



**THE LAW SOCIETY
of SCOTLAND**

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HM Treasury

Financial Stability and depositor protection: Special Resolution Regime

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: Further Consultation”.

CHAPTER 3

Special bank administration

The Committee has concerns about the way in which it is proposed that the special bank administration be operated.

For example, at paragraph 3.115, amongst the functions proposed for the Bank of England is “approving those assets, or types of asset, that may be realised immediately for the benefit of creditors (that is, “non-essential assets”). And, again, at paragraph 3.116, it is stated that “it will be necessary to curtail some of the rights that creditors would have in an ordinary administration”. Decisions such as to which assets will be passed to the bridge bank, which left and which realised, when and how, will have a potentially serious effect on the holders of those assets and, as set out in the consultation, such judgments will be entirely within the discretion of the Bank of England, with a lack of specific criteria set out as to how such a decision should be taken. Nor does there seem to be any mechanism whereby such important decisions can be challenged, notwithstanding their import, other than by the broad catch-all of judicial review.

It is also noted that the criteria to be established for the end of the special bank administration procedure are largely within the discretion of the Bank of England and further, at paragraph

3.138 the secondary duty imposed on the Bank in their oversight of the operation of the bridge bank is the very low test of not to act “recklessly” in a way that led to the destruction of value in the potential proceeds of resolution.

Given the acknowledged curtailment of the rights which creditors would have in a normal insolvency procedure, the Committee is concerned that when invoking, operating and ending this special procedure great care is taken in safeguarding as far as possible those rights, steps are taken to ensure that decisions on these rights are not overly arbitrary and, where required, an effective mechanism to challenge such decisions be adopted.

Bank resolution fund

At paragraph 3.135 it is proposed that a bank resolution fund be mandatory in the case of a bridge bank, but only discretionary for temporary public ownership. The Committee notes the reasons given for such an approach but considers that such an important issue needs further exploration and clearer reasoning.

CHAPTER 4

Entry into bank insolvency procedure

The Committee notes the test for entry into bank insolvency procedure set out a paragraph 4.8 is that the bank is “unable, or is likely to become unable, to pay its debts or where such an application is considered to be fair (meaning just and equitable)”. The Committee re-iterates its comments in response to the accompanying consultation “Financial Stability and Depositor Protection: Further Consultation” with regarding to the proposed triggers for a bank entering a special resolution regime. Specifically, the Committee has concerns regarding the lack of specificity in this test and the lack of clarity in the criteria applied.

Insolvency Services Account

The Committee further notes the ongoing consultation with the Scottish government on this

issue and would be interested in commenting on the proposed details for a Scottish arrangement once these have been framed.

Set-off

The Committee notes that there are specifically Scottish issues surrounding the proposal on set-off and considers that it will not be possible simply to translate English insolvency set-off rules into the Scottish context.

CHAPTER 5

UK deposit-takers

The Committee has considered the proposals at paragraphs 5.34 and 5.35 with regard to applying the special resolution regime only to UK incorporated deposit-takers. The Committee understands the logic of this approach but wonders about the application of the Winding up Directive and how, in practice, the regime would be applied to an entirely foreign branch of a UK-regulated bank and, indeed, what the consumer protections would be for a branch of a foreign bank taking deposits in the UK.

Banks which are part of larger corporate groups

The Committee notes the proposals regarding an obligation on corporate groups to provide support services to a deposit-taker to which a stabilisation tool had been applied. The Committee wonders what, in practical terms, will be the outcome for former group companies where the main support services, such as the IT system, are within the bank which is being transferred to a bridge bank, rather than vice versa, and what steps will be taken to ensure the operational viability of the remaining group.



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