

# **Banking Act 2009**

## Special resolution regime: Code of Practice

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February 2009



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Banking Act 2009  
Special resolution regime:  
Code of Practice

Presented to Parliament pursuant to sections  
5 and 6 of the Banking Act 2009

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## **HM Treasury contacts**

This document can be found in full on our website at:  
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If you require this information in another language, format or have general enquiries about HM Treasury and its work, contact:

Correspondence and Enquiry Unit  
HM Treasury  
1 Horse Guards Road  
London  
SW1A 2HQ

Tel: 020 7270 4558

Fax: 020 7270 4861

E-mail: [public.enquiries@hm-treasury.gov.uk](mailto:public.enquiries@hm-treasury.gov.uk)

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# 1

## Introduction

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**1.1** The Banking Act 2009 (the Act), covering England, Scotland, Northern Ireland and Wales, strengthens the UK's statutory framework for financial stability and depositor protection.

**1.2** The Act puts in place a permanent special resolution regime (SRR), providing the Financial Services Authority (FSA), Bank of England and the Her Majesty's Treasury (the Authorities) with tools to protect financial stability by effectively resolving banks and building societies that are failing, while protecting depositors, taxpayers and the wider economy.

**1.3** This Code of Practice, issued in accordance with sections 5 and 6 of the Act, supports the legal framework of the SRR, and provides guidance as to how and in what circumstances the Authorities will use the special resolution tools. In particular, it sets out guidance on the use of:

- the **three stabilisation options**: transfer to a private sector purchaser, transfer to a bridge bank and transfer to temporary public sector ownership;
- the **bank insolvency procedure**, which facilitates the Financial Services Compensation Scheme (FSCS) in providing prompt payout to depositors; and
- the **bank administration procedure**, for use where there has been a partial transfer of business from a failing institution.

**1.4** The Treasury has issued this Code having consulted the FSA, the Bank of England and the FSCS in accordance with section 6 of the Act. The Code is laid before Parliament on 23 February 2009.



# 2

## Overview of the Code

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**2.1** This Code of Practice provides guidance on the use of the SRR set out in Parts 1-3 of the Act. The SRR provides the Authorities with a permanent set of tools to deal with banks and building societies in circumstances in which their failure has become highly likely, and a threat is posed to the public interest. It consists of:

- the three **stabilisation options**: transfer to a private sector purchaser, transfer to a bridge bank and transfer to temporary public sector ownership;
- the **bank insolvency procedure**; and
- the **bank administration procedure**.

**2.2** The special resolution tools may be used by the Authorities to resolve a failing banking institution, and include powers to take bank holding companies into temporary public ownership, if necessary.

### Contents of the Code

**2.3** In accordance with section 5 of the Act, this Code sets out:

- how the special resolution objectives are to be understood and achieved;
- the choice between different resolution options;
- the information to be provided in the course of a consultation under this Part (i.e. information to be provided as part of any consultation between the Authorities and the giving of advice between one authority and another);
- the giving of advice by one relevant Authority to another about whether, when and how the stabilisation powers are to be used;
- how to determine whether Condition 2 in section 7 is met (this condition stipulates that, before a banking institution can be placed in the SRR, the FSA must have determined that it is not reasonably likely that action will be taken by or in respect of the institution that will enable it to satisfy its threshold conditions);
- how to determine whether the test for the use of stabilisation powers in section 8 is satisfied (i.e. how the Bank of England will determine the public interest test for the use of the bridge bank and private sector purchaser stabilisation options will be satisfied);
- sections 63 and 66 (general continuity obligations); and
- compensation.

**2.4** Sections 12 and 13 require the inclusion in the Code of certain matters relating to the governance of bridge banks and temporary public ownership.

**2.5** In describing the use of the statutory powers under the SRR (Chapters 3-10), the Code uses the general term 'banking institution' to refer to a bank, building society or bank holding company, except where otherwise stated.

## **The Authorities' regard to the Code**

**2.6** The Authorities are legally obliged to have regard to the Code under section 5(4) of the Act.

**2.7** The Treasury considers that one of the primary purposes of the Code is to provide a clear guide, for banking institutions and the financial markets, to how the Authorities will seek to achieve the special resolution objectives.

## **Revising and maintaining the Code**

**2.8** The Treasury will update the Code on a periodic basis, in the light of evolving experience. The Treasury will consult the Bank of England, FSA and the FSCS on any changes. In making material changes to the Code the Treasury will also consult the Banking Liaison Panel, which has a statutory remit to advise the Treasury on the Code of Practice under section 10(2)(b) of the Act.

**2.9** When a new Code is issued, the Treasury will lay a copy before Parliament as soon as is practicable.

## **Banking Liaison Panel**

**2.10** The Banking Liaison Panel will advise the Treasury on certain matters relating to the SRR. The remit and terms of reference of the panel will be published, and will include advising the Treasury on the effect of the SRR on banking institutions, persons with whom they do business, and the financial markets.

**2.11** The Treasury expects the Panel to take a particular interest in providing advice in relation to the operation of the safeguards provided by and under the Act in relation to partial property transfers and on this Code.

**2.12** Summaries of the proceedings of meetings of the Banking Liaison Panel will be published, subject to considerations of commercial and market confidentiality.

# 3

## Special Resolution Objectives

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**3.1** Section 4 of the Act provides for the special resolution objectives, as follows:

- objective 1 is to protect and enhance the stability of the financial systems of the UK;
- objective 2 is to protect and enhance public confidence in the stability of the banking systems of the UK;
- objective 3 is to protect depositors;
- objective 4 is to protect public funds; and
- objective 5 is to avoid interfering with property rights in contravention of a Convention Right (within the meaning of the Human Rights Act 1998).

### **Matters to be considered in having regard to the objectives**

**3.2** Specific terms used within the objectives are not generally defined by the Act. The objectives set out in the Act are context-specific and neither they nor the terms within them can be defined in an exhaustive or definitive manner. In addition, the specific relevance and application of the objectives may change over time (for example, as the threats to financial stability change over time).

**3.3** Therefore, this Code provides further explanation as to how the objectives may be achieved by outlining the factors that the Authorities may consider to be relevant in applying them.

### **Stability of the financial systems of the UK**

**3.4** The term “stability of the financial systems of the UK” refers to the stable functioning of the systems and institutions (including trading, payment and settlement infrastructure) supporting the efficient operation of financial services and markets for purposes including capital-raising, risk-transfer, and the facilitation of domestic and international commerce in addition to day-to-day banking operations.

**3.5** By virtue of section 4(9) of the Act, the reference to the stability of the financial systems of the UK includes in particular a reference to the continuity of banking services. Continuity of banking services is relevant not only for the protection of depositors under objective 2, but has wider relevance to the stability of the financial systems of the UK.

**3.6** The intention of the first objective is to (a) recognise the wider systemic risks posed by the potential or actual failure of a banking institution or group of companies containing a banking institution; and (b) require the Authorities to have regard to the likely systemic impact of their actions (including a decision not to act) when considering whether to use a SRR tool.

**3.7** The Authorities will have regard to ensuring that the transfer powers are not exercised in a manner that is likely to harm financial stability. As part of this, in transferring rights and obligations that confer a particular status (for example, as a settlement or clearance bank), the Authorities will seek to ensure that this status is not transferred to an unsuitable entity.

