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BANK RESOLUTION

Key Issues and Local Perspectives

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IX. UNITED KINGDOM

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1. Introduction

This chapter addresses the bank resolution regime of the United Kingdom (the "UK"). In particular, it provides an overview of the UK regime and its key features (section 2) before considering a number of issues in more detail, including resolution planning (section 3), stabilisation options (section 4), and modified insolvency procedures (section 5). The chapter then includes a number of case studies (section 6). It concludes by summarising the current planning that is being undertaken by the UK for its resolution regime after Brexit (section 7). The chapter is not intended to provide a summary of the resolution regime of the European Union (the "EU") overall, which can be found in chapter V of this book.

2. The bank resolution regime

2.1 Overview

The UK has a highly developed bank resolution regime which has yet to be tested by a major bank failure. It possesses special resolution tools under the Banking Act 2009 (the "Act"), which have only been used twice: once in relation to Dunfermline Building Society in March 2009; and once in relation to Southsea Mortgage and Investment Company Limited in June 2011. The UK's special administration regime, which includes a form of insolvency proceeding, has also been used on a small number of occasions. See the case studies in section 6 below.

The UK has primarily implemented the Bank Recovery and Resolution Directive (the "BRRD")[1] via the Act,[2] as amended by the Financial Services Act 2012 and the Bank Recovery and Resolution Order 2016. It applies to banks, building societies and certain investment firms incorporated in the UK, including the UK subsidiaries of foreign firms. The BRRD is fully implemented in UK law, but it has not been transposed word for word. There are therefore a number of differences between the general EU approach and the UK's approach. These include differences in the resolution objectives (the UK has seven resolution objectives rather than five) and differences in terminology (for example, the UK refers to the "private sector purchaser" tool rather than the "sale of business" tool, and the "bridge bank" tool rather than the "bridge institution" tool). It has also been suggested that there are substantive differences between the BRRD and the UK's mechanisms for ensuring that no shareholder or creditor is worse off in a bank resolution than they would be in ordinary insolvency proceedings (an issue discussed in section 4.8 below).

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1 Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms [2014] OJ L173/190.

2 The Act itself builds on the foundation of the Banking (Special Provisions) Act 2008.

The UK's resolution authority is its central bank, the Bank of England (the "Bank").[3] The Bank has been at the forefront of international cooperation on bank resolution and recovery. As the Independent Evaluation Office (the "IEO") of the Bank said in its June 2018 report, *Evaluation of the Bank of England's Resolution Arrangements* (the "IEO Report"):

> "The Bank has been instrumental in spearheading international efforts on developing policy on resolvability, where it is widely acknowledged as an intellectual leader. It is also among the forefront of its international peers in terms of implementing the domestic resolution framework, and has been praised for the external communication of its approach."[4]

HM Treasury (the "Treasury") has published a statutory code of practice which sets out its policy on the use of the special resolution regime.[5] Further detailed guidance is contained the Bank's October 2017 publication titled *The Bank of England's Approach to Resolution*, which is known as the Purple Book.[6] The Purple Book is seen by many in the industry as "setting the benchmark internationally".[7]

The Bank has made a commitment to Parliament to achieve a fully operational resolution framework in respect of major UK banks by 2022.[8] The last major step in completing that project is the implementation of the Resolvability Assessment Framework package, which was published on 30 July 2019 following a consultation that closed on 5 April 2019; see further section 3 below.

2.2 Special resolution objectives

The Act implements the BRRD's strategy of ending *too big to fail* and providing mechanisms for orderly bank failure. It does so via the following seven *special resolution objectives*, which expand on the five objectives in article 31(2) of the BRRD.

Objective 1 is to ensure the continuity of banking services in the UK and of critical functions.

Objective 2 is to protect and enhance the stability of the financial system of the UK, including in particular by:

(a) preventing contagion (including contagion to market infrastructures such as investment exchanges, clearing houses, recognised central securities depositories and central counterparties); and

(b) maintaining market discipline.

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3 See https://www.bankofengland.co.uk/financial-stability/resolution.

4 IEO Report, 3.

5 Available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/602948/Special-Resolution-Regime-Code-of-Practice.pdf.

6 Available at: https://www.bankofengland.co.uk/-/media/boe/files/news/2017/october/the-bank-of-england-approach-to-resolution.

7 See IEO Report, 13, box 2.

8 Bank of England, *The Bank of England's Response to the Treasury Committee's Enquiry into Capital* (2017), available at: http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/treasury-committee/capital-andresolution/written/69208.html.

Objective 3 is to protect and enhance public confidence in the stability of the financial system of the UK.

Objective 4 is to protect public funds, including by minimising reliance on extraordinary public financial support.

Objective 5 is to protect:

(a) investors to the extent that they have investments covered by an investor compensation scheme; and

(b) depositors to the extent that they have deposits covered by the Financial Services Compensation Scheme (the "FSCS") or another deposit guarantee scheme.[9]

Objective 6, which applies in any case in which client assets may be affected, is to protect those assets.

Objective 7 is to avoid interfering with property rights in contravention of a Convention right (within the meaning of the Human Rights Act 1998).[10]

The UK's objectives 3 and 7 are not found in article 31 of the BRRD, but they do reflect the recitals to the BRRD.[11] There is no hierarchy among the special resolution measures, which must be balanced as appropriate.[12]

2.3 The structure of the bank resolution regime

The Treasury, the Bank, the Prudential Regulation Authority (the "PRA"), the Financial Conduct Authority (the "FCA") and the FSCS each play a role in the UK's resolution regime.

Under the BRRD, the resolution function of the relevant authority must be kept operationally separate from its supervisory and other functions.[13] Unlike some jurisdictions which have chosen to entrust those functions to separate institutions, the UK has kept both within the Bank. The supervisory body is the PRA. The resolution function is performed by the UK's Resolution Directorate (the "Directorate"), which is part of the Bank's Deputy Governorship for Financial Stability.[14] The Directorate employed only 50 staff in June 2018. Its small size is to prevent it assuming a secondary supervisory function, and to give it a single voice.[15] On the other hand, the IEO Report suggested in June 2018 that the Bank may need to be able to expand the Directorate using other Bank employees in times of crisis.[16]

9 The FSCS is the UK's deposit guarantee scheme, which meets the requirements of the Deposit Guarantee Scheme Directive (Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes (recast) [2014] OJ L173/149).

