INSOLVENT BANKS AND THE FINANCIAL SECTOR SAFETY NET – LESSONS FROM THE NORTHERN ROCK CRISIS

This article explores the subject of banking crises, paying particular attention to the recent banking crisis in the UK, and attempts to provide some guidance as to what lessons can be learned from this. The crisis involved the Northern Rock bank, a leading mortgage provider, which found itself in financial difficulties in the late summer of 2007. The article provides an examination of the following: why banks deserve special treatment; the use of the financial sector safety net; regulation and supervision of banks; the protection of depositors; a legal framework for dealing with insolvent banks. It then sets out the Northern Rock story before considering the position in Singapore.

"A bank lives on credit. Till it is trusted it is nothing; and when it ceases to be trusted it turns to nothing."[1]

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I. Introduction

1 Banking crises involving bank failure, often on a massive scale, have been relatively common across the globe in the last 30 or so years. These events have affected developed as well as developing countries and in the last ten years banks have failed in at least 50 countries.[2] To minimise the economic and social damage that can be caused by failing banks, it is important that individual countries have in place a financial sector safety net which comprises a system of regulation and supervision. In many jurisdictions, there is now an additional component to the safety net, a scheme which will provide some degree of protection for depositors in the event of a bank failure.

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1 Walter Bagehot, *Lombard Street: A Description of the Money Market* (London: H S King, 1873).

2 Statistical information is available from the Basel Committee on Banking Supervision at www.bis.org and from the International Monetary Fund at www.imf.org.

2 It is generally thought that it would be virtually impossible to eliminate entirely the failure of individual banks and the purpose of the financial sector safety net is not to attempt the complete avoidance of insolvent banks. This is something which has been recognised in Singapore and in London.

3 The Monetary Authority of Singapore ("MAS") in its Annual Report of 2006/2007 has stated that "a 'zero-failure' regime is neither feasible nor desirable as it leads to considerable moral hazard for the regulator and places excessive regulatory burden on financial institutions".[3] In the UK, Howard Davies, the former Chair of the Financial Services Authority ("FSA"), has stated that "risk taking is an essential element in dynamic financial markets, and it would be both unrealistic and wrong to aim for a zero-failure regime. Regulators should, however, target a low level of failures which bring losses to retail savers and investors".[4] These views are both realistic and represent the generally prevailing international position. However, the recent problems in the UK as a result of a troubled bank, Northern Rock, demonstrated a clear reluctance by the UK authorities to even consider the possibility of allowing this bank to fail. The events surrounding the Northern Rock crisis and the efficacy or otherwise of the UK's financial sector safety net will be discussed in this article.

4 The principal aim of this article is to consider two relevant aspects of financial sector safety nets, paying attention in particular to the problems faced in the UK by the Northern Rock crisis. These are bank insolvency law and depositor protection schemes[5] although other aspects will be discussed where relevant.

5 It is hoped that by doing this some degree of guidance for the future for other jurisdictions in general, and Singapore in particular, will be provided.

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3 Monetary Authority of Singapore Annual Report 2006/2007.

4 Financial Services Authority Press Release, London, 21 January 1999.

5 The provision of emergency liquidity assistance by the central bank is another part of the safety net but it is beyond the scope of this paper to consider this in depth. For further reading on this see A Campbell, "Emergency Liquidity Financing for Banks in Distress: A Legal Framework for Developing Countries" [2006] Part 1 *Lloyd's Maritime and Commercial Law Quarterly* at 96 and R Delston & A Campbell, "Emergency Liquidity Financing by Central Banks: Systemic Protection or Bank Bailout?" in *Current Developments in Monetary and Financial Law* vol 3 (International Monetary Fund, Washington, DC, 2005) at p 429.

II. Why do banks deserve special treatment?

6 In most countries, banks are treated differently in some respects to other types of businesses. The taking of deposits from the public is one reason and this is coupled with the role banks play in the payments system. These two factors single banks out for some degree of special treatment.[6] A further issue is the possibility of "systemic risk" which can lead to problems at one bank [7]spreading to other banks and, in a sufficiently serious crisis, to the entire banking system. The banking system tends to be far more fragile than is generally realised and a healthy system depends on confidence. Why is this? According to Goodhart, "Fractional reserve banking is inherently a confidence trick, and, should confidence be lost, as is bound to happen from time to time, the house of cards is prone to tumble down."[8] Banks, instead of safekeeping the savings of depositors stored away safely in a vault,[9] will use the money deposited for the purpose of carrying on their business, and the business of banks tends to carry with it certain risks. From the legal perspective, the depositor has lent the money to the bank and has become an unsecured creditor.[10] The bank will then seek to use these funds to obtain a better rate of return than it is paying to the depositors and this inevitably involves some degree of risk.[11] The main risk is that borrowers may default and if this happens in sufficient numbers the bank may find itself in difficulties.

