

EXPLANATORY MEMORANDUM TO
THE FINANCIAL SERVICES AND MARKETS ACT 2000 (CONTRIBUTION TO
COSTS OF SPECIAL RESOLUTION REGIME) REGULATIONS 2009

2009 No. 807

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 under section 214B to the Financial Services and Markets Act 2000 ("the 2000 Act"), (inserted by section 171 of the Banking Act 2009 ("the 2009 Act")), and under section 428 which makes incidental, supplemental and consequential provision for statutory instruments made under the 2000 Act.

- 2.2 The purpose of the instrument is to allow the Treasury to call upon Financial Services Compensation Scheme (FSCS) funds to contribute to costs associated with the exercise of a stabilisation power.

- 2.3 The instrument also provides for any safeguards for the use of these powers, namely a cap on the amount that FSCS can contribute to, independent verification of resolution costs that the FSCS will contribute to and independent valuation of what the FSCS would have received in terms of recoveries had a stabilisation option under Part 1 of the 2009 Act not been used.

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 under section 171 of the 2009 Act to make regulations under section 214B of the 2000 Act.

- 3.2 Accordingly, these Regulations have been made by the Treasury and laid before Parliament under sections 259(4) to (6) of the 2009 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 this power without laying a draft of the Regulations for approval.

- 3.4 The provisions in Parts 1, 2 and 3 of the 2009 Act (the special resolution regime (SRR)) confer powers on the relevant Authorities (the Bank of England and the Treasury) to resolve banks ("bank" is defined in section 2 of the Act). The powers under Part 1 of the Act also apply to building societies (defined under section 119 of the Building Societies Act 1986) by virtue of sections 84 to 87 of the 2009 Act. These powers came into force on 21st February 2009 and are intended to replace the powers

under sections 3 and 6 of the Banking (Special Provisions) Act 2008 (c. 2), which are subject to a sunset clause and largely cease to be exercisable on 20th February 2009.

3.5 An order made under sections 130, 158 and 259(1) of the 2009 Act is being laid concurrently with these Regulations. This order applies the provisions in Parts 2 and 3 of the 2009 Act to building societies.

3.6 Following action to the Dunfermline Building Society, these Regulations have been drawn up to allow FSCS funding to be provided to facilitate the stabilisation options. These Regulations therefore facilitate the Authorities' use of these powers, enabling them to meet the SRR objectives with regard to the Dunfermline Building Society.

3.7 The Regulations are standing regulations and are not specific to the Dunfermline Building Society. However, a permanent replacement for these Regulations will be consulted upon before the Summer Recess.

4. Legislative Context

4.1 The regulations are made under section 214B of the 2000 Act (inserted by section 171 of the 2009 Act.) Section 214B allows the Treasury to make regulations to require the FSCS to contribute to costs incurred in connection with the exercise of a stabilisation power in respect of a banking institution under Part 1 of the 2009 Act. A "banking institution" for the purposes of the Regulations means either a deposit-taking bank, a building society or a credit union.

4.2 Under the regulations, where the Treasury have made or intends to exercise a stabilisation power in respect of the banking institution, the Treasury will send a notification to the FSCS setting out the scheme's liability. The notification will also set out when the FSCS should make payment, which can be immediately after the exercise of the stabilisation tool, at the end of the resolution or at other points in the course of the resolution as the Treasury think fit.

4.3 The FSCS cannot pay out more than it would if the banking institution were to go into default and it were to have to meet the claims of depositors eligible for compensation under Part 15 of the 2000 Act. On receipt of the notification, the FSCS will therefore ascertain this limit. The FSCS's liability is also reduced by the amount that it, having paid out the claims of depositors, would have been expected to recover in the insolvency of the banking institution. An independent valuer is to be appointed to calculate this hypothetical cost.

4.4 The notification can be revised from time to time until the Treasury determine that no further revisions need to be made. The Treasury will then arrange for the total liability of the scheme to be audited and then will issue a final notification setting out the payments due from the FSCS. If the FSCS has already made payments towards its liability, the Treasury will reimburse the FSCS for any amounts paid in excess of the FSCS's limit together with interest.

4.5 The regulations also contain an appeals procedure for disputes arising. The independent valuer's determination may also be appealed.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom

6. European Convention on Human Rights

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

“In my view the provisions of the Financial Services and Markets Act 2000 (Contribution to Costs of Special Resolution Regime) Regulations 2009 are compatible with the Convention rights”.