10 Banking Act 2009, s 4(3) to (9).

11 See in particular recitals 50 and 53.

12 Banking Act 2009, s 4(10).

13 BRRD, art 3.

14 IEO Report, 7.

15 ibid, 7.

16 ibid, 22.

The tools potentially available for use in a resolution can be broken down as follows:

(1) the stabilisation options (Part 1 of the Act);

(2) the Bank (or Building Society) Insolvency Procedure (Part 2 of the Act); and

(3) the Bank (or Building Society) Administration Procedure (Part 3 of the Act).

The Treasury, the Bank, the PRA and the FCA are each required to have regard to the special resolution objectives in using or considering the use of any of the above tools.[17]

3. Resolution planning and the resolvability assessment framework

The Bank develops a resolution plan for each UK firm and group, based on a preferred resolution strategy which follows one of three broad resolution strategies: *bail-in, partial transfer* or *insolvency*.[18] See further sections 4 and 5 below. Banks are required to undertake contingency planning for resolution. In order to ensure that resolution plans can be effective, the Bank undertakes an annual resolvability assessment (in consultation with the PRA or FCA) for each firm to identify any barriers to resolvability, such as loss-absorbing capacity and cross-border cooperation issues.[19]

The PRA undertakes continual and bespoke supervision of firms' health.[20] Since 2014 the Bank has also run concurrent stress tests (to inform wider policy). These are now annual for the UK's largest banks and building societies. Other firms must carry out their own stress testing according to annual PRA guidance.[21] Firms under stress may be put on a FCA/PRA watchlist.[22] The PRA will assess a firm's proximity to failure using the PRA's Proactive Intervention Framework (the "PIF"), which assesses firms in five categories, called *stages*, ranging from *low risk to viability of firm* to *firm in resolution or being actively wound up*.[23] A higher PIF stage will usually mean the Bank intensifies its contingency planning for resolution, informed by its own watchlist.[24]

As noted in section 2.1 above, the Resolvability Assessment Framework was published on 30 July 2019. It is designed to increase transparency over the resolvability of firms where the preferred resolution strategy is bail-in or partial transfer. The Resolvability Assessment Framework has three main elements:

(1) The Bank will assess resolvability in accordance with a Policy Statement, which sets out the outcomes the Bank considers necessary to support resolution.[25] The key requirements are as follows:[26]

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17 Banking Act 2009, s 4(2).

18 Purple Book, 27, para 3.2.

19 ibid, 27, para 3.7.

20 See PRA, *The Prudential Regulation Authority's Approach to Banking Supervision* (2018) 28-40, available at: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/approach/banking-approach-2018.pdf.

21 See https://www.bankofengland.co.uk/stress-testing.

22 Purple Book, 31, para 3.27.

23 ibid, 31, para 3.28 and fig 7.

24 ibid, 31, para 3.30.

25 Bank of England, *The Bank of England's Approach to Assessing Resolvability* (2019). The Bank has also published the following Policy Statements (each in 2019): (a) *Funding in Resolution*, (b) *Continuity of Access to Financial Market Infrastructure*, (c) *Restructuring Planning*, and (d) *Management, Governance and Communication*.

26 Bank of England, *Approach to Assessing Resolvability* (note 25) 5, para 1.14.

(a) Firms must have adequate financial resources in the context of resolution. They must therefore:

(i) meet the minimum requirement for own funds and eligible liabilities, appropriately distributed across their business;

(ii) be able to support a timely assessment of their capital position and recapitalisation needs; and

(iii) be able to analyse and mobilise liquidity in resolution.

(b) Firms must be able to continue to do business through resolution and restructuring.

(c) Firms must be able to coordinate and communicate effectively within the firm and with the authorities and markets so that resolution and subsequent restructuring are orderly.

(2) Firms are required to produce an assessment of their preparations for resolution, identifying any barriers to successful resolution and putting in place plans to address them. A report of the assessment must be submitted to the PRA and the firm must publicly publish a summary of its most recent report.[27] This is intended to provide more transparency to investors and the public.

(3) The Bank intends to make a public statement concerning the resolvability of each major UK firm. These will not be simple "pass" or "fail" judgments but will identify any shortcomings. The Bank envisages publishing a series of public statements as follows:

(a) a first statement in 2021 following firms' completion of their first assessments in 2020, focusing on the progress made by firms and their plans for becoming fully resolvable by 2022;

(b) a second statement following firms' reports in 2022, assessing firms' progress against their plans and what work remains to achieve the resolvability outcomes; and

(c) in subsequent years, from 2024, public statements are expected to focus on how far firms maintain their resolvability in light of their evolving business models and their progress in addressing any issues they or the Bank have identified.

4. Stabilisation options

4.1 Overview

The Act implements each of the resolution tools set out in the BRRD, which it refers to as stabilisation "options" that can be exercised by use of specified statutory "powers". The stabilisation options are: private-sector purchaser (called "sale of business" in the

[27] PRA Policy Statement PS15/19: *Resolution Assessment and Public Disclosure by Firms* and Supervisory Statement 4/19: *Resolution Assessment and Public Disclosure by Firms*.

BRRD[28]); bridge bank (called "bridge institution" in the BRRD[29]); asset management vehicle (called "asset separation" in the BRRD[30]); bail-in;[31] and temporary public ownership (one of the "government financial stabilisation tools" in the BRRD[32]).

4.2 Pre-conditions for the use of stabilisation options

There are four general conditions for a stabilisation option to be used, and the Act designates the decision-making responsibilities in relation to each:[33]

(1) First, the PRA (or the FCA if the entity is solely regulated by the FCA[34]) must decide that the firm is *failing or likely to fail*.[35] In making such a decision, the PRA must consult with the Bank.[36] The criterion would be satisfied in the following circumstances:[37]

(a) there has been a failure to meet asset or management requirements that would justify the PRA cancelling the bank's permission to carry out regulated activities;

(b) the firm's assets are less than its liabilities;

(c) the bank is unable to pay its liabilities; or

(d) extraordinary public financial support is required but other than to remedy a serious disturbance in the economy of the UK.