7 Another aspect of the business of banking which increases risk is that banks invariably operate on the basis of fractional reserves. This means that they will seek to use as much of their capital as possible for potentially profit-making business. Traditionally, this has been mostly

6 See A Campbell & Cartwright, *Banks in Crisis: the Legal Response* (Ashgate, Aldershot, 2002); E Hupkes, *The Legal Aspects of Bank Insolvency: A Comparative Analysis of Western Europe, the United States and Canada* (Kluwer, The Hague, 2000); T Asser, *Legal Aspects of Regulatory Treatment of Banks in Distress* (International Monetary Fund, Washington DC, 2001).

7 For an excellent account of risks faced by banks see S Heffernan, *Modern Banking* (Wiley, Chichester, 2005) ch 3 "Management of Risks in Banking".

8 C Goodhart, *Bank Failures and Bank Insolvency Law in Economies in Transition* (R M Lastra & H N Schiffman eds) (Kluwer, The Hague, 1999) at p xiii.

9 Readers familiar with Gringotts Bank in the Harry Potter stories will know that Harry's gold is kept secure in a vault with protection from the Goblins! See J K Rowling, *Harry Potter and the Philosopher's Stone* (Bloomsbury, London, Paperback Ed, 1997) at pp 56–59.

10 See A Campbell & D Singh, "Legal Aspects of the Interests of Depositor Creditors: The Case for Deposit Protection Systems" in *Deposit Insurance* (A Campbell, J R LaBrosse, D G Mayes & D Singh eds) (Palgrave Macmillan, Basingstoke, 2007) at pp 40–46.

11 There are various types of risk faced by banks, the most common one being credit risk. For further detail see A Campbell, "Bank Insolvency and the Problem of Non-performing Loans" (2007) Journal of International Banking Regulation vol 9(1) at 25.

by way of loans. Typically, they will seek to keep as little capital as possible in cash or near cash form. In most countries, there will be a regulatory minimum level of required capital.[12] This means that should there be exceptionally high demand from depositors for repayment, the bank may find itself without sufficient liquidity to meet these demands. This risk is increased hugely by another aspect of traditional banking business. This is the idea of "borrowing short and lending long". This makes banks particularly susceptible to risk as they typically lend on the basis of term loans which are made for a fixed period of time. From a legal contractual perspective, the bank will have no right to attempt to accelerate repayment of these loans unless there has been an act of default by the borrower which would permit such action by the lender.[13] Deposits, on the other hand, are normally repayable either on demand or on relatively short notice. This creates a maturity mis-match which can be potentially problematic. However, these risks can be minimised by ensuring adequate liquidity to deal with normal day-to-day business and by the availability of an interbank market coupled with the ability of the central bank to provide liquidity in certain circumstances. Where a bank is dependent on sources of funds from a more concentrated base, as was the case with Northern Rock, the business model can become extremely high risk and this should be a matter of concern for the banking regulator.

8 Perhaps the most important aspect of the business of banking is the need for the public to have confidence in its banks. It is of singular importance that confidence is not lost as this may not only affect a single bank but may also have systemic implications. It is, in fact, the systemic aspect which is most important to bank regulators and central banks. The banking crises in Mexico in 1995 and East Asia in 1997 demonstrated the extent and speed with which a systemic crisis can develop when confidence is lost.[14]

9 For these reasons, it is vital that countries develop a financial sector safety net to ensure the safety of individual banks and to protect

12 The Basel Capital Adequacy Accord will most often be used and this is in the process of change with the proposals for a new approach to minimum capital by the Basel Committee on Banking Supervision. This has become known as Basel II. The recent liquidity problems being experienced in many countries since the summer of 2007 have led to calls for a rethink which could lead to significant changes.

13 Some loans may be repayable immediately. This is normally the position in common law jurisdictions with regard to overdrafts but, even though the legal right to immediate repayment is given, not all borrowers will be in a financial position to repay the entire amount at short notice.

14 See R M Lastra & H S Schiffman, *Bank Failures and Bank Insolvency Law in Countries in Transition* (Kluwer, 1999) in general for an excellent discussion of these.

bank depositors. In the next part of this article, the components of a financial sector safety net will be examined.

III. The financial sector safety net

10 Most countries have introduced a financial sector safety net which typically involves the central bank as provider of emergency liquidity assistance (which may or may not also be responsible for the regulation and supervision of individual banks), the banking regulator (where this role is undertaken by a separate body) and the Ministry of Finance. In addition, in many jurisdictions, there will also be a deposit insurance scheme in place and this means that the role of the deposit insurance agency will also be a relevant part of the financial sector safety net. As noted above, the aim of a financial sector safety net will not be to prevent all bank failure and because of this there will be a need for a legal framework which is capable of dealing effectively with insolvent banks.

