EXPLANATORY MEMORANDUM TO

THE BUILDING SOCIETY INSOLVENCY RULES (NORTHERN IRELAND) 2014

2014 No. 41

1. Introduction

1.1. This Explanatory Memorandum has been prepared by the Department of Enterprise, Trade and Investment (as the Department with lead responsibility for insolvency matters in Northern Ireland) on behalf of the Department of Justice to accompany the Statutory Rule (details above) which is laid before the Northern Ireland Assembly.

1.2. The Statutory Rule is made under Article 359(1C), (2), (2C), (3) and (3A) of the Insolvency (Northern Ireland) Order 1989 as amended by the Building Societies (Insolvency and Special Administration) Order 2009 ("the 2009 Order") and is subject to the negative resolution procedure.

2. Purpose

2.1. These Rules set out the procedure for the building society insolvency process (BSIP) under Part 2 of the Banking Act 2009 ("the Act") as applied by the 2009 Order.

3. Background

3.1. The Act, which received Royal Assent on 12 February 2009, replaced the powers to resolve failing banks conferred by the Banking (Special Provisions) Act 2008.

3.2. The BSIP is a specially modified insolvency procedure for building societies, which may be used in certain circumstances as an alternative to the insolvency processes for building societies set out in the Insolvency (Northern Ireland) Order 1989 (as applied to building societies by section 90A of , and Schedule 15A to, the Building Societies Act 1986). The BSIP is designed to speed up payout by the Financial Services Compensation Scheme (FSCS) to depositing members of a building society, or to enable their accounts to be quickly transferred to another institution.

3.3. The BSIP is based, with modifications, on the provisions on winding up set out in Part 4 of the Insolvency (Northern Ireland) Order 1989 (as applied to building societies). These insolvency rules are needed to make detailed provision on the procedure to be followed if a building society is undergoing the BSIP. A number of the provisions in these rules are made by reference to the Insolvency Rules (Northern Ireland) 1991, which set out procedural rules for the insolvency of companies. There are no procedural rules for the insolvency of building societies.

3.4. The main features of building society insolvency are that, in the event of a building society becoming insolvent, it enables those depositors who are eligible for compensation under the FSCS to either (a) receive compensation for their unpaid deposits as soon as possible after the building society goes into building society insolvency; or (b) have their

accounts transferred to a different building society. This is the first Objective of the insolvency process.

3.5. The procedure can only be initiated by the Bank of England or the Financial Conduct Authority (FCA) or Prudential Regulation Authority (PRA) by application to the court. The court then makes a building society insolvency order, appointing a building society liquidator. The rules provide for a hearing to be held quickly to prevent a run on the society and preserve its assets.

3.6. In the initial stages, the building society liquidator is accountable to a liquidation committee comprising the appropriate regulator (FCA or PRA), the Bank of England and the FSCS. Once the building society liquidator considers that the first Objective is achieved, the liquidation committee will pass a resolution to that effect and the building society insolvency will move to the second Objective which is to wind up the affairs of the building society so as to achieve the best results for the creditors as a whole.

3.7. New rules and modifications to existing rules have been introduced in order to facilitate the achievement of the unique objectives of the bank insolvency procedure and to reflect the role of the Bank of England and the FCA and PRA in this procedure.

3.8. In keeping with ordinary insolvency, only an insolvency practitioner may be appointed as building society liquidator. The objectives of a building society liquidator are to provide support services or facilities to the Bank of England and the appropriate regulator to wind up the affairs of the building society so as to achieve the best results for the creditors and shareholding members.

3.9. The rules also add detail to the appointment of a provisional building society liquidator in any period between the submission of an application for a building society insolvency order and the court hearing for the making of such an order.

3.10. In order to facilitate the achievement of Objective 2 of the building society insolvency procedure, the Bank of England will have an important role to play in the process and will be responsible for agreeing the liquidator's proposals. The Bank of England will also fulfil the sort of functions usually carried out by a creditors' committee.

3.11. The Rules avoid making changes to the existing priority order of creditors. In particular, the claims of building society members, which are technically ranked as 'contributories' (i.e. they are equivalent to shareholders), are below those of normal creditors. This was a conscious decision, in order to avoid pre-empting any implementation of section 2 of the Building Societies (Funding) and Mutual Societies (Transfers) Act 2007 (2007 c. 26), which will give parity to building society members and other creditors. This Act extends to the whole of the United Kingdom.