(2) Second, the Bank must decide that it is not reasonably likely that action other than resolution will prevent the failure of the firm.[38] In making this decision, the Bank must consult with the PRA, the FCA and the Treasury.[39] Possible alternative actions include supervisory measures such as suspending dividends or management bonuses, financial restructuring or partial sale.[40] This condition is deemed met if, but for financial assistance from the Treasury or the Bank, it would be met.[41] Insolvency is not required.[42] Any mandatory write-down of capital instruments will be taken into account.[43]

(3) Third, the Bank must decide that using a stabilisation option is in the public interest in the advancement of a special resolution objective.[44] In making that decision, the Bank must consult with the PRA, the FCA and the Treasury.[45]

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28 BRRD, arts 38 and 39.
29 ibid, arts 40 and 41.
30 ibid, art 42.
31 ibid, arts 43ff.
32 ibid, arts 56 to 58.
33 For a graphical representation, see Purple Book, 15, fig 3.
34 Banking Act 2009, s 83A.
35 ibid, s 7(2).
36 ibid, s 7(5F).
37 ibid, s 7(5C).
38 ibid, s 7(3).
39 ibid, s 7(5G).
40 Purple Book, 14, para 1.22.
41 Banking Act 2009, s 7(5B).
42 Purple Book, 14, para 1.23.
43 ibid, 14, para 1.21.
44 Banking Act 2009, s 7(4).
45 ibid, s 7(5H).

(4) Fourth, the Bank must decide that the special resolution objectives will not be met to the same extent by a winding-up of the bank.[46] In making that decision, the Bank must consult with the PRA, the FCA and the Treasury.[47]

4.3 Private-sector purchaser[48]

This involves the transfer of all or part (in a *partial transfer*[49]) of a firm's shares or property to an authorised private purchaser. It does not require the consent of the firm, nor its shareholders, customers or counterparties.[50] The transfer process will usually follow an auction.[51] The marketing process must be transparent, without conflicts of interest, must take account of the need to act quickly and must maximise the sale price as far as possible.[52]

Firms for which partial transfer is appropriate tend to have a single critical function, relating to accounts customers use for everyday payments and cash withdrawals.[53] The tool will be used for firms with between 40,000 and 80,000 transactional accounts, below the threshold for bail-in (see section 4.6 below).[54] A transactional account is one used at least nine times in the three months prior to an annual monitoring date.[55] As a minimum, this tool should mean high-ranking deposits (including FSCS-protected deposits) are transferred with high-quality assets to a private-sector purchaser or bridge bank. The rest of the firm is likely to be put into insolvency.[56]

4.4 Bridge bank[57]

A bridge bank may be used where there is no immediate private-sector purchaser.[58] The Act implements the BRRD requirements that the bridge bank must be wholly or partly owned by the Bank, controlled by the Bank and created to receive the transfer with a view to maintaining access to critical functions and later selling the business.[59]

The Bank will not consider resolution complete, where a bridge bank has been used, until there is a more permanent arrangement.[60] If, within two years of the initial transfer to the bridge bank, there has been no onward transfer, the Bank must without delay take steps to wind up the bridge bank (subject to exceptions and extensions).[61]

46 ibid, s 7(5).
47 ibid, s 7(5H).
48 See ibid, s 11.
49 Purple Book, 8 and 16, box 1.
50 ibid, 15, para 1.27.
51 ibid, 25, para 2.19.
52 Banking Act 2009, s 11A(2).
53 Purple Book, 16, box 1.
54 ibid, 8.
55 ibid, 16, box 1.
56 ibid.
57 See Banking Act 2009, s 12 (banks) and s 84D(A1) (building societies).
58 Purple Book, 25, para 2.20.
59 Banking Act 2009, s 12(1A); BRRD, art 40(2).
60 Purple Book, 26, para 2.35.
61 Banking Act 2009, s 12(3A) to (3D).

4.5 Asset management vehicle[62]

This tool can only be used with another resolution tool.[63] An asset management vehicle is wholly or partly owned by the Bank, controlled by the Bank and created for the purpose of receiving assets from a firm or bridge bank.[64] It can also only be used if a normal liquidation of the assets would adversely affect financial markets, the transfer is necessary to ensure the proper functioning of the transferring bank or bridge bank or it would maximise recoveries.[65]

The asset management vehicle must manage the assets transferred to it with a view to maximising their value by sale or winding down.[66]

4.6 Bail-in[67]

The Purple Book states that the Bank considers this tool appropriate for the largest firms, with balance sheets of not less than GBP 15 billion to GBP 25 billion, which are too large to split up or sell to a private purchaser.[68] These include all global systemically important banks and domestic systemically important banks,[69] but not central counterparties.[70]

The Bank's preferred strategy for the majority of global systemically important banks is *single point of entry* ("SPOE") bail-in. Under the SPOE strategy, the bail-in tool is applied to a single entity in the group, normally the top financial holding company of the group which has issued shares and debt instruments to the market. This ensures that the subsidiary operating companies remain fully operational and can be recapitalised in the case of significant losses by triggering the internal instruments they have issued to the parent company.[71] By contrast, a *multiple point of entry* strategy may be appropriate for a few global systemically important banks that operate in key jurisdictions through intermediate holding companies that are managed and funded in local markets.[72]

4.7 Temporary public ownership[73]

This is the last resort.[74] In addition to the usual conditions for resolution,[75] the Treasury may only take a bank into temporary public ownership if satisfied that it is necessary to resolve or reduce a serious threat to the UK financial systems, or to protect the public interest where the Treasury has provided financial assistance.[76] The Treasury must consult the PRA, the FCA and the Bank before making that decision.[77]

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62 See ibid, s 12ZA.
63 ibid, s 8ZA(2).
64 ibid, s 12ZA(2).
65 ibid, s 8ZA(3); Purple Book, 25-6, para 2.25.
66 Banking Act 2009, s 12ZA(4).
67 See ibid, s 12A (banks), s 81BA (banking group companies), and s 84A (building societies).
68 Purple Book, 16, box 1.
69 ibid, 24, box 3.
70 ibid, 19, para 1.48.
71 ibid, 22, para 2.8, and 24, box 3.
72 ibid, 22, para 2.9.
73 See Banking Act 2009, ss 9 and 13.
74 Purple Book, 17, para 1.38; BRRD, art 56(3).
75 Banking Act 2009, s 9(5).
76 ibid, s 9(1) to (3).
77 ibid, s 9(4).