A. Regulation and supervision

11 The major technique used to reduce the likelihood of failing banks is an effective system of regulation and supervision.[15] The responsibility for undertaking the task of supervision is most commonly given to the central bank, but there is an increasing tendency towards giving this task to a separate body and, in some countries, this has resulted in a "super regulator" which has responsibility, not just for the banking sector, but for the entire financial services sector. This is the position, for example, in the UK where the FSA is the body which has been established for this purpose. Prior to the establishment of the FSA, the Bank of England, which is the central bank of the UK, had responsibility for bank regulation and supervision. It now has responsibility for the overall health of the financial system but no longer has any role to play in the prudential regulation of individual banks.[16]

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15 For a discussion of the rationales and objectives of financial regulation see Campbell & Cartwright, *supra* n 6 at ch 2.

16 This regulatory framework in the UK was introduced in 1997 after the election of the new Labour Government. Almost immediately after its election the Chancellor of the Exchequer, Gordon Brown, announced that regulation and supervision would be transferred from the central bank to a newly created body, the Financial Services Authority. At the time this was viewed as a radical, innovative and welcome development. This was followed by a major piece of legislation, the Financial Services and Markets Act 2000, which covers all aspects of financial regulation in the UK. The Northern Rock crisis was the first test for the new "tripartite" system and most commentators have questioned the effectiveness of it in practice. Reforms are now being proposed and are discussed later in this article.

12 The regulatory process for banks involves the concept of licensing, or prior approval, of both banks and those who own and manage them. This is something that is recognised by the Basel Committee on Banking Supervision in its *Core Principles for Effective Banking Supervision*[17] and virtually all jurisdictions use a licensing system for banks. It is important to realise that, while a licensing system can ensure that the appropriate standards are being met at the time the licence is granted,[18] the role of the supervisor must involve the continuous oversight of the licensed body to ensure continuing compliance. This will involve ensuring that such matters as minimum capital requirements are maintained and also that those responsible for owning and managing the bank are "fit and proper" persons at the time permission is granted and continue to be so.

13 One of the major roles of a banking regulator is to be able to assess the various types of risk that banks face. Banks face many possible risks which must be managed on a continuous basis. According to Heffernan, "the risks specific to the business of banking are: credit; counterparty; liquidity or funding risk; settlements or payments risk; market place risk, which includes currency risk and interest-rate risk; capital or gearing risk; operational risk; and sovereign and political risk".[19] The troubles experienced by banks in the recent past originate with credit risk but, more recently, this has been transferred to liquidity or funding risk.

14 While it is primarily the job of the management of banks to devise and implement their own risk strategies, it is imperative that those involved in regulation and supervision are fully aware of what these strategies are and how to accurately and effectively assess them. To be effective, those responsible for the regulation and supervision of banks should be in a position to be able to properly assess all of these different risks and this involves being in a position to fully understand what these risks are.

15 The trend internationally in recent years has been to introduce a banking regulatory framework modelled on the Basel Committee's *Core*

17 The work of the Basel Committee has become synonymous with international best practice in relation to the regulation and supervision of banks. It has been described as "soft law par excellence". R Cranston, *Principles of Banking Law* (Oxford: Oxford University Press, 2005) at p 64.

18 And that those who own the bank and who undertake senior management functions are fit and proper. See the *Basel Core Principles for Effective Banking Supervision and the Core Principles Methodology* at www.bis.org.

19 Heffernan, *supra* n 7, at p 104. Chapter 3 of this book entitled "Management of Risks in Banking" provides an excellent and detailed account of all the risks faced in banking and should arguably be compulsory reading for all those interested in the regulation and supervision of banks.

Principles. While this is a very welcome development, it needs to be recognised that it is one thing to design and implement a piece of legislation which provides an appropriate safety net framework but it is another to ensure that it will be effective in practice. To be operationally effective, a regulator or supervisor requires adequate resources, both human and financial, to be able to undertake its task effectively. This has been a problem in many jurisdictions in recent years with regulators in many countries having insufficient public funds allocated to it to allow it to undertake its task appropriately. A further problem is often a lack of trained staff and an increasingly complex range of financial products being offered by banks, many of which are not only difficult to understand, but also difficult to assess in relation to the risk posed. The problem of a failure to understand some of the products being offered and also some of the business models being used makes effective risk assessment very difficult, if not impossible, in some cases.

16 The role of the banking regulator in the 21st century is extremely challenging and is constantly becoming more complex.