## Public confidence in the stability of the banking systems

**3.8** The term “public confidence in the stability of the banking systems” refers to the crucial role that public confidence has in maintaining the stable and efficient operation of financial services and markets. The confidence of the general public is of particular significance in maintaining stability in a banking system based on a fractional reserve model, whereby institutions’ deposit liabilities exceed the liquid assets they hold at any one time.

**3.9** Public confidence has a number of dimensions. For example, it refers to the expectation that (a) deposits will be repaid in accordance with their terms; (b) normal banking services will continue to be available; (c) problems (or perceived problems) in one institution will not extend to other institutions (contagion); and (d) if an institution does fail, systems exist to protect the interests of depositors.

**3.10** The intention of the second objective is to provide that the Authorities have regard to the need to act so that a failing institution will be resolved in a manner that protects and enhances public confidence in the banking system as a whole.

## Protection of depositors

**3.11** The term “protection of depositors” refers specifically to the objective of protecting depositors from the effects of the failure of an institution, as an end in itself. This objective goes beyond the need to ensure public confidence in the banking systems (although, as noted above, depositor protection may be an important element of such confidence), and recognises the important public policy objective of ensuring that depositors in a failed institution are adequately protected.

**3.12** Under the Act such protection can be delivered in different ways. For example by (a) facilitating fast payout to eligible depositors up to the compensation limit under the FSCS (or arranging a bulk transfer of accounts) through the bank insolvency procedure; or (b) facilitating continuity of banking services through the stabilisation options provided in the SRR.

**3.13** Effective depositor protection is particularly important in the case of deposits protected by the FSCS. Protection of these deposits, including prompt access to them, is also likely to be conducive to the realisation of a number of other SRR objectives such as protecting and enhancing public confidence in the banking systems. However, the use of the SRR may also offer protection to other types of depositor and non-depositor creditors if necessary to meet the special resolution objectives.

## Protection of public funds

**3.14** The term “protection of public funds” refers primarily to the protection of taxpayers’ interest in the effective expenditure of public money. The intention of the fourth objective is to recognise the strong duty of the Authorities, and particularly the Treasury, to protect public funds in taking decisions with implications for public funds.

## Avoiding interference with property rights

**3.15** The term “avoiding interfering with property rights in contravention of a Convention right” refers in particular to holders of property rights in a failing banking institution. This can include the institution itself, its shareholders (or, in the case of a building society, members), creditors, counterparties, or other third parties. Such persons may hold property in the failing institution, or have a right of control over such property, or both. The primary Convention right at issue is Article 1 of Protocol 1 to the Convention (right to property). Other Convention rights (including Article 6, the right to a fair trial and Article 14, prohibition of discrimination) may also

be relevant. The inclusion of this objective acknowledges the importance ensuring that any interference with the Convention rights is in the public interest and proportionate.

### **Balancing the objectives**

**3.16** Neither the Act, nor this Code, ranks the SRR objectives. Under section 4(10) of the Act, the objectives are to be balanced as appropriate in each case. This provision recognises that the relative weighting and balancing of objectives will vary according to the particular circumstances of each failure, including both (a) circumstances specific to the failing institution; and (b) general circumstances relating to the wider financial system.

### **Authorities' regard to objectives**

**3.17** The special resolution objectives in the Act serve two purposes:

- they reflect the purpose of the SRR measures in the Act; and
- they set out the objectives to which the Authorities must have regard when using or considering the use of their powers under the SRR.

**3.18** This means that the Authorities must consider the effect of their likely actions (including inaction) and assess them in light of the objectives. This applies to the exercise of all powers under Parts 1, 2 and 3 of the Act.

**3.19** The sole exception to this requirement relates to a determination made by the FSA, under section 7(2) and (3) of the Act, that an institution is failing or is likely to fail to satisfy the threshold conditions within the meaning of the Financial Services and Markets Act 2000 (FSMA) that that it is not reasonably likely that action will be taken to enable the bank to satisfy those conditions. These decisions will be taken in the context of the FSA's objectives under FSMA.

**3.20** In exercising the powers under Parts 1, 2 and 3, the Authorities will also, as is the case with any public body in the exercise of its functions, necessarily have regard to restrictions and conventions of public law, in particular the requirement for the Authorities to act reasonably and to have respect for the rule of law and principle of legal certainty. The Authorities must also act in accordance with common law principles of procedural fairness when exercising the SRR tools.

**3.21** Following actions taken under the SRR, the Authorities shall make a public statement explaining (a) how they have acted with regard to the special resolution objectives; and (b) how they have balanced the objectives against each other. The form that such an explanation will take will depend on the circumstances.

**3.22** However, it should be noted that it may not be possible to divulge certain information; for example, information the release of which would threaten financial stability or confidence in the banking systems will not be made available by the Authorities in any public statement.



# 4

## Roles of the Authorities

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**4.1** The resolution of failing banking institutions will involve intensive coordination, cooperation and information sharing between the Authorities at each stage of the decision-making process. Each of the Authorities will take lead responsibility for specified aspects of the resolution.

**4.2** As set out in section 7 of the Act, the FSA will be responsible for making the determination that a banking institution is failing (or is likely to fail) to satisfy its threshold conditions, and that it is not reasonably likely that action will be taken by or in respect of the institution that will enable the institution to meet those conditions. The FSA will also be responsible for the authorisation of a bridge bank and ongoing supervision of institutions in the SRR.

**4.3** The Bank of England will be responsible for the operation of the SRR, including the decision on which of the SRR tools to use, and its implementation (with the exception of the power to take an institution into temporary public ownership). The Bank of England will also remain responsible for the provision of liquidity support, which uses the Bank of England's balance sheet.

**4.4** The Treasury will be responsible for decisions with implications for public funds, for ensuring the UK's ongoing compliance with its international obligations, and for matters relating to the wider public interest. The Treasury will also be responsible for the temporary public ownership tool. The Treasury will also exercise a number of the ancillary powers under the SRR (particularly those where Parliamentary scrutiny is required), including the power to modify the law and powers in relation to compensation.

**4.5** The FSCS will also work closely with the Authorities. Under the compensation scheme, triggered in the insolvency procedure, the FSCS has the role of delivering payout to eligible depositors. Further, under section 171 of the Act the FSCS may be a contributor to the cost of the SRR.

**4.6** The FSCS will need to assess and prepare for the payout, and its assessment of the possibilities for payout, or account transfer, will be a relevant factor in the selection of the SRR tool by the Bank of England. For both a depositor payout or account transfer, or for any contribution to SRR costs, information-sharing protocols will be put in place to ensure that the FSCS has access to information relating to the failing institution and its systems at the appropriate time.

**4.7** A revised Memorandum of Understanding between the Authorities will outline how the Authorities will coordinate with each other before and during the resolution of an institution, including through the operation of the Tripartite Standing Committee.



# 5

## General and specific conditions for choosing the SRR tools

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### SRR tools

**5.1** The Act provides the Bank of England and the Treasury with the following stabilisation options for resolving a failing institution:

- in the case of bank or building society, transfer by the Bank of England of the banking institution or some or all of its business to a private sector purchaser;
- in the case of a bank or building society, transfer by the Bank of England of some or all of its business to a bridge bank; and
- in the case of a bank, building society or holding company of a bank, transfer by the Treasury of the institution into temporary public ownership.

**5.2** As set out below, bringing a bank holding company into temporary public ownership is only likely to occur when other options are considered to be inadequate. Temporary public ownership is the only tool that can be used in respect of bank holding companies.

