

EXPLANATORY MEMORANDUM TO
THE BUILDING SOCIETIES (BAIL-IN) ORDER 2014

2014 No. 3344

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

2. **Purpose of the instrument**
 - 2.1 The Financial Services (Banking Reform) Act 2013 (“the 2013 Act”) introduced the bail-in stabilisation tool to the Special Resolution Regime (“SRR”) in Part 1 of the Banking Act 2009 (“the 2009 Act”). The bail-in tool allows the Bank of England to write down the liabilities of a failing bank and convert debt into equity in order to recapitalise a failing bank. This Order adapts the bail-in tool as it applies to building societies.

3. **Matters of special interest to the Joint Committee on Statutory Instruments**
 - 3.1 None

4. **Legislative Context**
 - 4.1 Section 17 of the 2013 Act gives the Treasury to the power to make an order to facilitate the exercise of the bail-in powers in relation to building societies. Specific provision is required to ensure the effective application of bail-in to building societies which differ materially from banks. In particular, the 2013 Act specifies that an order may allow the Bank of England to cancel membership rights or shares in a building society, and to convert a building society into a company, or transfer the business of a building society to a company for the purposes of executing a bail-in.

 - 4.2 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 (“BRRD”) requires among other things that Member States make the bail-in tool available for national resolution authorities to apply to financial institutions including in particular banks and building societies. The UK will transpose these BRRD requirements by Part 1 of the 2009 Act as amended by:
 - 4.2.1 the 2013 Act, which introduced the bail-in tool into the 2009 Act;

- 4.2.2 the Bank Recovery and Resolution Order 2014 (S.I. 2014/XXXX) which further amends the 2009 Act to make it fully consistent with the BRRD; and
- 4.2.3 this Order which makes modifications to Part 1 of the 2009 Act consequent on its application to building societies.
- 4.3 This Order in addition modifies the application of the Companies Act 2006 where a building society is demutualised by resolution instrument preliminary to a bail-in, and disapples the transfer of business and cancellation of registration provisions in the Building Societies Act 1986.
- 4.4 A transposition note for the BRRD will be attached to the explanatory memorandum for the Bank Recovery and Resolution Order 2014. The BRRD was given scrutiny clearance by the House of Lords European Union Committee on 12 June 2013¹ and by the House of Commons European Scrutiny Committee on 21 June 2013².

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 RT Hon Andrea Leadsom MP has made the following statement regarding Human Rights:
- 6.2 In my view the provisions of the Building Societies (Bail-in) Order 2014 are compatible with the Convention rights.

7. Policy background

- What is being done and why

- 7.1 The 2013 Act added the bail-in tool to the SRR, giving authorities a fourth stabilisation option to deal with failing banks. The bail-in powers apply to all building societies.

¹ <http://www.parliament.uk/documents/lords-committees/eu-sub-com-a/CWM/cwm2013-14/CwMsubA9May13-30Nov13-.pdf> – see p.9

² <http://www.publications.parliament.uk/pa/cm201314/cmselect/cmeuleg/83-v/8318.htm>

- 7.2 The Order enables the Bank of England to cancel members' rights and shares in the building society. This is in line with a basic principle of bail-in that the "owners" of the firm, i.e. those entitled to make decisions relating to the firm and to enjoy economic value generated by the firm, should lose this interest as part of bail-in. Building society members are not directly analogous to shareholders in a bank, but are the most direct comparison.
- 7.3 In order to apply the bail-in tool effectively to building societies, the Bank of England may either convert the society into a company or transfer all of its business to a company. The bail-in tool would then be applied to the successor company, or to the successor company and its parent undertaking.
- 7.4 As a resolution tool, the bail-in tool will only be used under the conditions in section 7 of the 2009 Act. It may only be used if the building society is failing or likely to fail, and it not reasonably likely that other action can be taken to restore viability. In addition to this, exercise of a resolution tool must be necessary having regard to the public interest in the advancement of the special resolution objectives in section 4 of the 2009 Act, and a resolution tool is only to be used if one or more special resolution objects would not be met to the same extent by winding up. The special resolution objectives in section 4 include ensuring the continuity of banking services in the UK and of critical functions, protecting and enhancing the stability of the financial system in the UK and public confidence in it, and protecting public funds and certain private interests such as deposits covered by the Financial Services Compensation Scheme.

- Consolidation

- 7.5 No consolidation is necessary here. The Order largely consists of amendments to the 2009 Act.

8. Consultation outcome

- 8.1 The Treasury ran a public consultation on this issue, along with other elements of the bail-in regime, from 13 March to 7 May 2014. This Order includes provision for a building society to be transferred to or converted into a public limited company. This would mean demutualisation of the building society. The Government is of the view that this approach is the most operationally straightforward way of achieving a successful resolution. This approach is also consistent with the provisions in the BRRD which allow Member States to change the legal form of an institution for the purposes of resolution.
- 8.2 Respondents generally disagreed with this approach, arguing that alternative approaches could be taken that would maintain the building society's mutual status, such as building societies issuing specific types of debt instruments. Following the consultation, the Government is still of the view that demutualisation would most likely need to occur for a building society bail-in to

be successful. This is due to the lack of certainty around other methods of resolution which would preserve mutual status. But demutualisation is not a requirement of a building society bail-in, and there may be circumstances where an alternative method is more appropriate.

9. Guidance

9.1 It is not considered necessary to issue specific guidance in connection with this Order. However, under section 5 of the Banking Act 2009, the Treasury is obliged to issue a code of practice about the use of the stabilisation powers. The Code of Practice will contain further material on this Order.

10. Impact

10.1 The impact on business, charities or voluntary bodies is expected to be incorporated within the total costs estimate of the whole bail-in tool. The costs resulting from these provisions are estimated to be zero and are already reflected in the costs of the whole bail-in tool. This is because building societies are in scope of the bail-in tool by virtue of the primary legislation powers in the Banking Act 2009. This legislation allows the bail-in tool to be applied more effectively to building societies to ensure a successful resolution.

10.2 The impact on the public sector is also estimated to be zero.

10.3 An Impact Assessment is attached to this memorandum and will be published alongside the Explanatory Memorandum on the legislation.gov.uk website.

11. Regulating small business

11.1 The legislation applies to small business.

11.2 The impact of these requirement on firms employing up to 20 people is expected to be minimal. It is unlikely that resolution powers would be used on such small firms as they are unlikely to meet the criteria necessary for resolution tools to be used, as it is unlikely to be in the public interest to do so.

11.3 The basis for the final decision on what action to take to assist small business is whether the business would meet the tests for resolution tools to be used. The Government believe that, in most cases where a small bank or building society is failing, resolution powers will not be used.

12. Monitoring & review

12.1 This legislation will be reviewed within a maximum of 5 years after coming into force, see article 7 which contains a review requirement.

13. Contact

David Hunter at the Treasury Tel: 020 7270 1242 or email:
David.Hunter@hmtreasury.gsi.gov.uk can answer any queries regarding the instrument.