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Restructuring Bankruptcy & Insolvency Group Legal Alert

The Banking Act 2009 introduces new bank insolvency and administration procedures

On 12 February 2009 the Banking Act 2009 (the "**Act**") received Royal Assent. The Act, which provides a new and permanent framework for dealing with banks in financial difficulties, is a significant development in the insolvency laws of this country as they apply to UK banks. It is particularly relevant in an economic climate in which more bank failures cannot be ruled out.

The relevant parts of the Act come into force on 21 February 2009, when the emergency legislation (the Banking (Special Provisions) Act 2008) which was enacted to deal with Northern Rock expires.

The special resolution regime

The framework contained in the Act (known as the "**special resolution regime**" or "**SRR**") allows for a failing bank to be taken into temporary public ownership or for all (or part) of its business to be transferred to a "bridge bank" (owned by the Bank of England) or to a private sector purchaser.

The Act also provides for a bank insolvency procedure (based on the existing liquidation regime) and a separate bank administration procedure (to be used if part only of a bank's business is transferred in order to ensure that the residual bank provides the services and facilities required to enable the bridge bank or private sector purchaser to operate effectively).

20 February 2009

A brief overview of the bank insolvency and adminstration procedures is set out below.

Bank insolvency procedure

A bank insolvency order (which appoints an insolvency practitioner to act as bank liquidator) may be made by the Court upon the application of the Bank of England, FSA or Secretary of State in certain prescribed circumstances.

The Court may make an order on the application of the Bank of England or the FSA if satisfied that the bank has eligible depositors and that either the bank is unable, or likely to become unable, to pay its debts or the winding up of the bank would be fair. The Court may make an order on the application of the Secretary of State if satisfied that the bank has eligible depositors and either the winding up of the bank would be in the public interest or the winding up of the bank would be fair.

The objectives of the bank liquidator are to: (i) work with the FSCS so as to ensure that, as soon as reasonably practicable, each eligible depositor has its accounts transferred to another financial institution or receives compensation from the Financial Services Compensation Scheme ("FSCS") ("**Objective 1**"); and (ii) wind up the failed bank so as to achieve the best result for the bank's creditors as a whole ("**Objective 2**"). Objective 1 takes precedence over Objective 2, although the bank liquidator is obliged to begin working towards both objectives immediately on appointment. Therefore, although no preferential status is afforded to the claims of depositors, the bank liquidator, in complying with Objective 1, is required to focus his (limited) resources upon them and this may be detrimental to the interests of the general body of creditors.

To achieve these objectives the bank liquidator has the powers and duties of a liquidator under Insolvency Act 1986, as amended by the Act.

The bank may exit the bank liquidation procedure into either a company voluntary arrangement or an administration, or it may be dissolved.

Bank administration procedure

A bank administrator (who must be an insolvency practitioner) may be appointed by the Court on the application of the Bank of England if the latter can show that the residual bank, which remains following a transfer of part only of the business to a bridge bank or a private sector purchaser, is unable to pay its debts or is likely to become unable to do so as a result of the transfer (or proposed transfer).

The role of a bank administrator is to ensure that the residual bank provides such services or facilities as are required to enable (in the opinion of the Bank of England) the private sector purchaser or bridge bank to operate effectively ("**Objective A**"). In other respects a bank administration is similar to an administration under the

Insolvency Act 1986, with the objectives of the bank administrator being to: (i) rescue the residual bank as a going concern; or (ii) achieve a better result for the residual bank's creditors as a whole than would be likely if the residual bank were wound up ("**Objective B**"). However, Objective A takes priority over Objective B, although the bank administrator is obliged to begin working towards both objectives immediately on appointment. Objective A does not cease until the Bank of England determines that the residual bank is no longer required to support the private sector purchaser or bridge bank.

In pursuing Objective B, the bank administrator must aim to achieve the rescue of the residual bank as a going concern unless he believes that either it is not reasonably practicable to do so or objective (ii) would achieve a better result for the residual bank's creditors as a whole.

In order to achieve these objectives the bank administrator has the powers and duties of an administrator under Insolvency Act 1986, as amended by the Act.

If the bank administrator is unable to rescue the residual bank, it may exit the bank administration procedure into a company voluntary arrangement or it may be dissolved.

Conclusion

If further banking collapses do occur it will be interesting to see whether the new bank insolvency and administration procedures (and the wider framework set out in the SRR) achieve the Government's stated objectives of protecting and enhancing the stability of UK financial systems and protecting depositors and public funds.

If you would like further information about the issues raised by this case please contact

Ian McDonald

Partner
Tel: +44 20 3130 3856

Devi Shah

Partner
Tel: +44 20 3130 3669

David Morrison

Partner
Tel: +44 20 3130 3876

David Allen

Partner
Tel: +44 20 3130 3813

Ashley Katz

Partner
Tel: +44 20 3130 3818

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