**5.3** Each of the three stabilisation options is achieved through the exercise of one or more of the “stabilisation powers”, which are the powers to effect the transfer of shares and other securities or property, rights and liabilities, by operation of law. These stabilisation powers include the onward and supplemental transfer powers, which are discussed in paragraphs 6.2-6.12 of this Code.

**5.4** The Act also provides the FSA and the Bank of England with the ability to apply to the court for a bank insolvency order to wind up a banking institution in the interests of creditors as a whole, and to facilitate a rapid FSCS payout to eligible depositors or transfer of their accounts to another institution.

**5.5** The Bank of England can also apply for a bank administration order to facilitate the transfer of part of a failing banking institution’s business to a private sector purchaser or bridge bank.

### Determining that the regulatory pre-conditions are satisfied

**5.6** A stabilisation power may be exercised in respect of a banking institution only if the FSA is satisfied that the conditions set out in section 7 of the Act have been met. The first condition is that the FSA determines that the institution is failing, or is likely to fail, to satisfy the threshold conditions.

**5.7** The second condition is that the FSA must also determine that, having regard to timing and other relevant circumstances it is not reasonably likely that (ignoring the stabilisation powers that are available to exercise the stabilisation options) action will be taken by or in respect of the banking institution that would enable it to satisfy the threshold conditions.

**5.8** This determination is a regulatory matter for the FSA, which will be undertaken in line with its existing statutory objectives under FSMA 2000. Before determining whether it is reasonably

likely that action will be taken by or in respect of the institution that will enable it to satisfy the threshold conditions, the FSA must consult the Bank of England and the Treasury.

**5.9** The threshold conditions represent the minimum conditions that a firm is required to satisfy, and continue to satisfy, in order to have permission to undertake regulated activities. In making this determination, the FSA are required to discount financial assistance provided by the Treasury or Bank of England disregarding ordinary market assistance offered by the Bank on its usual terms. The concept of 'ordinary market assistance' contained in section 7(4)(b) does not create a new 'hard-edged' legal definition. The Bank of England provides banks with a spectrum of assistance in all types of different circumstances. Whether or not financial assistance from the Bank of England constitutes "ordinary market assistance... on its usual terms" will depend on a combination of factors, including the terms of the Bank's operation, the circumstances of the bank receiving liquidity from the Bank, and conditions in the relevant markets in which the firm was, or would otherwise be, seeking to access funding. Furthermore, these factors may vary during the period that any assistance is given. The provision does not imply whether a particular facility is, for all banks using it, "ordinary market assistance" or not.

**5.10** The FSA Handbook contains rules and guidance relevant to an authorised firm.<sup>1</sup> In particular, the "COND" sourcebook contains rules and guidance on the threshold conditions. There are a range of conditions, including: legal status and location of offices; the adequacy of the firm's resources (financial and non financial) in relation to the regulated activities which the firm undertakes; and suitability issues (for example competent and prudent management, conducting business with integrity and in compliance with proper standards). The FSA is currently updating its handbook to provide further guidance on its actions under section 7 of the Act.

## **Determining that the specific conditions for exercising the SRR tools are met**

**5.11** Under section 8 of the Act, the Bank of England may only exercise a stabilisation power if satisfied that the exercise of the power is necessary having regard to the public interest in:

- the stability of the financial systems of the United Kingdom;
- the maintenance of public confidence in the stability of the banking systems of the United Kingdom; or
- the protection of depositors.

**5.12** The Bank of England must consult the Treasury and the FSA before making this determination and deciding how to proceed. In determining whether to proceed with the bank insolvency procedure, the Bank of England will also consult with the FSCS.

**5.13** The three public interest conditions may overlap (to a greater or lesser degree) depending on the particular circumstances of the banking institution and the wider circumstances of the financial system as a whole.

**5.14** The test of "necessity" is a high one, and the Bank of England and the Treasury will necessarily have regard to public law restrictions, the Authorities regard to the special resolution objectives and the duty to act compatibly with the Convention rights.

**5.15** The assessment must seek to balance the short and long-term effects on financial stability, public confidence and depositor protection of different resolution options. When considering

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<sup>1</sup> Available in the FSA Handbook. The Threshold Conditions section of the handbook sets out the minimum standards for becoming and remaining authorised (reference code: COND). (<http://fsahandbook.info>)

the need to protect depositors, the Bank of England will take into account not only the implications of losses but also the consequences of lack of continuity of depositor services. While particular importance is attached to the protection of FSCS eligible depositors, at times of heightened systemic risk greater emphasis may be placed on protecting a wider range of depositors of a failing institution. At other times, the preferred option might be to use the bank insolvency procedure to facilitate rapid FSCS payout to eligible depositors, or a transfer of their accounts to another institution.

**5.16** If, having had regard to the public interest test, the Bank of England determines that it is necessary to exercise one of the SRR tools, the Bank of England will need to consider as a practical matter which of the tools it will be possible to use; and further, whether use of the tool would be compatible with the Bank of England's legal obligations and the special resolution objectives.

## The choice between the tools

**5.17** In choosing between the resolution tools, the Bank of England will consider the relative merits of the stabilisation options and the bank insolvency procedure given the circumstances. There are, however, some general considerations that may be taken into account. Some of these are detailed below.

**5.18** Resolution by way of the bank insolvency procedure may be the option that best meets the special resolution objectives where the most appropriate outcome would be the winding up of the failed institution's affairs in the interests of creditors as a whole, and prompt FSCS payouts to eligible depositors or the bulk transfer of their accounts to another institution. It is also generally important for market discipline that firms – including banks and building societies – should not be immune from failure.

**5.19** Resolution by way of a transfer to a private sector purchaser is generally likely to be the resolution option that best meets the special resolution objectives if it can be effected in a cost effective way. It provides the flexibility for both whole-bank and part-bank solutions, and for a swift and certain transfer. It does, however, require a willing purchaser in order for it to be effective.

**5.20** Resolution by way of a transfer to a bridge bank may be appropriate where an immediate private sector sale is not possible, and where a stable platform is needed to prepare for and effect the onward sale of all or part of the bank to a private sector purchaser.

**5.21** Temporary public ownership is generally likely to be the least preferred option, and involves the Treasury taking control and ownership of a failing banking institution through the transfer of shares, in order to provide a stable platform for restructuring. Temporary public ownership may be the most suitable resolution option if, for example, the Treasury has provided a failing institution with a significant amount of public money in order to stabilise it prior to its entry into the SRR. The option may also be exercised where it is necessary to resolve or reduce a serious threat to the stability of the UK's financial systems. This is the only option available in relation to a holding company of a bank.

**5.22** A key determinant of the practicality of implementation will be the amount and quality of information available to the Authorities on the balance sheet and operations of the banking institution and on any interests of third parties.

**5.23** Further issues which the Authorities will need to take into account in determining the feasibility of different tools include:

- the existence of, or likelihood of finding, a private sector purchaser;
- the likely saleability of assets and liabilities of the failing banking institution, including whether a whole institution sale is viable;
- the likely speed of FSCS payout to eligible depositors, and the method by which this would be achieved under the bank insolvency procedure;
- the feasibility of effecting a partial transfer in compliance with the safeguards set out in primary and secondary legislation;
- the operational risks of managing a bridge bank, and the amount of public funding that may be required to keep it operational, including consideration of State Aid issues; and
- the time available to implement a private sector sale, including for due diligence by potential purchasers.

