EXPLANATORY MEMORANDUM TO

THE PAYMENT AND ELECTRONIC MONEY INSTITUTION INSOLVENCY (SCOTLAND) RULES 2022

2022 No. 1239

1. Introduction

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

2. Purpose of the instrument

2.1 The instrument introduces insolvency rules in Scotland, for the special administration procedure established in the Payment and Electronic Money Institution Insolvency Regulations 2021 ("the Regulations").

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is Scotland.

4.2 The territorial application of this instrument is Scotland.

5. European Convention on Human Rights

5.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

6. Legislative Context

6.1 The Payment and Electronic Money Institution Insolvency (Scotland) Rules 2022 ("the Rules") are made under section 411(1A) (b), (2), (2C) and (3) of the Insolvency Act 1986, as applied and modified by regulation 37 of the Regulations. The Regulations were made on 17 June 2021 principally under sections 233 and 234 of the Banking Act 2009 (as applied and modified by regulation 24A of, and paragraphs 2 and 3 of Schedule 2ZA to, the Electronic Money Regulations 2011 and regulation 23A of, and paragraphs 2 and 3 of Schedule 3A to, the Payment Services Regulations 2017).

7. Policy background

What is being done and why?

7.1 The Rules set out the procedure for the Payment and Electronic Money Institution Special Administration process established in the Regulations for Scotland.

7.2 The Regulations created a new special administration regime for payment and electronic money institutions, in order to facilitate a faster and more efficient return of

funds to customers in the event of insolvency. Under the regulations administrators are required to pursue the following special administration objectives:

- Objective 1 is to ensure the return of relevant funds as soon as is reasonably practicable;
- Objective 2 is to ensure timely engagement with payment system operators, the Payment Systems Regulator and the Bank of England, HM Treasury and the FCA; and
- Objective 3 is to either rescue the institution as a going concern, or wind it up in the best interests of the creditors.

7.3 The main features of the Payment and Electronic Money Institution Special Administration process are that:

- the payment or electronic money institution enters the procedure by court order;
- the order appoints an administrator;
- the administrator is to pursue the special administration objectives (with the exception of Objective 1 in certain cases) in accordance with the statement of proposals approved by the meeting of creditors and customers or, in certain circumstances, the Financial Conduct Authority (FCA); and
- in other respects, the procedure is similar to administration under Schedule B1 of the Insolvency Act 1986, subject to modifications and the inclusion of certain liquidation provisions of that Act (see regulation 37 and Schedules 1 and 2 of the Regulations).

7.4 The Rules comprise of thirteen parts and one schedule. These parts are as follows: Introductory Provisions; Application for Special Administration Order; Process of Special Administration; Expenses of the Special Administration; Relevant Funds Claims; Objective 1; Claims by and distributions to creditors; The Administrator; End of Special Administration; Applications to court; Prohibited Names; Provisions of General Effect; General Interpretation and Application. The schedule is titled Punishment of Offences

7.5 The Rules are based largely on the Payment and Electronic Money Institution Insolvency (England and Wales) Rules 2021[1]. Separate rules have been created for Scotland to account for the different Court systems that are established in Scotland compared to England and Wales.

7.6 Bespoke rules have been introduced specifically to facilitate the achievement of the unique objectives of the special administration procedures set out in the Regulations. The most significant of these rules are set out below.

Customer voting procedure and establishment of creditors' committee (part 3 of the Rules)

7.7 The statement of proposals drawn up by the administrator sets out the priority to be given to the three objectives set out in the Regulations. The statement of proposals must be approved by the meeting of creditors and customers (or, in certain circumstances, the FCA). The Rules set out how such approval is to be achieved.

1 https://www.legislation.gov.uk/uksi/2021/1178/pdfs/uksiem_20211178_en.pdf

7.8 Creditors must be given notice of the meeting of creditors and then, in order to be able to vote at the meeting, must give the administrator details of their claim and have that claim accepted for voting purposes (whether wholly or in part).

7.9 In general, a creditor's vote is calculated according to the amount of their claim as at the date the institution went into special administration, making adjustments for any amounts already repaid and any adjustment by way of set-off.