4.8 The procedure for bank resolution

The resolution of a firm usually takes place outside normal market hours over a weekend – as in the case of Dunfermline Building Society (see section 6.2 below) – commonly termed a "resolution weekend", although an actual weekend may not be required for smaller firms, or where there has been extensive advance planning or the firm is not failing especially quickly.[78]

Many of the Bank's resolution powers do not require the sanction of the courts. Much can be done by statutory instrument.[79]

The Bank considers there to be the following three phases, once an institution has entered into resolution:

(1) stabilisation, in which the Bank decides how best to use the resolution tools to preserve critical structures by restoring solvency;[80]

(2) restructuring, to address the causes of the institution's failure and restore viability;[81] and

(3) exit from resolution, in which the Bank's role ceases.

The UK has implemented a number of safeguards (broadly aimed at protecting members of the public) required by the BRRD, such as:

(1) *Continuity obligations* to preserve facilities and services that the use of resolution tools might otherwise disrupt.[82]

(2) No shareholder or creditor should be worse off than they would be in an insolvency (and any that are will be compensated by the Treasury, which in turn will recover from industry).[83]

It has been suggested[84] that the *no creditor worse off than in liquidation* ("NCWOL") approach under the Act is difficult to reconcile with the BRRD. The Act does not appear to limit the freedom of the resolution authority to take resolution actions so long as adequate after-the-event compensation is paid, whereas the BRRD can be interpreted as imposing the NCWOL safeguard as an express limitation on the resolution authority's freedom of action.[85] It remains an open

78 Purple Book, 21, para 2.6.

79 A list of powers to make statutory instruments in the resolution context (for instance to effect share transfers) is at section 259 of the Act. Those that do not require the scrutiny of Parliament are at section 259(5) of the Act.

80 Purple Book, 21, paras 2.2 and 2.4.

81 ibid, para 2.2.

82 Banking Act 2009, ss 63 to 70; BRRD, art 64(3).

83 Purple Book, 17, para 1.35; BRRD, art 34(1)(g).

84 Simon Gleeson and Randall Guynn, *Bank Resolution and Crisis Management: Law and Practice* (OUP 2016) paras 13.49 to 13.55.

85 This interpretation arises from the difference between the language of article 73(a) of the BRRD (which provides that in a partial transfer of property the shareholders and those creditors whose claims have not been transferred must receive in satisfaction of their claims "at least as much as what they would have received" in a normal winding-up) and article 73(b) in relation to bail-in (which provides that shareholders and creditors whose claims have been written down or converted to equity must "not incur greater losses than they would have incurred" in a normal winding-up). One view is that no distinction was intended between article 73(a) and (b) and the difference merely reflects that it is inappropriate to use the language of "satisfaction of claims" when talking about claims that have been converted to equity.

question whether the UK approach potentially allows for "over-bailing-in" creditors with compensation after the event, and whether this is compatible with the BRRD. In practice, this issue is unlikely to arise because, in deciding whether to use the bail-in tool, the Bank and PRA are bound to have regard to the NCWOL safeguard as well as the need to balance the burdens on the taxpayer and the industry as a whole under special resolution objectives 2, 3, 4 and 7.

(3) Eight percent of liabilities must be met by shareholders and creditors before use of public funds will be considered.[86] Further, Treasury consent is required if use a resolution tool is likely to have implications for public funds.[87]

(4) Contractual counterparties cannot terminate agreements purely because a firm is in resolution, so long as the firm continues to perform its substantive obligations.[88]

(5) Netting and set-off provisions and collateral arrangements will be respected.[89]

(6) The Bank can suspend contractual payment and delivery obligations,[90] and termination rights,[91] for two days.[92]

(7) If the Treasury notifies the Bank that the use of a resolution tool would contravene an international-law obligation of the UK, then the Bank cannot exercise that tool.[93]

4.9 Schemes of arrangement and company voluntary arrangements

A financial institution may avail itself of a statutory procedure other than a resolution procedure to reorganise its capital structure. Two key procedures in this regard, which are not specific to financial institutions, are *schemes of arrangement* and *company voluntary arrangements* ("CVAs"). A scheme of arrangement involves a compromise between a solvent or insolvent company and one or more classes of its shareholders or creditors, which is sanctioned by the court. A company voluntary arrangement is an insolvency proceeding involving a compromise between a company and its creditors, which is capable of binding unsecured creditors.

5. Modified insolvency

5.1 Overview

The statutory modified insolvency regimes for banks,[94] building societies,[95] credit unions,[96] and investment firms[97] are applied either alongside the stabilisation options or when using a stabilisation option is not appropriate.[98] The special insolvency

86 Purple Book, 17, para 1.38; BRRD, art 37(10)(a) (government financial stabilisation tools) and art 44(4) and (5) (bail-in tool).
87 Banking Act 2009, ss 78 to 79.
88 ibid, s 48Z.
89 ibid, s 48P.
90 ibid, s 70A.
91 ibid, s 70C.
92 ibid, ss 70A(3) and 70C(6); BRRD, art 71.
93 Banking Act 2009, ss 76 and 77.
94 ibid, s 91.
95 ibid, s 130.
96 ibid, s 131.
97 Investment Bank Special Administration Regulations 2011.
98 Purple Book, 12-13, para 1.12.

procedures will only be used for firms holding protected deposits or client assets. Otherwise normal insolvency procedures apply.[99]

5.2 The Bank (or Building Society) Insolvency Procedure

The Bank (or Building Society) Insolvency Procedure ("BIP"),[100] part of the special resolution regime, is designed to ensure rapid payout of deposits protected by the FSCS or the transfer of FSCS-protected deposits to a viable firm.[101]

An application for BIP may be made by the Bank, Secretary of State or PRA[102] (or the FCA if the entity is solely regulated by the FCA[103]) on the grounds that:[104]

(i) the firm is unable or likely to become unable to pay its debts;

(ii) winding-up would be fair; or

(iii) (in the case of an application by the Secretary of State) winding-up would be in the public interest.