**5.24** Before determining which of the stabilisation options to use, the Bank of England must consult the FSA and the Treasury.

**5.25** If the Treasury notifies the Bank of England that they have provided financial assistance in respect of a banking institution for the purpose of resolving or reducing a serious threat to financial stability, a different public interest condition must be satisfied before the Bank of England can exercise its stabilisation powers. This test is that the exercise of the power is necessary to protect the public interest. The Treasury will lead in judging that this public interest condition is met but the Bank of England will still lead in deciding that an exercise of a particular stabilisation option best protects that public interest.

## **Specific conditions for temporary public ownership**

**5.26** Under section 9, if the Treasury believe that an institution should be taken into temporary public ownership, specific conditions for this tool must be met in addition to the general condition relating to the failure to meet the threshold conditions. The specific condition is that the Treasury must be satisfied that such action is necessary to:

- resolve or reduce a serious threat to the stability of the financial systems of the UK; or
- protect the public interest, where the Treasury have provided financial assistance in respect of the banking institution for the purpose of resolving or reducing a serious threat to the stability of the financial systems of the UK.

**5.27** Temporary public ownership is the only tool that can be used in respect of bank holding companies. There are specific considerations relevant to bank holding companies, which are outlined in paragraphs 5.35-5.41 of this Code.

## **Specific conditions for entering the bank insolvency procedure**

**5.28** Under section 96, an application to the court for a bank insolvency order may be made on one of three grounds:

- that a banking institution is insolvent, i.e. it is unable, or is likely to become unable, to pay its debts;

- that winding up the banking institution would be ‘fair’ (this has the same legal meaning as the phrase “just and equitable” in the Insolvency Act 1986); or
- that winding up the affairs of the banking institution would be fair and in the public interest (Secretary of State only).

**5.29** The general conditions also apply to the bank insolvency procedure. Therefore, before the Bank of England or the FSA makes an application to the court for a bank insolvency order, the FSA must be satisfied that the conditions set out in section 7 of the Act have been met.

## Specific considerations relevant to building societies

**5.30** Under sections 84-88, the stabilisation options can also be applied to building societies.

**5.31** Building societies have different corporate structures to banks. Individuals who have a share account or a mortgage with a building society are members and therefore have certain rights including rights to vote (with some limited exceptions) and receive information.<sup>2</sup> Each member of a building society has one vote, regardless of how much money they have invested or borrowed, or how many accounts they hold. Further, building society shares are not like company shares. Generally, shares in a building society can be withdrawn by investors in line with the society’s rules and terms of issue. So, they are more like deposits. For these reasons, some of the SRR tools need to be tailored to building societies.

**5.32** The private sector purchaser and bridge bank stabilisation options are broadly the same for building societies as they are for banks. However, the temporary public sector ownership stabilisation option for building societies is different to that for banks. This is because, given the ownership structure for building societies, it would not be possible to effect public ownership of a building society through a share transfer.

**5.33** The Act therefore provides the Treasury with the power to take a building society into temporary public ownership through cancelling private membership rights and becoming a member of the society in question either by transferring all deferred shares, such as PIBS (Permanent Interest Bearing Shares, a special type of long-term, interest-bearing investment in a building society) to the Government or by issuing new deferred shares to Government on the building society’s behalf.

**5.34** The effect of taking a building society into temporary public ownership will be that customers lose voting and other membership rights but their savings and mortgages will be unaffected. Under section 86 these “former members” may be given a right to participate in the distribution of any surplus on the winding up of the society, once all creditors and any remaining members of the society had been paid in respect of their liabilities and shares.

## Specific considerations relevant to bank holding companies

**5.35** Under section 82, where it is necessary, the Treasury may bring the holding company of a banking institution into temporary public ownership.

**5.36** A bank holding company may only be taken into temporary public ownership if the FSA is satisfied that a bank in the group satisfies the general conditions set out in section 7. The Treasury must also be satisfied that it is necessary to take action for the purposes specified in the specific conditions for temporary public ownership set out in section 9, to resolve or

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<sup>2</sup> Minors do not have voting rights, and societies can require shareholding members to hold at least £100 in shares to enjoy voting rights. Mortgage holders in subsidiaries of a building society will not have membership rights in the society itself, unless they also have a share account or mortgage directly with the society.

reduce a serious threat to the stability of the financial systems of the UK or to protect the public interest where financial assistance has been provided.

**5.37** In determining whether it is necessary to take action in relation to the holding company, the Treasury will consider whether action in relation to the bank alone would be sufficient for the purposes specified in section 9.

**5.38** Only the Treasury is able to exercise the power to take a bank holding company into temporary public ownership. In taking a decision to exercise the temporary public ownership tool in relation to a holding company, the Treasury will balance the interests of relevant parties against the public interest in resolving the difficulties caused by the failing bank.

**5.39** Although holding company temporary public ownership is an option involving the whole of the holding company, partial transfers of the company's property may be carried out by the Treasury in onwards or other subsequent transfers to private sector purchasers. The limitations on partial property transfers provided for in sections 47, 48 and 60 of the Act, and secondary legislation made under them (and described in Chapter 7 of this Code), will also apply to bank holding companies.

**5.40** The Treasury's legislative powers with respect to non-bank entities within the group are restricted. The full range of onward transfer powers (including the partial transfer powers discussed above) only apply to banks in the group and the holding company itself.

**5.41** It is considered highly unlikely that circumstances would arise under which it would be possible or desirable for the Treasury to take a holding company into public ownership, where that holding company did not have a close connection with the operation of the bank or where the primary activities of the holding company were not closely related to financial services.

## **Announcement of tools**

**5.42** When publicly announcing any action to exercise the stabilisation options or initiate the bank insolvency procedure, the Bank of England will explain the grounds on which it considers that the conditions for the exercise of the tool (set out in section 8 or, for the bank insolvency procedure, section 96) are met.

**5.43** When publicly announcing any action to take a banking institution into temporary public ownership the Treasury will explain the grounds on which it considers that the one of the conditions set out in section 9 (or, in the case of a holding company, the conditions in section 82) are met.

**5.44** It should be noted that it may not be possible to divulge certain information where, for example, its release would threaten financial stability or confidence in the banking systems.

# 6

## Ensuring that resolutions are effective

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**6.1** There are a number of supplementary and ancillary powers that may be needed to ensure that resolutions are effective. This Code provides further information on powers are covered by sections 63-70 (continuity obligations), 26-31 (supplemental, reverse and onward share transfers), 42-46 (supplemental, reverse and onward property transfers) and 75 (power to change law).

### **Bridge Bank and Private Sector Purchaser: Supplemental, reverse and onwands transfers**

**6.2** The Bank of England may make supplemental, reverse or onward transfer instruments in relation to property or securities. Supplemental transfers allow further transfers of property or securities from the original owner to a bridge bank or private sector purchaser. Reverse transfers provide for property to be moved back from a bridge bank to the previous owner, subject to certain restrictions. Onward transfers allow for the bridge bank's property or shares in the bridge bank to be transferred to a private sector purchaser or a Treasury-or Bank of England-owned company. These powers increase the chances of a private-sector solution, reducing the barriers to an onwands sale

**6.3** This may become necessary, for example, if additional details come to light about the nature of the transferred securities, property or business, after the initial transfer, which would effect the saleability of the bridge bank, or the achievement of the SRR objectives more widely. The Bank of England must consult with the Treasury and the FSA before making any of these types of transfer instrument.

