

**EXPLANATORY MEMORANDUM TO  
THE BUILDING SOCIETIES (INSOLVENCY AND SPECIAL ADMINISTRATION)  
ORDER**

**2009 No. 805**

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

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

2. **Purpose of the instrument**

- 2.1 The instrument exercises the powers in sections 130 and 158 of the Banking Act 2009 ("the Act") to apply Parts 2 and 3 of the Act to Building Societies.

- 2.2 Part 2 of the Act (Bank Insolvency) creates a new insolvency procedure to facilitate the prompt payment, in a bank insolvency, of depositors who are eligible claimants under the Financial Services Compensation Scheme. Part 3 of the Act (Bank Administration) creates a new administration procedure for banks in certain cases. This Order applies the procedures in these Parts to building societies. In doing so it makes certain amendments to the Building Societies Act 1986.

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

- 3.1 The instrument is the first use of the powers of Her Majesty's Treasury in sections 130 and 158 of the Act to apply Parts 2 and 3 of the Act to building societies.

- 3.2 Accordingly, this Order has been made by the Treasury and laid before Parliament under sections 259(4) to (6) of the Act, for approval by resolution of each House of Parliament during the period of 28 days (ignoring periods of dissolution, prorogation or adjournment of either House for more than 4 days) beginning with the day on which the Regulations are made.

- 3.3 The Treasury are satisfied that it is necessary to exercise these powers without laying a draft of the Order for approval.

- 3.4 The provisions in Part 1 of the Act (the special resolution regime) confer powers on the Authorities (the Bank of England and the Treasury) to resolve banks and building societies in difficulties. These powers came into force on 21<sup>st</sup> February 2009 and are intended to replace the powers in sections 3 and 6 of the Banking (Special Provisions) Act 2008 (c. 2), which are subject to a sunset clause and largely ceased to be exercisable on 20<sup>th</sup> February 2009. Parts 2 and 3 of the Act are also necessary, to give the Authorities the options of using Bank Insolvency or Bank Administration in relation to a failing

institution. However, Parts 2 and 3 do not apply directly to building societies: instead the Treasury has a power to apply them to building societies using secondary legislation.

- 3.5 This Order has been made without laying a draft for approval as the Treasury consider it necessary to have Part 3 in place for building societies so that building society special administration is available in relation to the Dunfermline Building Society.
- 3.6 While Part 2 of the Act is not being used in relation to the Dunfermline Building Society the Government considers it prudent at this time to have all Banking Act options available in relation to building societies. Further, it would otherwise require a second use of the power to apply Part 2 which would require the draft affirmative procedure.

#### **4. Legislative Context**

- 4.1 Parts 2 and 3 of the Act introduce two new insolvency procedures for banks. Both are based on existing insolvency processes under the Insolvency Act 1986.
- 4.2 The bank insolvency procedure set out in Part 2 of the Act is based on the process of liquidation in Part 4 of the Insolvency Act 1986 with modifications where required to facilitate the achievement of the unique objectives of the procedure. Bank insolvency may only be commenced by the court on an application made by the Bank of England, the Financial Services Authority or the Secretary of State. Where a bank insolvency order is made, an insolvency practitioner will be appointed as the bank liquidator. The bank liquidator will have two objectives; the first is to work with the Financial Services Compensation Scheme (FSCS) to ensure that either prompt compensation payouts can be made by the FSCS, or that the accounts of eligible depositors are transferred to another financial institution. The bank liquidator's second objective is to wind up the failed bank in the best interests of its creditors as a whole.
- 4.3 The bank administration procedure set out in Part 3 of the Act is distinct from the bank insolvency procedure and can only be used in conjunction with the property transfer resolution tool set out in Part 1 of the Act.
- 4.4 Part 3 of the Act provides that where the Bank of England makes, or intends to make, a partial sale or transfer to a commercial purchaser or bridge bank under the powers in Part 1 of that Act, the residual bank may be placed into bank administration. This procedure is based on the administration procedure set out in Schedule B1 to the Insolvency Act 1986 with modifications where required to enable the unique objectives of a bank administration to be achieved.
- 4.5 Only the Bank of England may apply to the court for the making of a bank administration order. Where such an order is made, an insolvency practitioner will be appointed as the bank administrator. The objectives of the bank

administrator are to provide support services or facilities to a commercial purchaser or bridge bank (so to allow the transferred part to operate successfully) (objective 1) and to administer the residual bank in such a way to achieve the best result for creditors (objective 2).