7.10 The Rules set out that under the Regulations, customers are to be notified of meetings in the same way as creditors and that:

- a customer must submit their claim for relevant funds to the administrator prior to the meeting in the same time frame in which a creditor would have to submit their claim;
- the chair of a meeting of creditors and customers, or customers only, has the power to admit or reject a relevant funds claim in whole or in part;
    - the value of a customer's vote will be calculated according to the value of the customer's relevant funds claim; and
    - the creditors and the customers will vote separately to approve the statement of proposals. The statement must be approved by both groups; The meeting of creditors and customers will also be able to appoint a creditors' committee. In order to ensure that this committee is a reasonable reflection of the interest of creditors and customers, the administrator will be required to determine the appropriate make-up of the committee and set out the maximum number of members to be elected by each class of voter in a manner that achieves that make-up.

Failure-related costs and costs of the realisation of relevant funds (part 4 of the Rules)

7.11 Under the Regulations, failure-related costs that have been incurred as a consequence of a failure by the institution to safeguard relevant funds are to be paid out of the institution's assets. The Rules set out the order of priority in which the various types of cost are paid. This is to avoid customers being primarily responsible for such costs. Where the institution's assets are insufficient to satisfy such liabilities, however, the remaining costs are to be paid out of the asset pool (consisting of funds of customers).

7.12 In the application of paragraph 99 of Schedule B1 of the Insolvency Act 1986, the costs of the administrator in pursuing Special Administration Objective 1 (ensuring the return of relevant funds as soon as is reasonably practicable) shall be borne by the customers. This follows the rule laid down in case law[2] that liquidators who deal with trust assets are entitled to be paid out of those assets for the work which had been carried out. The Rules provide that the administrator shall propose in the distribution plan the amount the administrator is to retain from relevant funds to pay the expenses of the administration in pursuing Special Administration Objective 1.

Return of relevant funds (parts 5 and 6 of the Rules)

7.13 The Rules set out how relevant funds claims are to be made. If the administrator decides to set a soft bar date (a deadline by which claims need to be submitted) or, with the approval of the Court, a hard bar date (the final deadline), the Rules set out the process leading up to the distribution following the soft bar date and hard bar date.

2 Re Sports Betting Media Ltd [2007] All ER (D) 123 (Jul) and Berkeley Applegate (Investment Consultants) Ltd, Re, Harris v Conway [1989] Ch 32, [1988] 3 All ER 71

The decision as to what can be distributed, and at what stage, will be left to the administrator's discretion (which is then subject to approval by any creditors' committee and the Court), but the Rules set out the process by which this is to be achieved. The Rules include details as to:

- the notice that the administrator is required to give to customers when setting a soft or hard bar date;
- the approval of a distribution plan (after a soft bar date) by the creditors' committee. This enables the administrator to set out a plan for distribution including timelines, customers to whom distributions are to be made, plans for disputed claims and plans for paying expenses of the administration. Court approval will then need to be sought for the distribution plan;
- the process by which the administrator notifies late soft bar date claimants (i.e. those who have not submitted their claim before the soft bar date);
- the treatment of a claimant who makes a claim after the soft bar date. The Rules provide that where the claim was made after the soft bar date but before the distribution, the administrator must, so far as is reasonably practicable, include the late relevant funds claim in the distribution. Where the late claim was made after the distribution, the administrator must, so far as is reasonably practicable, include this late claim within a subsequent distribution

7.14 The above applies only where the administrator sets a bar date. In appropriate circumstances, the administrator may make a distribution of relevant funds before setting a bar date for more complicated claims. The Rules provide details as to what a relevant funds claim must contain.

7.15 The Rules provide for an appeals process for claimants that are dissatisfied with the administrator's decision with respect to their relevant funds claim. They are able to apply to the court for the administrator's decision to be reversed or varied. Further, the administrator or, where the administrator declines to interfere in the matter, a creditor or customer can apply to the court to exclude or reduce a relevant funds claim if they consider that the relevant funds claim has been improperly admitted or ought to be reduced.