**6.4** The general and specific conditions of SRR intervention do not apply to these transfer instruments as they form part of the continuing resolution, and the Authorities will already have determined that the conditions have been met by the failing banking institution on its entry into the SRR.

**6.5** However, these tools can only be used in a manner consistent with the SRR objectives, and the general public law responsibilities governing the action of public bodies. In particular, where these further transfers interfere with property rights, the Bank of England must be satisfied that the action is in the public interest and is proportionate to the public interest aim being pursued.

**6.6** Furthermore, such transfers can only be conducted in accordance with the safeguards for partial property transfers provided for in secondary legislation made under sections 47, 48 and 60 of the Act.

**6.7** These considerations also apply to the Treasury, in its exercise of supplemental, reverse and onwands transfers, as described in the next sections.

### **TPO: Supplemental, reverse and onwands transfers**

**6.8** Where a banking institution has been taken into temporary public ownership, the Treasury may make supplemental and reverse transfers of securities. Supplemental transfers provide for transfers of further classes of securities from the holders of those securities to public ownership.

Reverse transfers provide for property to be moved back from public ownership to the original holders.

**6.9** The Treasury may also effect an onward transfer of the shares or business of a bank in temporary public ownership. These powers increase the chances of a private-sector solution, reducing the barriers to an onwards sale of a bridge bank or a bank in temporary public ownership.

**6.10** These subsequent transfers may become necessary, for example, if additional details come to light about the nature of the transferred securities or business after the initial transfer. As with all other forms of transfer, the Treasury must consult with the Bank of England and the FSA before making the order.

## **Powers in relation to holding companies in temporary public ownership**

**6.11** Under section 82, the Act provides for powers in relation to holding companies in temporary public ownership, similar to those for banks in temporary public ownership. These are limited in important respects. In particular, the Treasury's powers in respect of non-bank entities within the group are limited in that the full range of onward transfer powers only applies to deposit-takers in the group and the holding company itself. The Treasury may:

- make an onwards share transfer or reverse share transfer of the securities issued by the failing bank or another bank within the group;
- make an onward share transfer or reverse share transfer of the securities of the bank holding company; and
- make an onwards property transfer of the property of the bank holding company, a bank or another bank within the group (including property which takes the form of securities, for example shares held in a subsidiary undertaking).

**6.12** However, it is not otherwise possible under the Act for the Treasury to transfer the shares or property of any non-bank subsidiaries within the group. Resolution of these parts of the group (i.e. their return to the private sector) will therefore need to be undertaken via normal commercial routes.

## **Continuity obligations**

**6.13** Where it is necessary to use a stabilisation option in respect of an individual banking institution that forms part of a group of companies, the general continuity obligations will apply.

**6.14** Group companies will be obliged under the continuity obligations to provide services and facilities that the Bank of England or Treasury considers are required to enable the acquirer of the transferred business to operate it effectively. A general continuity obligation will arise following a transfer automatically, by operation of law.

**6.15** In addition, it may be appropriate to impose special continuity obligations. These obligations will be restricted to ensuring that necessary services and facilities continue to be provided to the business transferred.

**6.16** The special obligations provide powers to create, modify or cancel contracts and confer or impose rights and obligations between a transferee and the group companies of a residual bank and the residual bank itself – but only in relation to services and facilities required to operate the banking business effectively. Providers will be due reasonable consideration for any services provided.

**6.17** The Bank of England may only exercise these powers with Treasury consent, and Ministers will assess the broad public interest of the particular situation.

## **Power to change law**

**6.18** Where necessary for the purpose of enabling the powers of Part 1 of the Act to be used effectively, the Treasury may exercise its power under section 75 of the Act to modify legislation. This power may be used in respect of both primary and secondary legislation, and the provisions of common law.

**6.19** The power may only be used to facilitate or in connection with the use of one the stabilisation options. The power may be used in two ways:

- to make a specific amendment to a piece of legislation for the purposes of making the resolution of a specific banking institution effective. Generally, such an amendment would only apply to that banking institution or a related institution (e.g. a group company). It would not generally apply to any other banks, or any other banking institutions; or
- to make an amendment to legislation that is applied to all resolutions or a class of resolutions carried out under the SRR. This would then apply in each resolution where the Bank of England or the Treasury used a stabilisation tool

**6.20** The power can be used retrospectively if this is necessary or desirable for giving effect to the particular exercise of a power under the Act. However in using the power, the Treasury must have regard to the fact that it is in the public interest to avoid retrospection. The Treasury will also necessarily have regard to existing public law restrictions, in particular the requirement on the Treasury to have respect for the rule of law and legal certainty. In addition the Treasury must have regard to the special resolution objectives and act compatibly with the Convention rights. Thus the power could not be used for purposes unconnected with the use of the powers under the Act, for example to change the law for wider public policy objectives.

**6.21** The power cannot be used to amend the Act itself, or any standing secondary legislation made under it. The power can be used in relation to an instrument or order made in the exercise of a stabilisation power, including transfer orders and instruments.

**6.22** In general, exercise of the power to change law will be approved in advance by Parliament under the draft affirmative resolution procedure. Where the Treasury consider it to be necessary to make an order without prior Parliamentary approval, the 28-day procedure will be used. Under this procedure, the order can be made and brought into force immediately but will cease to have effect 28 days later unless approved by both Houses of Parliament.

**6.23** The Banking Liaison Panel has a statutory right to provide advice on use of the power to change law. However, this does not include a right to provide advice on an exercise of this power that is carried out in connection with or to facilitate a particular use (proposed or actual) of a stabilisation power.



# 7

## Partial transfers and safeguards

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### Partial transfers

**7.1** The property transfer powers (sections 33-48) provide the flexibility to transfer just some, but not necessarily all, of the property of a failing institution. The Bank of England (or following temporary public ownership, the Treasury) will exercise the power to effect a partial transfer when they believe that this approach will best meet the special resolution objectives.

**7.2** The most likely use for this power is to transfer the 'good' part of an institution's business to a new entity – either a private sector purchaser or a bridge bank – with a 'residual bank' left behind, containing any assets and liabilities that are not transferred.

**7.3** It is also possible to exercise the power to move 'bad' assets to a bridge bank leaving the residual company solvent.

**7.4** The Authorities recognise the significant potential for partial property transfers to interfere with vital market interests including set-off and netting arrangements and security interests. The Act provides that limits may be placed on the ability of the Bank of England or the Treasury to make partial property transfers. Such limits are set out in secondary legislation, as set out in Chapter 7 of this Code.

### Bank administration procedure

**7.5** Part 3 of the Act provides for a bank administration procedure to be applied following a partial property transfer. This procedure may be required in the event of a partial transfer of a banking institution's business to a bridge bank or private sector purchaser. Where a partial transfer of property takes place, the 'residual bank' (the part left behind) may be insolvent. Despite being insolvent, it may be vital that the residual bank continues to provide services and facilities to the purchaser or bridge bank where these are required to enable the transferred business to be operated effectively. For example, it might be impossible to transfer certain business assets or service contracts as part of the initial arrangements. These items may be vital for the successful operation of the transferred business.

**7.6** Therefore, the Act provides that the Bank of England may make an application to the court for a bank administration order.

**7.7** The bank administration procedure is a new insolvency procedure created to deal with an insolvent residual bank following a partial transfer. It is largely based on existing insolvency provisions, specifically the administration procedure as set out in Schedule B1 to the Insolvency Act 1986. It is designed to ensure that any essential services and facilities that cannot be immediately transferred to a bridge bank or private sector purchaser will continue to be provided, for a period of time.