In the case of an application by the Bank, PRA or FCA, conditions (1) and (2) as set out in section 4.2 above apply.[105]

A liquidator will be appointed,[106] along with a liquidation committee to supervise and advise on how the liquidator should deal with deposits.[107]

The liquidator's statutory priority is to work with the FSCS to pay out protected deposits[108] within seven days if possible.[109] The secondary statutory aim is to wind up the firm. In insolvency, FSCS deposits are super-preferred.[110]

5.3 The Bank (or Building Society) Administration Procedure

The Bank (or Building Society) Administration Procedure ("BAP"),[111] part of the special resolution regime, is used where part of a firm has been sold to a private purchaser.[112] The court appoints an administrator[113] on the application of the Bank. The grounds for an application are that the Bank intends to use the private-sector purchaser tool, and the firm is unable to pay its debts or likely to become unable to pay its debts as a result of the use of that tool.[114]

99 ibid, 18, para 1.40.
100 See Banking Act 2009, pt 2.
101 Purple Book, 18, para 1.41.
102 Banking Act 2009, s 95.
103 ibid, s 129A.
104 ibid, s 96.
105 ibid.
106 ibid, s 105.
107 ibid, ss 100 to 102.
108 ibid, ss 99, 123 and 124.
109 Purple Book, 18, para 1.42.
110 The order of priority since January 2015 is at Purple Book, 18, fig 4.
111 See Banking Act 2009, pt 3.
112 ibid, s 136(2)(a).
113 ibid, s 144.
114 ibid, s 143.

The administrator has two statutory objectives: (i) supporting the commercial purchaser and (ii) normal administration, that is, to rescue the firm as a going concern or achieve a better result than winding up the firm without prior administration. The first has priority.[115]

5.4 The Special Administration Regime

Investment firms are potentially subject to the Special Administration Regime (the "SAR"), governed by the Investment Bank Special Administration Regulations 2011 (the "Regulations") and other statutory instruments. The SAR is distinct from the special resolution regime, and its application has resulted in several reported cases in the UK.

The main features of the Regulations are:[116]

(1) An investment bank enters SAR by a court order (*special administration order*) appointing an administrator.[117]

(2) The administrator must, in accordance with proposals from the creditors, clients, and FCA or PRA, pursue the three special administration objectives which are:

(i) ensuring the return of client assets as soon as reasonably practicable;

(ii) ensuring timely engagement with market infrastructure bodies and authorities; and

(iii) rescuing the investment bank as a going concern or winding it up in the best interests of creditors.[118]

There is no prescribed hierarchy among the special administration objectives.[119]

If an investment bank is deposit-taking but without eligible depositors, then the SAR rather than BIP must be used.[120]

The application for the special administration order may be made by the investment bank, its directors, a creditor or contributory, a designated magistrates' court officer exercising powers in relation to fines, the Secretary of State, the FCA and/or the PRA.[121]

The grounds for applying are that the investment bank is or is likely to be unable to pay its debts, it would be fair to put the investment bank into SAR, or it would be expedient to do so.[122] The regulator may direct the administrator to prioritise one or more of the special administration objectives described above.[123]

115 ibid, ss 137, 138 and 140.
116 Investment Bank Special Administration Regulations 2011, reg 3(2).
117 ibid, regs 4 and 7.
118 ibid, reg 10.
119 ibid, reg 10(3). However, see text at note 123 below regarding prioritisation.
120 Investment Bank Special Administration Regulations 2011, reg 3(4).
121 ibid, reg 5.
122 ibid, reg 6.
123 ibid, regs 16-19.

In respect of the first special administration objective, the administrator has: reporting obligations to the FSCS;[124] restricted rights to transfer property;[125] obligations to reconcile client money and make up any shortfall from the investment bank's own accounts;[126] the right to set a bar date or apply to the court for a "hard" bar date for claims to ownership of or security over an asset, or to client money;[127] and the obligation to pro-rate shortfalls in omnibus accounts.[128]

A supplier may not terminate a supply to an investment bank in SAR unless charges remain unpaid for 28 days, the administrator consents, or the court gives the supplier permission. The supplier cannot make supply conditional on payment of outstanding charges.[129]

If the administrator thinks it has achieved the rescue of the investment bank as a going concern, it must apply to the court to end the administration.[130] It may propose a CVA if it pursues winding-up.[131]

6. Case studies

6.1 Introduction

As noted in section 2.1 above, there has been no major bank failure in the UK since the making of the Act. Nonetheless, the private-sector purchaser tool was used in relation to Dunfermline Building Society ("DBS") in March 2009 and the modified insolvency procedures have been used since. The IEO stated in its June 2018 report that, "although it has been [some time] since the Bank has carried out a resolution of a PRA-regulated firm, the requisite expertise and know-how is available."[132]

6.2 Dunfermline Building Society – resolution: the private-sector purchaser tool

DBS was established in 1869. It was Scotland's largest independent building society in March 2009 with 350,000 customers, 550 staff and 34 branches.[133]

By February 2008 DBS was one of two UK lenders offering mortgages with loan-to-value ratios over 100 percent.[134] DBS diversified into commercial lending to be more competitive.[135] Doing so had added GBP 25 million to member value and had not come close to breaching any statutory limits,[136] but from 2005 the Financial Services Authority (the "FSA"), as regulator, had raised commercial lending at DBS as a concern.[137] DBS had also set up a subsidiary, Dunfermline Solutions, to provide software solutions and