Distributions to customers who are also creditors due to having shortfall claims (part 7 of the Rules)

7.16 Where the administrator is aware that a customer has a shortfall claim (a claim that will not be met from the asset pool), the customer does not need to submit a separate proof in their capacity as a creditor. Rather, the administrator will treat the record of the shortfall claim as if it were a proof submitted by the customer in respect of their shortfall claim.

8. European Union Withdrawal and Future Relationship

8.1 This instrument does not relate to withdrawal from the European Union / trigger the statement requirements under the European Union (Withdrawal) Act.

9. Consolidation

9.1 Not applicable. These are the first insolvency rules for Scotland relating specifically to payment and electronic money institutions and do not contain any amendments of existing legislation.

10. Consultation outcome

10.1 The Government consulted on introducing the special administration regime for payment and electronic money institutions in all parts of the United Kingdom. The consultation included detail on the application of the proposed rules.

10.2 The consultation on the special administration regime ran from 17 December 2020 to 28 January 2021, during which time the Government received fifteen written responses.

10.3 The consultation document indicated the Government's intention to introduce rules for Scotland as part of a new special administration regime for payment and electronic money institutions. It set out that the Rules would accompany the Regulations and create the new insolvency regime. The consultation contained a summary of the provisions that the Government proposed to incorporate into the Rules.

10.4 Most respondents expressed support for the introduction of a special administration regime for payment and electronic money institutions. Respondents provided detailed and useful comments which enabled the refinement of policy including its application to Scotland. Responses to matters relating specifically to the Rules included comments on the bar date, requirements on the administrator to contact customers, the circumstances where trust assets could be encumbered by security rights and the expenses of the special administration. The Government has outlined its response to these detailed submissions in the consultation response document.

10.5 The consultation response document was published on 26 April 2021. [3]

11. Guidance

11.1 No further guidance is being published alongside this instrument.

12. Impact

12.1 There is no, or no significant, impact on business, charities or voluntary bodies.

12.2 There is no, or no significant, impact on the public sector.

12.3 A de minimis Impact Assessment is submitted with this memorandum and published alongside the Explanatory Memorandum on the legislation.gov.uk website.

13. Regulating small business

13.1 The legislation applies to activities that are undertaken by small businesses. None of these costs are estimated to be a significant burden. The special administration regime Rules will include provisions on the payment of expenses properly incurred by Insolvency Practitioners in performing their functions.

13.2 No specific action is proposed to minimise regulatory burdens on small businesses as the Government considers that the Rules impose negligible costs to small businesses. This legislation will only take effect in the rare event of an insolvency, with there being no significant ongoing, one-off or ad hoc costs. Under ordinary and well established company insolvency, there is no distinction drawn in the treatment of

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3 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/980540/Insolvency_changes_for_payments_and_electronic_money_firms_consultation_response_FINAL.pdf

small businesses and other businesses in the event of an insolvency. The Government has therefore mirrored this approach.

14. Monitoring & review

14.1 Section 236 of the Banking Act 2009 applies in modified form in relation to electronic money and payment institutions under amendments made by the Payment Services and Electronic Money (Amendment) Regulations, S.I. 2020/1275. Therefore, HM Treasury is required to review the Regulations within two years of them coming into force. The review must consider how far the Regulations are achieving the objectives specified in section 233(3) and whether the Regulations should continue to have effect. This review specifically relates to the Regulations and not the accompanying Rules, but the two instruments are linked and therefore the Government will consider the rules at this time.

14.2 HM Treasury will ensure that arrangements for review are consistent with better regulation policy.

15. Contact

15.1 Lucinda Greenslade at HM Treasury email: Lucinda.greenslade@hmtreasury.gov.uk can be contacted with any queries regarding the instrument.

15.2 Mario Pisani, Deputy Director for Resilience and Resolution at HM Treasury can confirm that this Explanatory Memorandum meets the required standard.

15.3 Economic Secretary to the Treasury, Andrew Griffith MP at HM Treasury can confirm that this Explanatory Memorandum meets the required standard.