**7.8** The bank administration procedure imposes on the bank administrator an objective to ensure the supply of essential services and facilities to the transferee. To this end, the bank administrator will have unique statutory objectives: firstly, to provide support to a private sector

purchaser or bridge bank in relation to the transferred business; and secondly to rescue the residual bank as a going concern or wind up its affairs in the best interests of creditors.

**7.9** By obliging the residual bank to continue to provide services to the transferee, the bank administration procedure is intended to increase the likelihood of a successful resolution of a failing banking institution's business.

**7.10** Once the Bank of England considers that it is no longer necessary for the residual bank to continue to provide support services, the procedure will continue in a similar way to an ordinary administration although to keep down costs, maximise returns to creditors, and to protect the interests of creditors by providing for a full-range range of outcomes, some of the existing powers of a liquidator have been built in to the procedure.

## **Safeguards for partial property transfers**

**7.11** Partial property transfers under the Act are subject to restrictions imposed by secondary legislation, to ensure that banking institution creditors and counterparties are adequately protected, thereby mitigating any negative market consequences. These legislative safeguards are intended to continue to allow the flexibility to execute a bank partial transfer where necessary. The Treasury will keep the safeguards under review.

**7.12** The safeguards, which are established in secondary legislation<sup>1</sup> (the safeguard order), are:

- a broad safeguard for set-off and netting arrangements;
- a broad protection for secured liabilities;
- protection for structured finance arrangements (such as covered bonds and securitisations);
- a requirement to establish a compensation scheme which has regard to ensuring that no pre-transfer creditor is "worse off" than they would have been had the institution gone into an insolvency process;
- restrictions on reverse partial transfers, which prevent the Bank of England or the Treasury from transferring certain types of financial contract from the solvent 'newco' back to an insolvent 'resco', in the interests of ensuring those transferred to 'newco' can have confidence in their position;
- protection for default rules of clearing houses and investment exchanges and market contracts, reflecting protections under Part VII of the Companies Act 1989;
- an express bar on action in contravention of Community law;
- prohibition on use of the powers to provide for continuity of intra-group services and facilities in a way which would contravene the key safeguards provided for in the Safeguards Order; and
- targeted protections for termination rights under financial contracts (that are relevant for set-off and netting).

**7.13** Remedies in the event of a breach of a safeguard are set out in the secondary legislation. The Authorities are under a statutory duty to comply with the safeguards, and this duty is unaffected by the existence of such remedies. The remedy provisions exist to provide certainty to the market as to the outcome should the safeguards be inadvertently contravened.

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<sup>1</sup> Available from the Office of Public Sector Information website, in the section covering statutory Instruments (2009) numbers 300 - 399 ([www.opsi.gov.uk](http://www.opsi.gov.uk)).

**7.14** The Authorities consider that the provision of certainty is relevant to achievement of special resolution objectives 1, 2 and 5. And further, the Authorities will necessarily have regard to restrictions and conventions of public law, in particular the requirement on Government of respect for the rule of law and legal certainty.



# 8

## Governance arrangements for bridge banks

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**8.1** Bridge banks are defined in section 12 of the Act.

### Bridge bank objectives

**8.2** A bridge bank is intended to be a short-term operation, until appropriate private sector solutions can be arranged and implemented.

**8.3** To this end, the primary bridge bank objective shall be to facilitate the sale of a bridge bank – in whole or in part – to one or more private sector purchasers.

**8.4** Insofar as the pursuance of that objective is not compromised, the Bank of England shall take steps to manage its relationship with the bridge bank at arm's length. However, an arm's length arrangement may not be appropriate if a bridge bank is only in existence for a short period of time (as is intended and envisaged). Paragraphs 8.11-8.14 of this Code provide further guidance on this point.

**8.5** In some circumstances, it may not be feasible for some or all of a bridge bank's business to be transferred to a private sector purchaser. In these circumstances, the bridge bank will either be wound up, in a manner that meets the special resolution objectives and is in the interests of the remaining creditors of the bridge bank, or taken into temporary public ownership.

**8.6** It should be noted that the bridge bank objectives are subordinate to the special resolution objectives. In situations where there is a conflict between the two sets of objectives, the special resolution objectives take precedence.

### Contents of property transfer instruments

**8.7** Section 33 of the Act describes the provisions that a property transfer instrument may make. There are a number of options for how an instrument may describe which property, rights and liabilities have been transferred. Section 33(2) provides that "a property transfer instrument may relate to– (a) all property, rights and liabilities of the specified bank, (b) all its property, rights and liabilities subject to specified exceptions, (c) specified property, rights or liabilities, or (d) property, rights or liabilities of a specified description."

**8.8** The Bank of England shall take steps to specify appropriately in the given circumstances which property, rights and liabilities of a failing banking institution have been transferred.

**8.9** Once a property transfer instrument is made, the Treasury shall lay a copy in the Houses of Parliament.

### Establishment

**8.10** The Bank of England shall establish or acquire an incorporated company to which property, rights and liabilities will be transferred. The Bank will work with the FSA to arrange appropriate authorisations where necessary to carry on the relevant regulated activities. The company will need to comply with authorisation requirements on an ongoing basis and will be subject to FSA supervision.

## Nature of the shareholder relationship

**8.11** A bridge bank when it is established or acquired will be a company limited by shares that is wholly owned by the Bank of England.

**8.12** The nature of the shareholder relationship with a bridge bank will vary depending on the nature of each resolution and the particular ‘phase’ of the resolution. In broad terms, a bridge bank might go through a number of phases, and the key phases include:

- the stabilisation phase, immediately following the transfer; and
- the sale / purchase phase, where the Bank works with one or more private sector purchaser to transfer the business while managing the bridge bank on a conservative basis.

**8.13** In many cases the purchase phase may immediately follow the stabilisation phase. In these situations, it is likely that arm’s length management may not be appropriate. The Bank would be expected to take an active role in managing the affairs of the bank, first to ensure stabilisation, and second to ensure a successful transaction.

**8.14** However, in situations where there is expected to be a lengthy period of time prior to a sale, the Bank shall put in place an appropriate governance structure. This structure shall be based on the objective of taking steps to manage the relationship with the bridge bank at arm’s length.

**8.15** Arm’s length is defined as leaving the day-to-day management of the bridge bank to its board of directors and keeping shareholder involvement at a strategic level (for example, the Bank shall have an oversight role to ensure that its objectives continue to be met in the face of changing circumstances).

## Articles of association

**8.16** The articles of association of a bridge bank will provide for the company regulations governing the relationship between the Bank of England (in its capacity as shareholder) and the directors of the company. These articles will be based on the model articles prescribed by the Secretary of State for a limited liability company but with such modifications as are necessary or appropriate. Such modifications shall be based on what best meets the bridge bank objectives.

## Directors

**8.17** The Bank of England shall take steps to put in place appropriate arrangements for the management of a bridge bank.

**8.18** As noted above, the nature of the management structure put in place will depend on the particular circumstances of the resolution. Over the period of stabilisation, the management arrangements may involve a relatively small core of directors with appropriate skills and experience. If a bridge bank is, as intended, only in existence for a short period of time, then this arrangement may remain suitable.

