EXPLANATORY MEMORANDUM TO

THE BUILDING SOCIETIES (INSOLVENCY AND SPECIAL ADMINISTRATION) (AMENDMENT) ORDER 2010

2010 No. [XXXX]

1. This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 Part 2 of the Banking Act 2009 ("the Act") creates a new insolvency procedure to facilitate the prompt payment, in a bank insolvency, of depositors who are eligible claimants under the Financial Services Compensation Scheme (FSCS). Part 3 of the Act creates a new administration procedure for banks in certain cases.

2.2 This instrument exercises the powers in sections 130 and 158 of the Act to apply Parts 2 and 3 of the Act to building societies. It amends the Building Societies (Insolvency And Special Administration) Order 2009 (No. 805) ('the original Order'), making certain technical improvements.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 The instrument is the second use of the Treasury's powers in sections 130 and 158 of the Act, and accordingly is laid under the draft affirmative procedure. The original Order was made by the Treasury on 29th March 2009 and laid before Parliament under sections 259(4) to (6) of the Act, for approval by resolution of each House of Parliament within 28 days.

3.2 The instrument corrects drafting errors identified by the Joint Committee in its report on the original Order.[1] Article 2(2), sub-paragraphs (b), (d), (f) and (g) correct the errors relating to paragraphs 18 and 31 of Schedule 1 identified in the report. The other errors identified in the report, which relate to paragraphs 28(3) and 37 of Schedule 1, were corrected in the original Order when it was reprinted following approval by Parliament (it was issued free of charge to recipients of the original instrument).

4. Legislative Context

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

[1] The JCSI's comments on the order are available in The House of Lords House of Commons Joint Committee on Statutory Instruments Twelfth Report of Session 2008-09, paragraph 6 and Appendix 6, published on the Parliament website (www.publications.parliament.uk/pa/jt200809/jtselect/jtstatin/82/82.pdf).

4.2 The bank insolvency procedure set out in Part 2 of the Act is based on the process of liquidation in Part 4 of the Insolvency Act 1986 with modifications where required to facilitate the achievement of the unique objectives of the procedure. Bank insolvency may only be commenced by the court on an application made by the Bank of England, the Financial Services Authority or the Secretary of State. Where a bank insolvency order is made, an insolvency practitioner will be appointed as the bank liquidator. The bank liquidator will have two objectives; the first is to work with the Financial Services Compensation Scheme (FSCS) to ensure that either prompt compensation payouts can be made by the FSCS, or that the accounts of eligible depositors are transferred to another financial institution. The bank liquidator's second objective is to wind up the failed bank in the best interests of its creditors as a whole.

4.3 The bank administration procedure set out in Part 3 of the Act is distinct from the bank insolvency procedure and can only be used in conjunction with the property transfer resolution tool set out in Part 1 of the Act. Part 3 of the Act 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. This procedure is based on the administration procedure set out in Schedule B1 to the Insolvency Act 1986 with modifications where required to enable the unique objectives of a bank administration to be achieved.

4.4 The original Order applies the bank insolvency and administration procedure to building societies with a number of modifications (see paragraph 4.7 of the Explanatory Memorandum to the original Order). This Order makes the following amendments to the building society insolvency procedure and the building society special administration procedure as established by the original Order:

4.4.1 corrections of drafting errors in Schedule 1 identified in the JCSI report (see section 3.2 above);

4.4.2 a modification to section 195 of the Insolvency Act 1986 as applied by the original Order. Section 195 provides that in meetings of contributories of companies, regard shall be had to "the number of votes conferred on each contributory by the Companies Act or the articles"; this is inappropriate for building societies as the Companies Act does not apply and building societies do not have articles. Instead, reference is made to the value of the shares held by each contributory (as the contributories are shareholding members of the society);

4.4.3 a modification to section 116(4) of the Banking Act 2009 as applied by the original Order. That section is concerned with the deferral of the dissolution of a bank at the end of the bank insolvency procedure. Subsection (4) requires a person who obtains a direction of the Secretary of State to defer dissolution to deliver a copy of the direction to the registrar of companies (Companies House) within 7 days. That is inappropriate for building societies, as the Financial Services Authority is both the registrar for building societies and the person who would make any direction under section 116. The amendment

requires the Authority, on making any direction under section 116(1), to place it on the public file of the society concerned.

