bank's situation.

An administrator's first aim is to rescue the company as a going concern. We take the view that the type of insolvency proceedings which would be appropriate depends on the nature of the bank's difficulty. If it is simply a case that the bank is solvent but is experiencing liquidity problems administration would be the procedure of choice, leading hopefully to a take-over by another bank. On the other hand if the bank has solvency problems arising for example because loans are not going to be repaid or securities have become worthless then winding up would appear to be the proper course.

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

We remain of the view that the government should ensure that there should be no ceiling on the compensation payable out of the FSCS to depositors if a bank fails. We believe that there should be a ceiling on what the FSCS would have to pay out with anything above that being paid by Government. To ask the banking system to pay increased levies to fund the FSCS at a time of reduced liquidity is to compound the liquidity problem.

With a guarantee of full compensation news of problems affecting a bank would no longer prompt fearful depositors to rush to add to the bank's difficulties by rushing to withdraw their money. Instead they could sit at home secure in the knowledge that their savings would be fully protected regardless of what liquidity or solvency problems the bank was facing. They would be able to safely leave such problems to be the concern of the banks themselves, the financial regulatory authorities and the government. Runs on banks" would become a thing of the past.

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