3.12. The FSCS will be able to assume the rights of members to participate in the insolvency process when it makes a payout to members (the procedure by which it does this is set out in the FSCS rules) - this is necessary to

ensure that the FSCS can make recoveries from the insolvency; it is not necessary to make explicit provision for this in these Rules.

3.13. On the recommendation of the Banking Liaison Panel (BLP) (the body that advises the Treasury on secondary legislation made under the Banking Act 2009), the Rules give the FSCS certain additional rights in the BSIP: to apply to the court to challenge the liquidator's remuneration (included in rule 105), to call meetings of the liquidation committee (rule 120), and to stop a resolution by post (rule 130).

3.14. These rights are appropriate as the FSCS is likely to be owed substantial amounts of money, but is technically a contributory rather than a creditor, because of the nature of the rights it has assumed from the members.

3.15. Also, as recommended by the BLP, the Rules provide that members should retain residual rights to participate in the BSIP when the FSCS has exited from the process, and that members retain the right to be informed about the progress of the insolvency procedure.

3.16. The procedure introduces for the first time a statutory provision for set-off in relation to building society insolvency. This was welcomed by the Financial Markets Law Committee, which had expressed concern that the absence of such a provision created legal uncertainty around the liquidator's treatment of mutual dealings when a building society enters insolvency.

3.17. This instrument is the first use of the powers by the Department of Justice under Article 359 of the Insolvency (Northern Ireland) Order 1989 as amended by sections 125 and 134 of the Act and by the 2009 Order, to make rules to give effect to the building society insolvency procedure in Northern Ireland, with the concurrence of the Department of Finance and Personnel and the Lord Chief Justice of Northern Ireland.

4. Consultation

4.1. Drafts of the equivalent instrument for England and Wales were consulted on with the Bank of England, the Financial Services Authority (which was the predecessor to the FCA and PRA), the FSCS, the Insolvency Service and the Chancellor of the High Court. The Northern Ireland draft was considered by the Northern Ireland Courts and Tribunals Service.

4.2. As this is the first set of Rules to be made in relation to the building society insolvency procedure, in accordance with section 125(8) of the Act, the Insolvency Rules Advisory Committee has not been consulted.

5. Equality Impact

5.1. The building society insolvency procedure set out in Part 2 of the Act and the 2009 Order may only be instituted in connection with the powers to wind up the affairs of the building society so as to achieve the best results for the creditors and shareholding members.

5.2. An Equality Impact Assessment has not been prepared for this instrument. It is considered that it fully complies with section 75 of the Northern Ireland Act 1998.

6. Regulatory Impact

6.1. The building society insolvency procedure may only be used in relation to the winding up of the affairs of a building society.

6.2. The definition of a building society is given in section 84 of the Act and the procedure to which these rules give effect could not be used in relation to other businesses, charities or voluntary bodies.

6.3. The Bank of England and the appropriate regulator will have important roles to play in effecting the winding up of the affairs of a building society. Part 2 of the Act and these Rules were developed in consultation with the Bank of England and the FSA (as it was then). The Act and the 2009 Order extend to the whole of the United Kingdom. An Impact Assessment was prepared for the equivalent Rules brought into operation in England and Wales in November 2010. As these Rules are aimed at implementing the same regime in Northern Ireland, it was not considered that a separate Impact Assessment was required. No impact on small business is therefore anticipated.

7. Financial Implications

7.1. N/A

8. Section 24 of the Northern Ireland Act 1998

8.1. The Department has considered its obligations under section 24 of the Northern Ireland Act 1998 and is satisfied that the Rules are not incompatible with the Convention rights, are not incompatible with EU law, do not discriminate against a person or class of person on the grounds of religious belief or political opinion; and do not modify an enactment in breach of section 7 of the Northern Ireland Act 1998.

9. EU Implications

9.1. Not applicable.

10. Parity or Replicatory Measure

10.1. These Rules follow the formats in the equivalent rules for England and Wales. Equivalent Rules have also been made for Scotland. Given the current financial instability, it is vital that powers to resolve failing banks, building societies and other financial institutions in all parts of the UK continue to be exercised effectively.

11. Additional Information

11.1. Not applicable.