7. Policy background

7.1 In January and July 2008 the Government consulted on the FSCS contributing to the costs of the special resolution regime (SRR). The main rationale for this measure was two-fold: first where intervention is necessary to prevent the cost to the wider economy of the failure of a bank, there is a strong argument for banks to contribute to that cost. Banks, and the financial services sector more widely, benefit directly from the achievement of the SRR objectives in particular, the objective of enhanced financial stability and confidence in the banking system. Therefore it is entirely appropriate that the sector should contribute to measures that achieve these objectives.

7.2 Secondly, the nature of the trigger for entry into the SRR (as set out in section 7 of the 2009 Act) – is that the firm is failing to meet, or is likely to fail to meet its threshold conditions, and that it is not reasonably likely that action will be taken by or in respect of the firm that would enable it to meet its threshold conditions. This would, in all conceivable circumstances, lead otherwise to a payout under the FSCS. Therefore, but for the use of a resolution tool, the financial services sector would have to fund (through the FSCS) the cost of compensation to depositors arising as a result of the failure of a deposit-taker. Therefore it is entirely appropriate that the Treasury may provide that the banks should contribute to the costs arising from an exercise of the SRR stabilisation tools, which are designed to address a failing bank or building society.

7.3 On this basis, the 2009 Act includes powers for the FSCS to contribute to the SRR. Given stakeholders’ concerns about the use of these funds, a number of safeguards have been put in place in the Act and in the secondary legislation. First, the FSCS will only contribute up to the limit of what it would have paid out had the banking institution gone into default without a resolution tool being used (this limit takes into account any recovery the FSCS is likely to have made from the estate); second, if the FSCS does pay out to any depositors then it should not be called upon to contribute to the costs of any other resolution tools for the same bank or building society; and finally, there will be independent verification of the nature and amount of the expenses occurred, which will be subject to appeal mechanisms.

7.4 The Government committed to consulting further on the resolution costs that the FSCS will fund. These Regulations have been made on an emergency basis given the resolution of the Dunfermline Building Society. However, the Government is still committed to consulting upon permanent secondary legislation, which will replace these Regulations.

8. Consultation outcome

8.1 The enabling power to require the FSCS to contribute to the SRR was consulted upon. Some consultees were concerned about the use of FSCS funds in this manner, but agreed with the safeguards provided. Notwithstanding these concerns, the Government believed that it was important to include in the 2009 Act the power to use FSCS funds in this manner, for the reasons given above.

8.2 These Regulations have been made on an emergency basis: the Government has given a commitment to consult on these Regulations and will make any amendments or a replacement set of Regulations following the conclusion of that consultation.

9. Guidance

9.1 The Treasury do not propose to issue specific guidance in relation to this Order. However, under section 5 of the 2009 Act (Code of practice), the Treasury are obliged to issue a code of practice about the use of the stabilisation powers, the bank insolvency procedure and the bank administration procedure. The code of practice was laid before Parliament on 23 February 2009. The Treasury are currently reviewing this code in consultation with stakeholders and will consider whether any further guidance on this Order is appropriate.

10. Impact

10.1 Impact Assessments were provided for the consultation on the Government's proposals for banking reform, published in July 2008 and for the Act (published October 2008). These included assessments of the impact of the power to require the FSCS to contribute to the costs of an SRR and of the powers to make the secondary legislation put forward today.

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

11. Regulating small business

11.1 These Regulations provide for the FSCS to contribute to the resolution of a failed building society or bank. The FSCS is funded by levies collected from financial services firms. Concerns have been raised by stakeholders about the impact on smaller deposit-taking firms of levies that were imposed to finance the FSCS contributions to the costs of bank resolutions in 2008 (which were done under the Banking (Special Provisions) Act 2008). In response to this concern, these Regulations have been drafted to provide greater flexibility in the timing of the contributions that the FSCS could be required to make to future resolutions. This means therefore that there can be greater flexibility in the timing of levies to fund those contributions.

12. Monitoring & review

12.1 The 2009 Act requires the Treasury to make arrangements for a panel to advise the Treasury about the effect of the SRR on banks, persons with which banks do business and the financial markets (section 10 of the 2009 Act (Banking Liaison Panel)).

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; 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.