B. Protecting depositors – The role and function of a depositor insurance scheme

17 The question of how to protect bank depositors when banks fail has been of considerable importance in many countries in the last 30 years. Depositors in many countries have lost savings and this has led to social and political problems as well as economic ones. In recent years, many countries have been introducing deposit insurance schemes[20] in an attempt to deal with this problem and both Singapore and the UK have done this. Relevant aspects of both the Singapore and the UK schemes will be examined but before that a number of issues relating to bank depositors as creditors, and the various ways in which they can be protected, will be considered.

18 From the legal perspective, the depositors of a bank will be classified as unsecured creditors and, as such, will rank after those with security or some sort of priority.[21] As such, in the event of the insolvency of the bank in which they have the savings, they are likely to receive less than they are owed by the bank, and will often be entitled to receive nothing, should it subsequently go into insolvent liquidation. It is usually the case that in most legal systems unsecured creditors tend to receive only a small fraction of what they are owed. Often they will

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20 The International Association of Deposit Insurers provides extensive details at www.iadi.org.

21 The position throughout the common law world is based on the House of Lords decision in *Foley v Hill* (1848) 2 HL Cas 28. For a discussion of this see Campbell & Singh, *supra* n 10, at p 40.

receive nothing at all unless some form of protection is provided. In many jurisdictions, it has been decided that bank depositors are sufficiently important to deserve special treatment when the bank in which the deposits have been placed is unable to repay those deposits.

19 Providing protection for depositors usually has two main objectives. The first is the possible contribution this can make to the protection of the banking system generally and, second, as a method of providing protection to consumers.[22] There have been debates ever since the introduction of the first national deposit insurance scheme in the US in 1933 about which of these two objectives should have priority. In the US, there is no doubt that the major priority is the protection of the banking system and that the protection of individual depositors is seen as a by-product of this. In the EU, the requirement to introduce depositor protection has always been considered to be a consumer protection issue. Arguably it does not matter which of the objectives is thought to have been the priority as a well-designed deposit insurance system should be able to achieve both objectives.

20 There are several options for dealing with the issue of protecting bank depositors. The first is to treat them as any other ordinary unsecured creditor and to provide no protection other than what is provided generally to unsecured creditors. But as has been seen already, this option tends not to be popular in the 21st century. In fact, it appears that most of the countries which do not have depositor protection schemes are in the process of considering introducing them, although there are a few jurisdictions which have deliberately taken a decision not to provide any form of formal protection to depositors.[23]

21 The second option, which presently exists in a number of countries,[24] is still to treat depositors as unsecured creditors but to provide some degree of insolvency priority, thereby allowing them to rank before other unsecured creditors. The priority will only normally be available for deposits up to a certain amount and this will usually be set at a relatively low level. Where this is used, it will allow accelerated payments up to a particular sum to be made to all depositors thereby alleviating immediate hardship. This "acceleration" aspect is considered important and the liquidator will have to be given power to make these distributions without having finalised the bankruptcy estate. Using this

22 Deposit insurance was introduced in the US in 1933 by the Banking Act as a measure designed to restore stability to the banking system and not primarily as a consumer protection measure. The EU legislation has the primary aim of protecting consumers of banking services. See the Deposit Guarantee Directive 94/19/EC.

23 New Zealand is an example of a country which has decided not to implement a deposit insurance scheme.

24 For example this approach is common in the former states of the USSR.

approach may provide full cover for many small depositors and can therefore be a useful tool.

22 Another approach is to provide some form of guarantee or insurance for depositors and it is this approach which is very much the most popular option at present.[25] It is not possible here to examine deposit insurance schemes in detail and readers can turn to a number of sources for further reading.[26] However, there are a number of matters which need to be considered. The ones being considered here are:

(a) How much cover should be provided?

(b) How quickly can payments be made?

(c) How is the scheme to be funded?

(d) What is the role of the deposit insurance agency?

23 Perhaps the most fundamental, yet controversial, of these is how much cover to provide. In the US, each depositor at an insured institution is fully protected up to US$100,000. This is a generous level of cover and many countries have lower limits while some have higher. The question of how much protection to provide to depositors has always been controversial and is something which causes significant disagreement. It is now generally agreed that providing 100% cover for all deposits would be inappropriate as this would be potentially very costly and would significantly increase the amount of moral hazard within the banking system.[27] The relevance of an appropriate level of cover was seen during the recent crisis in the UK and will be discussed later.

24 With regard to the type of cover to be provided, there are at least three approaches which are in operation at present. First, is to provide total cover to all bank depositors. As previously mentioned, the

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25 In some countries, *eg*, the US, depositors benefit from both priority and a deposit insurance scheme.