4.4.4 a modification to the table in section 145 of the Banking Act 2009 as applied by the original Order. That section applies paragraph 80 of Schedule B1 to the Insolvency Act 1986, which relates to termination of administration where the administrator is appointed under a floating charge or by a company. However, paragraph 79, which relates to termination of administration where the administrator is appointed by the court, ought to apply because in building society special administration the administrator is appointed by the court. The modification substitutes the reference to paragraph 80 with a reference to paragraph 79.

4.4.5 modifications to the Banking Act 2009 (Parts 2 and 3 Consequential Amendments Order) 2009 (S.I. 2009/317) as it applies to building societies: these ensure that, in specified provisions of the Pension Protection Fund (Entry Rules) Regulations 2005 (S.I. 2005/590) and their Northern Ireland equivalent, references to "company" have effect as references to "building society";

4.4.6 consequential amendments to the Pension Protection Fund (Entry Rules) Regulations 2005 and their Northern Ireland equivalent, which govern entry to the Pensions Protection Fund. These amendments ensure that the making of a building society insolvency or special administration order are "prescribed insolvency events" for the purposes of these Regulations, and that in specified circumstances building society insolvency or special administration proceedings are stayed or come to an end for the purposes of the Regulations. They ensure consistency with bank insolvency and bank administration, but additional drafting is needed to cover building societies as they are not companies.

4.5 The Building Society Special Administration (Scotland) Rules 2009 (S.I. 2009/806 (S. 3)) were made on 29th March 2009 to facilitate the resolution of Dunfermline Building Society. Further Building Society Insolvency and Special Administration Rules will be made in due course, to cover the rest of the United Kingdom.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

The Financial Services Secretary to the Treasury (Lord Myners) has made the following statement regarding Human Rights:

"In my view the provisions of the Building Societies (Insolvency and Special Administration) (Amendment) Order 2010 are compatible with the Convention rights".

7. Policy background

- ***What is being done and why***

7.1 In January and July 2008 the Government consulted on the basis that the SRR, including the bank insolvency procedure and the bank administration procedure would be extended to building societies. This was on the basis that building societies' shareholding members should receive similar protection to bank depositors. Stakeholders strongly supported this principle and accordingly Part 1 was applied to building societies directly and powers were put in parts 2 and 3 of the Act (sections 130 and 158) to allow the Treasury to apply these parts to building societies through secondary legislation. Both the bank insolvency procedure and the bank administration procedure were supported by stakeholders before and during the passage through Parliament of the Banking Act.

7.2 The original Order was made on an urgent basis in order to enable the resolution of the Dunfermline building society in March 2009. At that time the Government committed to ex post consultation and to remake or amend the Order if necessary. This Order makes certain technical changes to the original order (see explanation in paragraph 4.4 above).

- ***Consolidation***

7.3 As the amendments made by this Order are minor and technical in nature, the Government considers it appropriate to proceed by way of an amending order rather than by remaking the original Order.

8. Consultation outcome

8.1 The original Order was made on an urgent basis in order to enable the resolution of the Dunfermline building society in March 2009. At that time the Government committed to ex post consultation and to bring forward an amending Order if necessary.[2]

8.2 The public consultation ran from 31 June to 31 October 2009, and comments from the House of Lords' Merits of Statutory Instruments Committee ('the Merits Committee')[3] on the original Order were highlighted in the consultation document[4]. The outcome of the consultation is set out in sections 7 and 8, below. Further scrutiny was carried out by the Banking Liaison Panel (BLP), which has a statutory role to advise the Treasury on secondary legislation made under Parts 1 – 3 of the Act. The

[2] This is set out in more detail in the Explanatory Memorandum to the Building Societies (Insolvency And Special Administration) Order 2009 (No. 805), which is available from www.opsi.gov.uk

[3] The Merits Committee's comments on the order are available in their 14th Report of Session 2008-09, published on the Parliament website (www.publications.parliament.uk/pa/ld200809/ldselect/ldmerit/80/80.pdf).