124 ibid, reg 10A.
125 ibid, regs 10B-G.
126 ibid, reg 10H.
127 ibid, regs 11 and 12A-E.
128 ibid, reg 12.
129 ibid, reg 14.
130 ibid, reg 20.
131 ibid, reg 21.
132 IEO Report, 20.
133 House of Commons Scottish Affairs Committee Fifth Report of Session 2008-2009, para 11.
134 ibid, para 13.
135 ibid, para 18.
136 ibid, para 21.
137 ibid, para 31.

back-office services, and had undertaken an information technology project whose poor management led to losses of GBP 9.5 million that were not clearly communicated to members.[138]

Worsening economic conditions meant the FSA increased stress testing from August 2007 and raised capital requirements in 2008. Although there was no immediate cash-flow issue,[139] this meant DBS was lacking GBP 20 million of Tier 1 regulatory capital.[140] By March 2009 an injection of GBP 60 million was needed to stabilise DBS for two years.[141] The UK authorities decided not to risk public money (on the basis that they would not get the GBP 60 million back, DBS never having made an annual profit over GBP 6 million) and a consortium of building societies refused to invest in DBS unless there was matching public investment. That triggered the use of the recently introduced resolution regime.[142]

Over the weekend of 28 and 29 March 2009, the Bank used the private-sector purchaser tool in respect of DBS. The FSA determined on Saturday 28 March that DBS met the criteria for resolution. Nationwide Building Society ("Nationwide") acquired retail and wholesale deposits, branches and residential mortgages (other than social-housing loans and related deposits). Social-housing loans and related deposits were transferred to a bridge bank. The remainder of DBS's business was put into BIP by a court order on 30 March 2009. There was no disruption to customers.[143] The main disruption for employees was that the head office was disbanded.[144]

Nationwide then bought the social-housing loans and related deposits at auction.[145] The transfer from the bridge bank to Nationwide was completed on 1 July 2009.[146]

There was widespread criticism in Scotland of the UK authorities' failure to keep DBS independent. Some likened the resolution to using a sledgehammer to crack a nut on the basis that a small amount of money could have been injected to preserve DBS's independence, and because the long-term prospects of DBS – rather than short-term non-viability – were the rationale for the resolution.[147] That said, the subsequent report by the House of Commons Scottish Affairs Committee found that: "the ultimate responsibility for the plight that Dunfermline found itself in lay with the Board of the Society. The poor project management of Dunfermline Solutions made a significant contribution to the failure of the Society."[148]

138 ibid, paras 24-8.
139 ibid, para 2.
140 ibid, paras 32-3.
141 ibid, para 36.
142 ibid, paras 37-40.
143 Bank of England, 'Dunfermline Building Society' (News Release, 30 March 2009), available at: https://www.bankofengland.co.uk/-/media/boe/files/news/2009/march/dunfermline-building-society.pdf.
144 House of Commons (note 133) para 85.
145 Bank of England, 'Dunfermline Resolution: Announcement of the Preferred Bidder for the Social Housing Lending Business' (News Release, 17 June 2009), available at: https://www.bankofengland.co.uk/-/media/boe/files/news/2009/june/dunfermline-resolution-announcement-of-the-preferred-bidder-for-social-housing-lending-business.pdf.
146 Bank of England, 'Dunfermline Resolution: Completion of the Sale of the Social Housing Lending Business to Nationwide Building Society' (News Release, 1 July 2009), available at: https://www.bankofengland.co.uk/-/media/boe/files/news/2009/july/dunfermline-resolution-completion-of-the-sale-of-the-social-housing-lending-business.pdf.
147 Derek Arnott, 'Dunfermline Building Society – The FSA's Supervisory Approach' [2009] JIBFL 509.
148 House of Commons (note 133) para 87.

The FSCS contributed to the costs of the resolution,[149] as did the taxpayer. The total public funds required were GBP 1.6 billion, most of which (apparently between GBP 1 billion and GBP 1.5 billion) was funded by the industry-funded FSCS.[150]

6.3 Southsea Mortgage and Investment Company Limited – resolution: the Bank Insolvency Procedure

On 16 June 2011 the Bank announced it had applied to the court for, and the court had made, an order putting Southsea Mortgage and Investment Company Limited ("Southsea") into BIP, with partners from BDO LLP as liquidators. Southsea was much smaller than DBS. It had approximately 250 depositors and retail deposits of GBP 7.4 million. The resolution followed "a deterioration in its financial position as a result of management decisions and the firm's specific business model". The FSCS would cover deposits of up to GBP 85,000 and there appears to have been no disruption for customers.[151]

Southsea is an example of a building society in respect of which the conditions for initiating resolution were found to be met but which was deemed too small for the bail-in or private-sector purchaser tools to be appropriate.

6.4 Worldspreads Limited – the Special Administration Regime

Worldspreads Limited ("Worldspreads") was an investment bank with 15,000 clients spread-betting and trading in contracts for difference. At an urgent Sunday hearing on 18 March 2012, the court (Hildyard J) made a special administration order,[152] after a new management team had found that its predecessors deliberately falsified client money reconciliations and inappropriately used client money, and mixed client money with company money. The gross amount owed to clients was approximately GBP 30 million. The investment bank had less than GBP 6 million in client accounts, and it had GBP 16.6 million in company accounts.[153] If clients could transact with Worldspreads on the opening of the Asian and Australasian markets (at 22:30 on the Sunday, London time), they would withdraw their money and render the operation of the business and the distribution of client assets impossible.[154]

The judge recorded that the relevant criteria were: (a) whether the subject company was an investment bank; and (b) either that the bank was or was likely to become unable to pay its debts, or it would be fair to put the bank into special administration. Factors indicating that a special administration order was fair in this case were that it should assist orderly resolution of client money claims, should mitigate the ongoing risks to clients, might allow a sale of part or all of the business, would permit an investigation by the administrators, and would facilitate structured liaison with market infrastructure bodies and the FSA as regulator.[155] The special administration order granted by the judge included recitals indicating the status of the special administration

149 Purple Book, 25, para 2.24.

150 House of Commons (note 133) para 66.

151 Bank of England, 'Southsea Mortgage and Investment Company Limited' (News Release, 16 June 2011), available at: https://www.bankofengland.co.uk/-/media/boe/files/news/2011/june/southsea-mortgage-and-investment-company-limited.pdf.