26 For further reading on deposit insurance schemes see A Campbell, J R LaBrosse, D G Mayes & D Singh, *Deposit Insurance* (Palgrave Macmillan, Chichester, 2007); D Hoelscher, M Taylor & U Klueh, Occasional Paper 251 (International Monetary Fund, Washington DC, 2006); G Garcia, *Deposit Insurance: Actual and Good Practice* Occasional Paper 197 (International Monetary Fund, Washington DC, 2000); R MacDonald, *Deposit Insurance* (Bank of England, London, 1996); E White, *Deposit Insurance* (World Bank, Washington DC, 1995); A Campbell & P Cartwright, "Deposit Insurance: Consumer Protection, Bank Safety and Moral Hazard" [1999] 10 EBLR 96; A Campbell, "Protecting Bank Depositors: Some International Comparisons" [2004] *Contemporary Issues in Law* vol 7(2) at p 140.

27 A discussion of moral hazard is beyond the scope of this paper. For further information on the relationship between moral hazard and deposit insurance see A Campbell, *supra* n 26, "Protecting Bank Depositors: Some International Comparisons".

general consensus is that this type of cover is not to be recommended. The second choice is to provide total cover but only up to a pre-determined ceiling, as in the US. A third approach is to provide partial cover only. The rationale for this approach, which has been developed from the insurance markets, is that a person receiving insurance cover should share some of the risk. This is a concept known as co-insurance and where it is used, as in the UK until very recently, a depositor will be expected to bear some of the loss of the failure of his or her bank. When deposit insurance was first introduced into the UK, no degree of total protection was provided and regardless of the size of the deposit a maximum of 75% of the amount in deposit would be payable by way of compensation. This meant that even depositors with very modest amounts of savings would suffer a significant loss. The argument in favour of this in the context of bank depositors has always been very weak. How is the average bank depositor to undertake a risk assessment? Most depositors consider banks to be a safe place in which to place their deposits and are more likely to rely on the fact that the regulator has licensed the bank to accept deposits as a justification for depositing. Not surprisingly, the use of co-insurance in deposit insurance schemes has not been widespread and Singapore has wisely chosen not to introduce this.

25 A variation on this theme was found in the UK until very recently. The first £2,000 on deposit was fully protected while above this up to £35,000 only 90% of a deposit was protected. This meant effectively that any depositor with a balance of more than £2,000 in an account would have had to suffer a loss on the failure of their bank. How this worked in practice in the Northern Rock case is significant and will be returned to later.

26 Another important factor is the timing of compensation payments. Under the Deposit Guarantee Directive,[28] compensation to depositors in the EU is to be made within 90 days of a proper claim for compensation being launched with the relevant deposit insurance agency. The legislation allows this period to be extended to six months in exceptional circumstances. Such a delay would be considered unacceptable in many countries and this is particularly true of the US where compensation is made more or less immediately on the failure of a bank.[29]

28 Directive 94/19/EC Art 10.

29 In fact, in the US, it is more often the case that the FDIC actually arranges for deposits to be transferred to another institution thereby minimising any disruption to depositors. This avoids disruption to depositors and helps to reduce costs. For further information, see www.fdic.gov.

27 Another issue of significance is how the scheme should be funded. Some countries choose to ensure that a fund is in existence of a size which is designed to be able to deal with bank failures, but another approach taken is to ask for contributions from solvent banks when an institution is in financial difficulties. This latter approach has a number of weaknesses, in particular, it makes it difficult to be able to act quickly to compensate depositors on a default by a bank, yet it is quite common for countries to fund schemes in this way.

28 Another important issue is what the actual role of the deposit insurance agency is to be. Is the scheme to be simply what is referred to as a "pay-box" or is it to have a wider role? Both Singapore and the UK operate "pay-box" schemes which exist only to reimburse depositors of a failed bank as and when such an event takes place. In contrast, the Federal Deposit Insurance Corporation ("FDIC") in the US acts also as a regulator and a receiver of failed institutions. Most countries do not have the resources to operate anything other than a "pay-box" deposit insurance scheme and leave such matters as regulation and insolvency procedures to another body.

C. A legal framework for dealing with insolvent banks[30]

29 As has already been seen, banks have certain characteristics which single them out for some degree of special treatment and this is also true in relation to how to deal with insolvent banks. In recent years, many developing countries have introduced a bank insolvency law framework and many developed countries already have special bank insolvency laws. Some developed countries, for example Switzerland, have recently reformed their bank insolvency laws. There are some countries, however, where there is no bank insolvency law with banks being subject simply to the normal corporate insolvency laws without any special provisions. The UK is an example of this approach, as was Singapore until recently (the new Singaporean approach is discussed later in the article), but for reasons discussed later in this article the situation is likely to change in the very near future.

30 When it is realised by either the management of a distressed bank or by the regulator that the bank may actually be insolvent rather than merely illiquid, it is important that the legal framework allows swift and effective action to be taken. The laws of many countries are deficient in this respect and this has often led to many problems which were potentially avoidable. It is still quite common for countries not to have any specific bank insolvency laws although many countries,

30 For general reading on bank insolvency laws see Campbell & Cartwright, Hupkes and Asser, *supra* n 6.

especially developing ones, have introduced new banking laws which include specific bank insolvency provisions in recent years.

