



**THE LAW SOCIETY**  
**of SCOTLAND**  
[www.lawscot.org.uk](http://www.lawscot.org.uk)

**HM Treasury**  
**Financial Stability and depositor protection: further consultation**

**The Law Society of Scotland's Response**

**September 2008**

## **INTRODUCTION**

The Banking Law Sub-Committee of the Law Society of Scotland (“the Committee”) welcomes the opportunity to consider the further HM Treasury consultation on financial stability and depositor protection, following the consultation “Financial Stability and Depositor Protection: Strengthening the Framework” of January 2008.

The Society has considered the consultation and has a number of comments to make, which are set out below. These should be read in conjunction with the Committee’s response to the concurrent consultation “Financial Stability and Depositor Protection: Special Resolution Regime”.

## **CHAPTER 3**

### **Liquidity disclosure 3.22 – 3.77**

In response to the previous consultation, the Committee raised concerns about any proposal to exempt banks in receipt of liquidity assistance from being required to register charges with Companies House. The Society’s main concern is that public registers should be complete and reliable in order to ensure there is no diminution in public confidence in their operation. As the previous consultation acknowledged, any departure from this practice could leave third parties acting in good faith exposed to inappropriate risk when relying on the accuracy of public registers.

The Committee reiterates that concern, although noting the points made in both consultations about the inappropriate disclosure of information hampering the effectiveness of assistance offered by the Authorities. It further notes that the Government intends to legislate so that any charges granted to a central bank in connection with its functions as a central bank will be exempt from registration. If that approach is adopted, the Committee considers that it should only be in truly exceptional circumstances, where the public interest can clearly be

seen to lie with a failure to disclose, and where appropriate steps are taken to protect those who may be affected by operating in ignorance of bank difficulties.

## CHAPTER 4

### Question 4.2

#### **Do you agree with the roles for the Authorities for the triggering and operation of the special resolution regime?**

In response to the previous consultation, the Committee raised a number of concerns regarding the proposed triggers for a bank entering a special resolution regime. These are set out again in full below:

1. The first factor which may be taken into account is that there is “a significant risk that the bank concerned would fail the relevant threshold conditions in the future (in particular, the conditions of adequate resources or suitability).” The Committee is of the opinion that this is a far too subjective test which places too much discretion in the hand of the regulator. Questions such as what constitutes a “significant” risk in the “future” are bound to occur and could give rise to very different interpretations on the part of the Authorities and on the part of the bank.
2. The Committee notes that the factors set out in paragraph 4.10 are intended to be considered as separate issues, any one of which could trigger the SRR. The Committee considers that that is inappropriate and that the conditions should be required to be read cumulatively so that the significant consequences of the SRR could only occur in a situation where there is a significant risk of failure in the future **and** the available regulatory powers have been exhausted **and** further options were needed to protect the stability of the financial system or the interests of depositors. Applied as set out in the consultation in the Committee’s view, only one of these factors arising could trigger the SRR.

3. Paragraph 4.10 indicated that “the detailed circumstances for initiating any of the tools in the SRR would be described in guidance, such as that sets out in the FSA Handbook, including quantitative and qualitative criteria”. The Committee considers that, given the repercussions of the initiation of SRR tools, care should be taken to ensure that the terms of such a trigger are set out at the appropriate legislative level. The Committee assumes that, given the effect of the SRR on the rights of shareholders, directors, creditors and other and the requirement to set aside the normal rules governing insolvency, these provisions will be set out in primary legislation. In that case, the Committee considers that as much as possible of the detail of the scheme be set out in secondary legislation or a statutory code. Wide consultation on the terms of such guidelines will also be required.

Whilst acknowledging the potential usefulness of the proposed special resolution regime, the Committee maintains its concerns regarding the extent of the discretion which will pass into the Authorities’ hands to take significant powers of intervention in the working of a bank. This should be seen against a backdrop of recent regulatory failures in the financial markets where, arguably, clearer requirements on authorities would have assisted in dealing with the issues which then arose.

The Committee therefore continues to consider that legislation should be clear in the criteria which can be applied to trigger a special resolution regime and that there should be an obligation to ensure that other appropriate regulatory tools have been exhausted before such extreme action is taken.

## **CHAPTER 5**

### **Protection for holders of banknotes issues in Scotland and Northern Ireland**

The Committee considers that it will be necessary to ensure that the legislative basis for the ring-fencing of backing assets in the case of the insolvency of bank which issues bank notes will function appropriately under the Scots law of trusts.

## **Scottish cheques**

The Committee notes, at proposal 5.94, that it is intended to use the forthcoming legislation to abolish the funds attached rule in Scots law, so far as it relates to cheques, with the intention of bringing the law in Scotland into line with that in the rest of the UK. The consultation states that Scots common law will continue to apply in situations where there are insufficient funds available to satisfy a cheque presented for payment.

The Committee understands the aim of this proposal and assumes that the intention is that the common law would also be disapplied for cheques but would remain in place for bills of exchange, and would welcome greater clarity on this issue.



**For further information and alternative formats please contact:**

Tel: 0131 226 7411

Email: [lawreform@lawscot.org.uk](mailto:lawreform@lawscot.org.uk)

The Law Society of Scotland  
26 Drumsheugh Gardens  
Edinburgh  
EH3 7YR  
[www.lawscot.org.uk](http://www.lawscot.org.uk)