152 *Re Worldspreads Limited* [2012] EWHC 1263 (Ch).

153 ibid, [5]-[7].

154 ibid, [10]-[11].

155 ibid, [21]-[24].

order under the United Nations Commission on International Trade Law Model Law on Cross-Border Insolvency to assist with overseas recognition.[156]

The case returned to court in 2015, when Birss J approved a procedure for distribution of client money, setting out a bar date for clients to contact Worldspreads' administrators, provisions dealing with costs and expenses, and methods for dealing with disputed claims and final distributions.[157] These were not covered by the Client Assets Sourcebook ("CASS") rules, which covered client assets but not client money.[158] The FSCS had been assigned 95.8 percent of claims, but there were about 1,000 clients with claims totalling GBP 1.2 million who had not assigned claims.[159] A further 10,662 clients, 9,230 of whom had a nil balance, had not responded.[160] There was an impasse not envisioned by the legislation.[161] The FCA had agreed a temporary modification to the CASS rules for Worldspreads specifically, but this did not prevent the need to come to court for directions.[162]

Birss J exercised the court's inherent jurisdiction to supervise and intervene in the administration of trust assets and made the order. In particular, the court was satisfied that the administrators had taken all reasonable steps to identify or notify potential client-money claimants and the solution balanced the interests of all clients and was in the best interests of the administration. Further, there was to be an additional round of communications.[163]

6.5 Co-operative Bank plc

Although the Co-operative Bank (the "Co-op") has never been the subject of resolution, the court has twice approved restructurings designed to avoid triggering the resolution mechanisms.

In 2013, the Co-op needed GBP 1.5 billion of regulatory capital to avoid resolution.[164] It had seven series of subordinated loan notes with aggregate principal values of *c*. GBP 907 million and *c*. EUR 35 million, two series of perpetual subordinated bonds with an aggregate principal value of GBP 310 million, and one series of preference shares with a nominal value of GBP 60 million.[165] It was proposed that the perpetual bonds and preference shares be replaced with new bonds. These proposals were approved at meetings of the holders.[166] Pursuant to a proposed scheme of arrangement, the holders of the loan notes would receive new debt instruments and equity, and would be entitled to participate in an offer of new equity.[167] The judge noted the overwhelming majority approval of holders and sanctioned the scheme.[168]

156 ibid, [35]-[39].
157 *Re Worldspreads Limited* [2015] EWHC 1719 (Ch), [2016] 1 BCLC 162.
158 ibid, [7]-[8].
159 ibid, [10].
160 ibid, [11].
161 ibid, [16].
162 ibid, [17] and [19].
163 ibid, [22]-[33].
164 *Re The Co-operative Bank plc* [2013] EWHC 4397 (Ch) [3].
165 ibid, [4].
166 ibid, [5].
167 ibid, [6].
168 ibid, [10] and [14].

In 2017, the Co-op needed to increase its regulatory capital because of a combination of losses suffered and the maturity of GBP 400 million of senior notes.[169] The court sanctioned schemes of arrangement as part of a restructuring and recapitalisation of the bank, in the absence of which the likely alternative would have been a mandatory write-down of the ordinary shares and subordinated notes, either as a preliminary step to, or in the course of, special resolution.[170] Before making the order, the court noted the evidence was that, in the event of resolution, it was anticipated that shareholders and subordinated noteholders would not recover anything.[171]

6.6 Hume Capital Securities plc – the Special Administration Regime

Hume Capital Securities plc ("Hume"), an investment bank, had client assets of over GBP 35.7 million in aggregate,[172] but incurred substantial losses and in March 2015 requested suspension of trading in its shares. It was suspended from membership of the Stock Exchange and agreed with the FCA to stop carrying out regulated activities save in respect of existing business. Hume was placed into the SAR by the court on 16 March 2015.

In *Re Hume Capital Securities plc*,[173] the court (HHJ Keyser QC) approved a distribution plan. The judge indicated that there was no specific guidance in the applicable statutory instrument for the court in deciding whether to approve a plan, but necessarily the court would wish to be satisfied that it furthered the objective of returning client assets as soon as reasonably practicable and that it was just and appropriate.[174] The acceptance of the plan by the creditors' committee was particularly material for the court and the FCA's stance was relevant, and due weight was also given to the administrators' judgment, although none of that was conclusive.[175]

Rather than partitioning assets in order to return them to clients, the administrators had devised a solution the judge described as "more elegant and simple but equally effective for the purpose of distribution of and return of assets".[176] The custodian role in the administration would be transferred to a third party that had formerly been interested in buying the assets. Each client would choose whether to have a relationship with the third party, have the assets transferred directly back to it (the client) or to have their assets kept by the custodian on trust for the administrators.[177] Fixed costs would be reimbursed by the FSCS.[178] The judge was satisfied that this was a "highly convenient method of achieving objective 1" which would work "fairly, equitably and reasonably", and that the alternatives would be "far more likely to impose unnecessary delay and costs upon the claimants".[179]

169 *Re The Co-operative Bank plc* [2017] EWHC 2269 (Ch) [4].
170 ibid, [10].
171 ibid, [11].
172 *Re Hume Capital Securities plc* [2015] EWHC 3717 (Ch) [12].
173 *Hume* (note 172).
174 ibid, [9].
175 ibid, [10]-[11].
176 ibid, [14].
177 ibid, [13]-[14].
178 ibid, [16]-[18].
179 ibid, [22].