31 It is particularly important that quick and decisive action can be taken when a bank is found to be insolvent and the law should provide for this. There is a need for some form of what in the US is termed "prompt corrective action". In the US, the action taken on a finding that the bank is insolvent is done by way of an administrative process, without the need for court involvement, and in most cases it is the deposit insurance agency, the FDIC, which will be responsible for undertaking this.[31] In most countries, however, it will be necessary for a court-based procedure to be used in these circumstances. In fact this is a topic which has been widely debated in recent years.[32] Is it preferable to use an administrative rather than judicial procedure? Although as yet there is no overall agreement, the recent tendency appears to be to move in the direction of introducing administrative procedures, which, for example, Switzerland has done recently, and of particular relevance for this article, as has Singapore. It is generally thought that the main advantage of an administrative procedure is speed. It is often found that judicial processes may be slow and this can be problematic and in many countries the court service may be inadequately resourced to deal with the problems of failing banks.[33]

32 However, this is not necessarily the case as was demonstrated in the collapse of Barings in 1995 where the judicial process was both swift and effective.[34]

33 Arguably what is more important than whether the process is administrative or judicial in nature is that it is possible for swift and appropriate action to be taken in order that the insolvent bank can be

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31 For detailed information on the US procedures see the website of the FDIC at www.fdic.gov.

32 In some countries, the constitution provides that property rights can only be interfered with by way of a court order and an administrative procedure would not be possible. However, even in such jurisdictions it should be possible to minimise the degree of court involvement.

33 It is often argued, with some merit, that in many jurisdictions it is difficult to find judges who fully appreciate the issues and the complexities of a bank insolvency and who have been adequately trained.

34 The events at Barings took place with significant speed and although the Bank of England attempted to arrange an informal rescue this could not be achieved. Barings bank was subjected to an administration order and the judge, Vice-Chancellor Scott, heard the case over a weekend in order to ensure that the process had been completed before the markets opened on the following Monday morning. The administrators sold Barings to the Dutch bank ING for the sum of £1 after receiving the approval of the judge. For a detailed account of this case see *The Administration of Barings: Future History* (Ernst & Young, London, 1995).

put under the control of a conservator[35] who can take control of the business of the bank, and preserve its value as far as possible, while the possible alternative outcomes are considered. One of the first matters that need to be dealt with is whether or not there is any possibility of avoiding an immediate liquidation of the bank. Ideally, a bank should only be put into liquidation where all of the possible alternatives have been considered and where the conclusion reached is that there is no realistic possibility of any other outcome which would provide better value for all of the affected parties.

34 With regard to alternatives to liquidation, a variety of bank resolution techniques have been developed in the US by the FDIC which has had, on a number of occasions, to deal with significant levels of bank failure. The FDIC has, since its creation in 1933, had the opportunity to develop these techniques and it is hardly surprising that most of the bank resolution methods which are in use at the present time have their origins in the US.

35 One feature of a bank insolvency which makes it different to most other types of company is that the banking regulator, together with the central bank, will be involved from the start of the process. In fact, an efficient bank regulator should have already become aware of the difficulties being experienced by any of the banks under its supervision well before its problems have become so serious as to lead to a state of insolvency. Accordingly, the regulator should be in a position to take the most appropriate action without delay. Provided, that is, the law gives it sufficient power to do so. In many countries, this is still not the case.

36 When is a bank insolvent? In corporate law, there are two tests for the insolvency of a company; the balance sheet test and the cash-flow test. The position for banks is different in that there is an additional one. This is the concept of regulatory insolvency[36] which is the situation where the bank no longer meets its minimum capital requirements although it is still solvent on the basis of the first two tests. In this situation, it is helpful if the regulator is given discretion to exercise forbearance and to provide assistance to "nurse" the bank back to regulatory compliance and, therefore, solvency. However, such attempts may not be successful and it is important that the regulator closely monitors the bank during this period.

37 The FDIC has, since the 1930s, been responsible for handling insolvent banks and the strategies it has devised have demonstrated both

35 In this paper, the term conservator will be used to describe the person appointed. Internationally, the terms used are official manager, receiver or administrator.

36 For further information on this see Hupkes, *supra* n 6, at p 12.

innovation and practicality. At the present time, most banks which are experiencing financial difficulties are doing so as a result of poor quality loan portfolios so it is important that any attempt to restructure the bank will be capable of effectively dealing with this problem.