**8.19** In circumstances where the bridge bank exists for a longer period of time, the Bank shall take steps to ensure the composition of the board of directors continues to remain appropriate. This may include appointing additional directors. The composition of the board will be decided by the Bank on a case-by-case basis, and having regard to relevant regulation and legislation

**8.20** At any time over the course of the resolution, the bridge bank’s board of directors may or may not include employees of the Bank of England.

**8.21** In addition, board members and senior managers performing key functions will need to be approved persons for the purposes of the FSA's regime, although there may be transitional arrangements in appropriate cases.

## Operating strategy

**8.22** The operating strategy for a bridge bank shall be decided by what best meets the bridge bank objectives. This is likely to involve the bridge bank operating on a conservative basis, to protect the franchise value of the business, and provide continuity of banking services.

**8.23** The Bank of England shall take steps to ensure that the bridge bank meets its regulatory requirements for its relevant regulated activities, including taking necessary steps to comply with relevant FSA requirements.

**8.24** In its role as shareholder, the Bank of England shall work with the board of directors to decide on how the bridge bank should be operated. A business plan will be required for authorisation purposes. Where appropriate, the board shall produce a business plan setting out how the directors intend to operate the bridge bank in a manner pursuant to meeting the objectives. This business plan shall be presented to the Bank of England, who shall ensure that it meets the Bank of England's objectives for the resolution. If a bridge bank exists for only a short amount of time it may be unnecessary to go through this process.

## Reporting

**8.25** Bridge banks are covered by a number of reporting requirements. These are:

- the provision of section 80(1) of the Act (a "bridge bank report");
- the provision of section 80(5) of the Act (a "specific report"); and
- any other reports as agreed between the directors of the bridge bank and the Bank of England.

### Bridge bank report

**8.26** It is envisaged that a bridge bank will typically exist for less than one year: It is intended to be a short-term operation. While a bridge bank report is not required in these circumstances, the Bank of England shall report appropriately about the resolution to the Chancellor.

**8.27** In the event that a bridge bank continues to exist after one year, the Bank of England must report to the Chancellor about the activities of the bridge bank. The first report must be made as soon as is reasonably practicable after the end of one year beginning with the date of the first transfer to the bridge bank. A similar report must also be made as soon as is reasonably practicable after the end of each subsequent year. Such reports shall include:

- an account of the activities of the bridge bank over the year; and
- how the Bank of England is intending to achieve the bridge bank objectives.

**8.28** When compiling the report, the Bank of England may choose to not reveal market-sensitive information.

**8.29** These reports to the Chancellor are supplementary to the reporting arrangements that the Bank of England in its role as shareholder will put in place to ensure it receives appropriate management information from a bridge bank.

## Specific report

**8.30** The contents of specific reports will be determined on a case-by-case basis, dependent on the specific request of the Treasury.

## Other reports

**8.31** In addition to bridge bank reports and specific reports, and the reporting requirements imposed on the bridge bank pursuant to the Companies Act 2006, the Bank of England shall consider, in each case, whether the bridge bank should have regard to any additional reporting requirements to which similar commercial banks may be subject. In addition, the Bank of England shall make arrangements to provide for regulatory reporting appropriate to the activities undertaken by the bridge bank.

## Disposal and onward transfer

**8.32** The primary bridge bank objective is to facilitate the sale of a bridge bank – in whole or in part – to one or more private sector purchasers. It is envisaged that a sale of business should follow as soon as possible after the initial transfer of property to a bridge bank.

**8.33** In each case, the Bank of England shall establish an appropriate mechanism for selecting a preferred purchaser and agreeing on a price for the business of the bridge bank. In its assessment the Bank of England shall take account of the special resolution objectives (section 4 of the Act). It shall also work with the FSA to ensure that the acquiring party is suitable for taking on the bridge bank's business.

**8.34** Following this process, the Bank of England shall complete the transaction. This may be achieved through a standard commercial agreement (for example, a sale of securities, or an asset sale using the Part 7 process of FSMA) or by exercising the onward transfer powers provided in the Act, either by making a bridge bank share transfer instrument (section 28) or an onward property transfer instrument (section 40).

**8.35** In some circumstances it may be appropriate to transfer some or all of a bridge bank's business to a public-sector transferee, either a company wholly owned by the Treasury or an onward bridge bank (defined in section 12). However, this would only occur if it best met the bridge bank objectives.

# 9

## Governance arrangements for institutions in temporary public ownership

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9.1 Temporary public ownership is described in section 13 of the Act.

### Temporary public ownership objectives

9.2 The objectives of an institution in temporary public ownership will reflect the special resolution objectives. Where possible, the intention shall be to return the business of the bank to the private sector in a manner that maintains financial stability and protects depositors and the taxpayer while acting in a way that promotes competition.

### Contents of share transfer orders

9.3 Section 16 of the Act describes the provision a share transfer order may make. A share transfer order may relate to either specified securities or securities of a specified description.

9.4 The Treasury shall take steps to specify appropriately which securities of a failing institution have been transferred.

### The nature of institutions in temporary public ownership

9.5 The securities of a bank in temporary public ownership shall either be held by a nominee of the Treasury (for example, the Treasury Solicitor) or by a company wholly owned by the Treasury.

9.6 Provision will be made as to the relationship between the Treasury (in its capacity as shareholder) and the directors of the company. As shareholder, the Treasury will have the power to exercise normal shareholder rights.

9.7 Immediately following the transfer of securities and for the initial period of stabilisation, the Treasury may take a 'hands on' role in managing the affairs of the bank. However, once stabilised, the Treasury shall seek to introduce corporate governance arrangements in line with best practice, as soon as is reasonably practicable. The nature of these arrangements will depend on how likely the bank is to remain in public ownership. If a bank is likely to remain in public ownership for longer than a short period (to be determined on a case by case basis), the Treasury shall set out for the directors objectives as to how the bank should be operated. Based on these objectives, the board shall produce a business plan setting out how the directors intend to operate the bank.

9.8 The plan may include:

- a commercial strategy;
- a funding plan, including arrangements for repaying any public money that has been provided;
- a risk management strategy; and

- an approach for complying with competition issues, state aid and regulatory requirements.

**9.9** This business plan shall be presented to the Treasury, who shall ensure that it meets the Treasury's objectives for the banking institution.

**9.10** The Treasury shall then take an oversight role to ensure that the plan continues to meet its objectives in the face of changing circumstances.

**9.11** In many cases, it will be appropriate for the Treasury to develop and implement an investment strategy for disposing of the investments in an orderly way.

**9.12** Insofar as the banking institution carries on relevant regulated activities, the FSA shall continue to authorise and regulate it where appropriate.

## **Arm's length management of institutions in temporary public ownership**

**9.13** In circumstances where an institution is likely to remain in public ownership for longer than a short period, the Treasury may seek to put in place arrangements to operate the bank at arm's length, for example through UK Financial Investments Limited (UKFI), which is an arm's length company wholly owned by the Government.<sup>1</sup>

**9.14** In such circumstances, the Treasury may set out objectives for the directors as to how the bank should be operated. It is likely that these objectives would include protecting and creating value with due regard to the special resolution objectives, and maintaining and promoting competition in the banking sector.

## **Disposal of institutions in temporary public ownership**

**9.15** Sale of the institution in temporary public ownership may be carried out through normal commercial means, or existing statutory mechanisms. However, the Treasury may alternatively make an onward share transfer, by order (under section 28), or onward property transfer, by order (under section 45). These may be more expeditious and therefore command more confidence than a transfer through existing commercial or statutory processes. The powers to make such orders provide for swift and effective transfer to a private sector purchaser, maximising the commercial opportunities and minimising risks to the purchaser.