[4] The full consultation document is available in the consultations section of the Treasury website www.hm-treasury.gov.uk.

BLP subgroup on building society insolvency have published their advice on the Treasury website.[5]

8.3 The public consultation closed on 31 October. Two stakeholders (the Building Societies Association and the Insolvency Service) responded to the insolvency questions, raising a number of technical questions. The issues were then considered by the Banking Liaison Panel (BLP), which has a statutory role to advise the Treasury on secondary legislation made under Parts 1-3 of the Banking Act.

8.4 The BLP's subgroup on building society insolvency has provided advice to the Treasury, which is published on the Treasury website. The BLP support the main policy proposals, and have made three further recommendations in relation to the BSIP and BSSAP, which are set out in their advice. Broadly, their recommendations are:

8.4.1 that the FSCS should have certain additional rights in the BSIP: to apply to the court to challenge the liquidator's remuneration, to call meetings of the liquidation committee, and to stop a resolution by post;

8.4.2 that 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; and

8.4.3 that Treasury should ensure that a building society special administrator can change the name of the residual society after a partial transfer (in order to avoid confusion between the transferred 'good' part of the business, and the residual business in administration).

8.5 The first two recommendations do not require changes to the Order, but will be dealt with in the building society insolvency rules referred to above.

8.6 The Government has considered the third recommendation, and concluded that this would require changes to the Building Societies Act 1986, which in turn might require changes to a range of provisions of that Act where the approval of members is required. This would diverge from the overall principle that we have adopted, that the building society insolvency procedure and the building society special administration procedure should closely follow the equivalent procedures for banks (and normal insolvency), and not make unnecessary changes to building society law. Under the building society special administration procedure as it stands, there are various routes by which a special administrator could pursue this goal, and he or she would ultimately have recourse to the courts. The Treasury has therefore not made specific provision for this final recommendation in the amending Order.

8.7 The Merits Committee raised two questions about the original Order, which were highlighted in the consultation:

8.7.1 why 'Ground B' (winding up in the public interest) is not available for the winding up of a building society, whereas it is available for a bank; and

[5] See the Banking Act section of the Treasury website (www.hm-treasury.gov.uk), which includes more information about the BLP.

8.7.2 why shareholding members are prevented from voting on the administrator's proposals.

8.8 The Government's position on these questions was set out in the original response to the questions of the Merits Committee, and highlighted in the consultation document. The questions were further discussed with the Banking Liaison Panel subgroup on building society insolvency, who agreed that the Order should not be amended in this respect.

9. Guidance

9.1 The Treasury do not intend to publish guidance in relation to this instrument, which makes minor and technical amendments to specialist procedures under the Banking Act.

10. Impact

10.1 An Impact Assessment was provided for the consultation on financial stability and depositor protection (published in July 2008) and for the Banking Bill (published October 2008), which included the powers to make the secondary legislation put forward today.

10.2 Accordingly an Impact Assessment has not been prepared for this instrument.

11. Regulating small business

11.1 The procedures applied by this Order can only be used when a building society is in difficulties and when the conditions set out in the Act are met. As such, it is not considered this Order will have an impact on small businesses.

12. Monitoring & review

12.1 The Act requires the Treasury to make arrangements for a panel to advise the Treasury about the effect of the special resolution regime on banks, persons with which banks do business and the financial markets (section 10 of the Act (Banking Liaison Panel)). In particular, the Panel may advise the Treasury about the exercise of powers to make certain statutory instruments. The Panel will keep this Order under review and, where appropriate, provide advice to the Treasury about this Order.

13. Contact

Chris Rusbridge at HM Treasury Tel: 020 7270 4552 or email: christopher.rusbridge@hmtreasury.gsi.gov.uk can answer any queries regarding the instrument.