- 4.6 A full explanation of bank insolvency and bank administration is given in the Explanatory Notes to the Banking Act 2009 and in the code of practice made under section 5 of the Act<sup>1</sup>.
- 4.7 This Order applies the bank insolvency and administration procedures to building societies, with a number of modifications, including the following:
  - 4.7.1 the procedures as applied to building societies are termed “building society insolvency” and “building society special administration”;
  - 4.7.2 the Secretary of State cannot make an application for building society insolvency, because the Financial Services Authority, not the Secretary of State, fulfils the role of registrar in relation to building societies;
  - 4.7.3 various modifications to Parts 2 and 3 of the Banking Act and the Insolvency Act 1986 (as applied by Parts 2 and 3), to reflect the different legislative regime that applies to building societies and the role of the FSA as registrar;
  - 4.7.4 modifications to Part 3 to reflect the status of members in a building society, in particular that the building society special administrator may make a distribution to shareholding members as well as to creditors in the objective 2 stage, although shareholding members are not able to vote on the administrator’s proposals;
  - 4.7.5 other modifications replicate the modifications to the Insolvency Act 1986 made in Schedules 15 and 15A to the Building Societies Act 1986 (which apply “normal” winding up and administration law to building societies).
- 4.8 “Normal” winding up and administration remain a possibility for building societies. The Order amends Part 10 of the Building Societies Act 1986 (which deals with winding up and dissolution) and makes consequential amendments to other provisions. In particular, any person commencing proceedings for administration or compulsory winding up, or a society wishing to commence voluntary winding up, must first notify the FSA (new section 90D). This and other changes to the Building Societies Act 1986 are equivalent to certain provisions in Parts 2 and 3 of the Banking Act 2009. The Treasury consider it appropriate to make some of the changes as textual amendments to the Building Societies Act 1986 so that where other insolvency procedures are affected all the relevant law is in one place.
- 4.9 The Order is being made because during the consultation process the Government made a commitment to applying the Special Resolution Regime and the Bank Insolvency and Administration Procedures to Building Societies, on the basis that they should be treated in the same way as banks and have the

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<sup>1</sup>The explanatory notes may be accessed at <http://www.opsi.gov.uk/acts/acts2009a>. The code of practice may be accessed at [http://www.hm-treasury.gov.uk/bankingact09\\_codeofpractice.htm](http://www.hm-treasury.gov.uk/bankingact09_codeofpractice.htm).

same insolvency procedures available. This proposal was supported by stakeholders.

- 4.10 The Government will make insolvency rules in relation to building society insolvency and building society special administration. These will be equivalent to the Bank Insolvency and Bank Administration rules already in place. There will be separate rules for England and Wales, Scotland, and Northern Ireland.
- 4.11 The Building Society Special Administration (Scotland) Rules 2009 were made immediately after this Order, to ensure that building society special administration is available in relation to the Dunfermline Building Society. The Act of Sederunt (Rules of the Court of Session Amendment No. 6) (Building Society Special Administration etc.) 2009 was also made on 29<sup>th</sup> March 2009, amending the rules of the Court of Session in connection with building society special administration in Scotland. Further Building Society Insolvency and Special Administration Rules will be made in due course, to cover the rest of the United Kingdom.

## **5. Territorial Extent and Application**

- 5.1 This instrument applies to all of the United Kingdom.

## **6. European Convention on Human Rights**

- 6.1 The Chancellor of the Exchequer, Alistair Darling, has made the following statement regarding Human Rights:

“In my view the provisions of the Building Societies (Insolvency and Special Administration) Order 2009 are compatible with the Convention rights”.

## **7. Policy background**

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

## **8. Consultation outcome**

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<sup>2</sup> These consultation documents may be accessed at:  
[http://www.hm-treasury.gov.uk/bankingact09\\_consultation.htm](http://www.hm-treasury.gov.uk/bankingact09_consultation.htm).

8.1 The measures in Parts 2 and 3 of the Act were subject to a number of consultations, including on the specific question of whether they should apply to building societies and as stated above there was broad support for this principle. While this Order has been made on an expedited basis to assist with effective resolution of a specific institution, the Government has committed to consulting on application of Parts 2 and 3 to building societies, and will do so as soon as possible. This will ensure that interested parties can consider in detail how the bank insolvency procedure and bank administration procedure should apply to building societies. Following the results of that consultation the Government will consider whether to make any changes to this Order; any changes will be put to Parliament for approval under the draft affirmative procedure.

## **9. Guidance**

9.1 The Treasury does not propose to issue specific guidance in relation to this Order. However, under section 5 of the Act (code of practice), the Treasury is obliged to issue a code of practice about the use of the stabilisation powers, the bank insolvency procedure and the bank administration procedure. The Treasury is currently revising this code, in consultation with stakeholders and will consider whether any further guidance on the application of Parts 2 and 3 to building societies is appropriate.

## **10. Impact**

10.1 An Impact Assessment was provided for the consultation on financial stability and depositor protection (published in July 2008) and for the Banking Bill (published October 2008)<sup>3</sup>, which included the powers to make the secondary legislation put forward today.

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

## **11. Regulating small business**

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

## **12. Monitoring & review**

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

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<sup>3</sup> The consultation may be accessed at: [http://www.hm-treasury.gov.uk/financial\\_stability\\_depositor.htm](http://www.hm-treasury.gov.uk/financial_stability_depositor.htm). The impact assessment on the Banking Bill may be accessed at: [http://www.hm-treasury.gov.uk/fin\\_banking\\_act2009.htm](http://www.hm-treasury.gov.uk/fin_banking_act2009.htm).

will keep this Order under review and, where appropriate, provide advice to the Treasury about this Order.

### **13. Contact**

Lucy French, Financial Stability and Banking Reform Team, HM Treasury, Tel: 020 7270 4479 or email: [lucy.french@hm-treasury.x.gsi.gov.uk](mailto:lucy.french@hm-treasury.x.gsi.gov.uk); HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ. Also contactable through the Treasury Switchboard at HM Treasury Tel: 020 7270 4558 or email: [public.enquiries@hm-treasury.gsi.gov.uk](mailto:public.enquiries@hm-treasury.gsi.gov.uk).