**9.16** Where an institution in temporary public ownership is being managed at arm's length by a separate body, it will be the responsibility of the arm's-length body, with appropriate consultation with the Treasury, to develop and execute an investment strategy for disposing of the investments in an orderly and active way.

## **Reporting**

**9.17** The Treasury shall make arrangements to ensure that a bank in temporary public ownership reports on a similar basis to other commercial banks. This includes regulatory reporting appropriate to the activities undertaken by the bank. In addition section 81 of the Act requires the Chancellor of the Exchequer to report to Parliament on an annual basis about the activities of a bank in temporary public ownership.

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<sup>1</sup> Further information is available from the UKFI website ([www.ukfi.gov.uk](http://www.ukfi.gov.uk))

# 10

## Compensation

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**10.1** Sections 49-62 of the Act make provision for the assessment of any compensation which may be due to those affected by an exercise of the stabilisation options, or where onward and reverse transfers are made. Provision is made for three types of orders, which may be made for the purposes of assessing or providing compensation:

- **compensation scheme orders**, which establish a scheme to determine whether compensation should be paid to transferors;<sup>1</sup> or provide for transferors to be paid compensation, and establish a scheme for this purpose;
- **resolution fund orders**, which establish a scheme under which the transferors become entitled to the proceeds of resolution in specified circumstances, and to a specified extent; and
- **third party compensation orders**, which establish a scheme for paying compensation to third parties (persons who are not transferors), for example counterparties of a bank who suffer compensatable interferences in their property rights as a result of an exercise of the powers under Part 1 of the Act.

### Bank resolution fund and the associated management duty

**10.2** The purpose of a bank resolution fund is to provide the failing bank or its former shareholders, as the case may be, with a contingent economic interest in the proceeds of the resolution of a failing bank. These proceeds may include, for example, the proceeds from the sale of property transferred from a failing bank into a bridge bank.

**10.3** A resolution fund order (under section 49) may make provision establishing who will be entitled to a share of the proceeds, and the manner in which the shares of the proceeds will be calculated.

**10.4** The proceeds may be calculated net of any resolution costs. These could include the costs of financial assistance – including loans or guarantees provided from or backed by public funds or administrative expenses incurred by the Authorities during the course of the resolution. This is to ensure that the taxpayer receives a suitable return for public funds that have been invested or put at risk during the course of the resolution.

**10.5** The Treasury may specify in a resolution fund order that the resolution authority, the Bank of England or the Treasury, is required to maximise the proceeds available for distribution (a “management duty”). However, the management duty must be complied with only in so far as compatible with the pursuit of the special resolution objectives, and the compliance with the Code of Practice under section 5.

**10.6** In determining whether to impose such a management duty, the Treasury will have regard to a number of factors, including the length of time the resolution is likely to take.

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<sup>1</sup> For example, the former shareholders of a bank where the securities transfer powers are exercised, or a failing bank where the property transfer powers are exercised.

**10.7** The resolution fund order may also include provision for the determination of any disputes about the application of its provisions.

## Independent valuer

**10.8** A compensation scheme order may provide for an independent valuer to be appointed to determine the amount of compensation, if any, due to those persons affected by an exercise of the stabilisation options. Alternatively, a compensation scheme order may provide for transferors (i.e. the former shareholders in the case of a share transfer, or the failing bank in the case of a property transfer) to be paid compensation. This may be achieved by the deeming of the amount paid by a private sector purchaser for the property of a bank to be the compensation due to the transferors.

**10.9** A person appointed to determine the amount of compensation, if any, payable under a compensation scheme order or a third party compensation order must be independent and impartial. Sections 54-56 make extensive provision for providing for and safeguarding the independence and impartiality of the valuer. For example:

- the valuer must be appointed by a person appointed by the Treasury; and
- an independent monitor must be appointed to oversee the arrangements for the remuneration and allowances of the valuer.

**10.10** The Act provides that in conducting his or her valuation exercise, the independent valuer must:

- disregard actual or potential financial assistance provided by the Bank of England or the Treasury (other than ordinary market assistance offered by the Bank on its usual terms), and
- have regard to any valuation principles specified by the Treasury in the compensation scheme order.

## Appointment of the valuer and criteria for independence

**10.11** The Treasury is required to appoint a person to appoint the independent valuer. It is possible that the Treasury might appoint more than one person for this function, in order to form an appointment panel. The appointing person or panel will appoint the valuer through a competitive and fair process. The following criteria will be relevant for an applicant to be considered for appointment as valuer:

- **Demonstrable independence** from Government and interested parties; and
- **Freedom from conflicts of interest:** potential candidates may be ruled out because of actual or potential conflicts of interest.

**10.12** In considering which person to appoint, the following additional criteria will be relevant:

- 1 **Professional skills and experience:** the primary qualification for the valuer is that he or she must have extensive professional financial company valuation skills. The valuer is likely to need to draw on a range of professional expertise, notably accountancy, investment banking and legal expertise in performing the function of valuation

- 2 **Experience and ability to carry out a high profile public process:** in addition to being able to carry out the professional task of assessing any compensation, the valuer will need to have the capacity, resources, and robustness to –
  - a. manage a high-profile, potentially multi-stage, public process; and
  - b. explain his or her assessment to a range of different audiences (for example, affected individuals, corporate stakeholder, or potentially a tribunal or court in the event of a legal challenge) in writing, in person and through professional intermediaries such as lawyers if necessary.
- 3 **Track record of timely delivery:** applicants will need to demonstrate by reference to an existing track record that they will be adequately resourced and capable of discharging the function of independent valuer in a timely and efficient manner in the absence of conventional contract performance management by a client.
- 4 **Value for money** is also an important criterion against which candidates will be assessed.

## Valuer's remuneration and role of the monitor

**10.13** Under section 56, the Treasury shall pay the remuneration and expenses of the independent valuer.

**10.14** The Treasury will put in place a monitor to oversee the remuneration and any allowances for the independent valuer, including his or her pension arrangements. As part of this role, the monitor may be required to approve certain actions or to authorise certain expenditures. The Treasury will remunerate and reimburse the expenses of the monitor.

## Valuation principles

**10.15** The Treasury may establish principles for the conduct of the valuation in addition to the mandatory valuation assumption. For example, the Treasury could:

- specify certain methods or matters to be taken into account; and
- require certain assumptions to be made as to the status of the bank had it not entered the SRR.



# A

## List of abbreviations

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|                           |   |
|---------------------------|---|
| the Act                   | the Banking Act 2009  |
| the Authorities           | the Financial Service Authority, the Bank of England and the Treasury   |
| the Code                  | the Banking Act 2009 special resolution regime Code of Practice   |
| Convention Right          | a right under the European Convention of Human Rights, within the meaning of the Human Rights Act 1998.             |
| FSA                       | Financial Service Authority   |
| FSCS                      | Financial Services Compensation Scheme  |
| FSMA                      | Financial Services and Markets Act 2000   |
| PIBS                      | Permanent Interest Bearing Shares   |
| SRR                       | special resolution regime   |
| the stabilisation options | transfer to a private sector purchaser, transfer to a bridge bank and transfer to temporary public sector ownership |
| UKFI                      | UK Financial Investments Limited  |



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