6.7 Strand Capital Limited – the Special Administration Regime

Strand Capital Limited ("Strand Capital") collapsed and was placed into special administration by an order on 17 May 2017 with Smith & Williamson and LA Business Recovery Limited as the administrators.[180] Strand Capital had approximately 3,000 customers and investments and cash deposits of approximately GBP 12.5 million.[181] However, its directors were unable to reconcile client assets or give access to trading platforms. The FSCS has started paying client money balances up to GBP 50,000 per customer. For customers who had invested through a self-invested personal pension ("SIPP"), compensation is being paid directly to the SIPP.[182] By November 2018, the FSCS had paid GBP 5.8 million in compensation.[183]

On 2 April 2019 Henry Carr J approved a distribution plan for the return of client assets, which had been unanimously approved by Strand Capital's creditors' committee.[184] The administrators anticipated no shortfall in client assets. Only a limited number of mostly corporate clients would have to bear costs associated with the distribution; FSCS compensation would cover such costs for the vast majority of clients.[185] The creditors' committee and the FSCS had approved an approach to costs whereby each account held by a client with an accepted client-asset claim paid a fixed amount.[186] The judge therefore considered that the distribution plan facilitated a "fair, reasonable and efficient means of returning client assets […] in a manner which will result in their return as soon as is reasonably practicable" and was in accordance with the Regulations.[187]

7. Brexit and bank resolution

There continues to be uncertainty surrounding the UK's resolution and recovery regime after Brexit, just as for many other areas of banking regulation.

The Bank issued two consultation papers specifically dealing with the challenges of Brexit in October 2018[188] and December 2018.[189] These relate to the EU Binding Technical Standards for bank resolution.

Technical Standards have historically been implemented in UK legislation by reference to numerous EU legal concepts and pieces of legislation. The Bank proposed a suite of changes to replace cross-references to EU law with purely domestic legislative wording.

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180 *Re Strand Capital Limited* [2017] EWHC 3561 (Ch); FCA, 'Strand Capital Limited Enters Administration' (Press Release, 17 May 2017), available at: https://www.fca.org.uk/news/press-releases/strand-capital-limited-enters-administration.

181 Administrators' report (June 2018) 26.

182 See https://www.fscs.org.uk/what-we-cover/investments/strand-capital-limited.

183 Administrators' report (December 2018) para 3.2.

184 *Re Strand Capital Limited* [2019] EWHC 1449 (Ch).

185 ibid, [8].

186 ibid, [11].

187 ibid, [16].

188 *UK Withdrawal from the EU: The Bank of England's Approach to Resolution Statements of Policy and Onshored Binding Technical Standards* ("Consultation 1"), part of the consultation package *The Bank of England's Approach to Amending Financial Services Legislation under the European Union (Withdrawal) Act 2018* (PRA CP25/18).

189 *UK Withdrawal from the EU: Further Changes to PRA Rulebook and Binding Technical Standards – Resolution Binding Technical Standards* (PRA CP32/18).

Key features of the proposed changes, as explained in the consultation papers, were the following:

(1) The BRRD does not have any legal effect after Brexit. The applicable legislation is domestic legislation as amended by the Bank Recovery and Resolution and Miscellaneous Provisions (Amendment) (EU Exit) Regulations 2018.[190]

(2) Aspects of the BRRD which are clearly not appropriate to the UK post-Brexit, such as joint decisions with the resolution authorities of the European Economic Area ('EEA'), should be interpreted as no longer applying.[191]

(3) After Brexit, only onshored Technical Standards apply.[192]

(4) Any references to the EU resolution colleges no longer apply.[193]

(5) Any references to the European Banking Authority no longer apply.[194]

(6) Any references to the EEA are references to the UK.[195]

(7) Any references to third countries include the EEA.[196]

(8) Specific references to non-EEA law (in particular the PRA rules on terms in third-country contracts that recognise that a liability may be written down, and the terms preventing termination purely because of resolution) are to be interpreted as set out in a related PRA Consultation paper.[197] [198]

(9) There are no amendments where the existing legislation deals with the relevant Technical Standard sufficiently.[199]

On 28 February 2019, the Bank and PRA issued near-final policy following these consultations. On 18 April 2019, the Bank and PRA published a Policy Statement[200] setting out their final policy, including Supervisory Statements and a Policy Statement, which will almost all have effect from "exit day" (then assumed to be 31 October 2019 at 23:00). In relation to the BRRD, the Bank and PRA have each issued an EU exit instrument.[201] On 25 July 2019, the Bank and PRA published a consultation paper[202] to consult among other things on temporary transitional provisions and changes to the EU exit instruments. The consultation closed on 18 September 2019.

190 Consultation 1, para 2.5.
191 ibid, para 2.6.
192 ibid, para 2.7.
193 ibid, para 2.9.
194 ibid, para 2.11.
195 ibid, para 2.12.
196 ibid, para 2.13.
197 ibid, para 2.14.
198 *UK Withdrawal from the EU: Changes to PRA Rulebook and Onshored Binding Technical Standards* (CP26/18).
199 Consultation 1, para 3.5.
200 PRA Policy Statement 5/19.
201 The EU Exit Instrument: The Technical Standards (Bank Recovery and Resolution Directive) (Amendment Etc) (EU Exit) (No 1) Instrument 2019 issued by the Bank, and the EU Exit Instrument: The Technical Standards (Bank Recovery and Resolution Directive) (EU Exit) (No 2) Instrument 2019 issued by the PRA.
202 *UK Withdrawal from the EU: Changes Following Extension of Article 50* (CP18/19).

The Bank and PRA have stated that they expect firms, after exit day, to continue to comply with guidelines complied with pre-Brexit on the application of the BRRD.[203] Ultimately, the Bank and PRA are keen to ensure that there is a smooth transition with as few substantive changes to the resolution regime as possible. Of course, after Brexit the UK is no longer bound in law to follow the EU's approach to resolution (which was in any event shaped to a significant degree by the contributions of UK regulatory bodies). However, the EU will no doubt insist on equivalence of the UK to the EU regime as a condition for a continued close relationship between the UK's and the EU's financial services sectors.

[203] Policy Statement: *Interpretation of EU Guidelines and Recommendations: Bank of England and PRA Approach after the UK's Withdrawal from the EU* (2019), para 2.2. A non-exhaustive list of the guidelines that continue to apply is set out in Appendix 2 to the Policy Statement.

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