38 In the lead up to a finding of insolvency, it will often have been the case that the management of the bank will have attempted to put into place a rescue strategy which has not been successful.[37] On the commencement of an insolvency procedure, a moratorium, or stay, will have come into play and this will make it easier for alternatives to liquidation to have a chance of success.[38]

39 Two possible courses of action once the bank is in conservatorship is for the bank's conservator, working with the banking supervisor, to attempt to promote the possibility of a merger or acquisition, or to engage in what has become referred to as a purchase and assumption transaction. In many instances of bank insolvency, it will not be possible to embark upon such strategies due to a lack of suitable laws in the jurisdiction. This has meant that in many banking crises there has often been no available alternative but to put insolvent banks immediately into liquidation, thereby resulting in an inefficient outcome in many respects. This has often led to an overall downturn in banking activity available within a particular country, resulting in a negative impact on the overall economy of the country.

40 Many developing countries, often with the assistance of major international organisations,[39] now have a legal framework which provides for alternatives to liquidation for troubled banks. Many, however, still do not.

41 Of course, it should not be assumed that simply by introducing provisions for bank restructuring into the law that it will automatically be easy to find a better alternative to liquidation for an insolvent bank. Much will depend on the resources available to the banking regulator, and this includes the availability of sufficient human expertise in resolving insolvent banks. For an acquisition or merger to be a possibility, it will be necessary to find a sufficiently healthy and well-

37 Normally, where there is a system of effective supervision, the management of the troubled bank will be working alongside the supervisor in an attempt to avoid insolvency. In such cases, it may be possible to find an alternative solution such as a takeover by a healthy bank.

38 A moratorium will ensure that no enforcement action can be taken against the bank while the moratorium is in force. This will provide some degree of breathing space to the conservator. It is often the lack of a moratorium which prevents informal workouts being successful.

39 Such as the International Monetary Fund, World Bank, Asian Development Bank and the European Bank for Reconstruction and Development.

capitalised bank which would be interested in such a transaction. From the perspective of the Government of the country in which the insolvent bank is located, a major advantage of a merger or acquisition is that it is a private sector solution without the need for large amounts of public money to be injected. It would, however, be unrealistic to expect to find a private sector solution in most cases of bank insolvency. Even where there is a willing acquirer, it may need some public assistance to enable it to undertake the transaction and to remain compliant with such matters as minimum capital ratios. In this type of situation, some degree of regulatory forbearance may become necessary and it is hoped that regulators will be willing to be sufficiently flexible.

42 In some countries, and this is especially true in many developing and small countries, there will be no domestic bank which will be in a position to assist in such a transaction and it may become necessary to consider allowing a sufficiently large foreign bank to acquire all or part of the insolvent institution. While this may cause some political and regulatory difficulties, there are definite advantages in that the opportunity to move into a new market may mean that the foreign bank is willing to pay a premium to acquire the insolvent bank.

43 To find a financially healthy bank which is willing to acquire the insolvent bank will invariably be the best outcome that could be achieved. One significant advantage will be that there will be no need for a liquidation process as the insolvent bank will simply cease to exist as a legal person. This also protects depositors, has significant time savings and, importantly, will usually be the lowest cost option.

44 Unfortunately, it will be the case, more often than not, that there is no party willing, or perhaps able, to acquire the entire bank as there will often be a significant amount of bad assets which no acquirer may be willing to take on. In recognition of this difficulty, the so-called "purchase and assumption" transaction has been developed.[40] This technique is often used when it is apparent from the outset that a merger or acquisition will not be possible to organise or when attempts to do so have failed. The way in which a purchase and assumption transaction operates is that a financially healthy bank will purchase some, but not all, of the failed institution. In many cases, the purchaser will not be willing to take on all of the assets and liabilities. It is the assumption of liabilities which may not be easy to quantify that tends to be the most significant factor in preventing an acquisition or merger.[41]

40 As with so many bank resolution techniques, this was originally developed in the US by the FDIC while variations of the technique have since been developed elsewhere.

41 See Hupkes, *supra* n 6, at p 89.

45 The legal position on a purchase and assumption transaction is that what the acquirer is getting are assets and liabilities whereas in an acquisition or merger the acquirer is purchasing the entire corporate entity together with its licence to operate.

46 It will in practice be much easier to find an acquirer, or acquirers, to take on good assets and liabilities but where a significant amount of assets are impaired, and possibly very difficult to value with any degree of accuracy, it is more efficient to ensure that the good parts of the business are preserved as a going concern. As a result of this, it is often the case that the regulator will need to have the legal power to remove the "bad assets" so that only the good assets are available for the practice and assumption transaction.[42]

47 Where a purchase and assumption transaction has been used there will usually have to be a liquidation of what is left and this tends to mean that shareholders in the failed bank will receive little or nothing in the liquidation process. The bank will no longer exist as a legal entity but, hopefully, value will have been maximised. In most cases, there will be some value left in the insolvent bank and it will have assets and liabilities which will be of interest to other banks. It will only be in the case where a bank is hopelessly insolvent that an immediate liquidation may be unavoidable. For the reasons already discussed, if the banking supervisor is undertaking its duties in an efficient manner, action should have been taken early enough to prevent the need for an immediate liquidation without the possibility of an alternative form of resolution.

48 Where the law allows a purchase and assumption transaction to be used it can be a very flexible tool which helps to protect value. This type of transaction has now been used with significant success in a number of jurisdictions worldwide.

IV. A British banking crisis – The Northern Rock story

49 The collapse of Barings Bank in 1995 represented the last significant banking crisis in the UK until the problems faced by Northern Rock bank became public in the late summer of 2007. While Northern Rock does not have any apparent Singaporean connection, Barings certainly did and it was the activities of a single "rogue trader" by the name of Nick Leeson that brought Barings, thought to be the oldest merchant bank in the City of London, close to bankruptcy.

42 This is usually undertaken when the loan portfolio is of dubious quality.

50 In the UK, there were several issues which made it difficult for the relevant parties to deal effectively and quickly with Northern Rock. The background to the crisis is set out briefly here to set the scene for the discussion which follows. Northern Rock, a former conservatively run mutually-owned building society, had embarked upon a strategy of high-speed growth and despite the significant increase in levels of business and profits the FSA did not appear to have considered that this was a matter that should be closely monitored.

51 It had traditionally funded its mortgage lending mainly from deposits from customers and did this in conjunction with a very conservative lending policy. In the mid-1980s, new legislation permitted building societies in the UK to demutualise and become banks[43] and Northern Rock took advantage of this. Despite having changed its status, Northern Rock continued to operate in the same way it had been doing, as a conservatively run mortgage lender. Many other building societies decided to take the same action and most of these also continued predominantly to be mortgage lenders.

52 This approach was to change radically and Northern Rock's growth in recent years had been stellar; by 2006, it had become the UK's fifth largest mortgage lender. To enable it to grow in this fashion, it had moved away from its traditional method of undertaking the funding side of its business. As a building society, it had funded its lending by way of deposits from its customers but to continue to do this would not allow it to grow as quickly as management wanted. Instead, it had started to raise funds from the money markets by either borrowing large tranches of funds or by the use of securitised products in the form of collateral debt obligations.[44] In the highly liquid money markets of the early 21st century, funds were plentiful and, equally important, inexpensive. Northern Rock could raise money not only in the UK but internationally and it was having no difficulty in raising sufficient funds to support its ambitious growth strategy.

53 By 2006, it had moved away considerably from its original business model of funding lending predominantly from deposits and by the summer of 2007, only about 25% of its funds were coming from depositors. About 75% were from the alternative sources referred to above.

54 Despite this unusually rapid rate of growth and profitability, it appears that Northern Rock had been assessed by the FSA as "low

43 The Building Societies Act 1986.
44 For detailed information on this type of funding see S Heffernan, *Modern Banking* (Wiley, 2005) ch 2.

probability risk". The risks involved in pursuing a strategy of this type had obviously not been fully appreciated.

55 During the summer of 2007, liquidity started to dry up on the world money markets and, by mid-August, the management of Northern Rock realised there were problems in refinancing some significant commitments that had come due. It was having difficulties both in raising funds and also in finding any funding available at a rate of interest that was sustainable.

56 By early September, the position of Northern Rock had become precarious. It had tried to find a buyer and for a time it appeared that Lloyd's Bank was interested in acquiring it but nothing was to come from this.[45] The Governor of the Bank of England, Sir Mervyn King, had consistently refused to make lender of last resort assistance available to Northern Rock.

57 On Wednesday 12 September news about Northern Rock's problems began to circulate and the run began.[46] Despite public assurances by the Chancellor, the queues at Northern Rock branches were growing. This was all being shown live on television with depositors being interviewed. Not surprisingly, this made things worse and by the Saturday morning a full-blown bank run was underway. Fortunately, it had not spread to any other bank or building society.

58 The events of the following Monday (17 September) were dramatic. Breakfast television was broadcasting live pictures of the lengthy queues at Northern Rock branches. The bank run was the main news item on all TV channels.

59 Many of the depositors of Northern Rock were not reassured by the Chancellor's statements nor by those of the FSA, Bank of England or Northern Rock itself.

60 The public relations campaign throughout the weekend had not worked and the weekend media news coverage had increased speculation about the problems.

61 The Chancellor, apparently after discussions with the Prime Minister and the other relevant parties, announced that all deposits at Northern Rock would be protected – a blanket guarantee. Particularly important was that the protection would also cover other banks. It was limited only by the use of the phrase "during the current crisis".

45 The Report of the House of Commons Treasury Committee, January 2008.

46 The last runs on British banks had been in the 19th century. These were Overend, Gurney & Co Bank in 1866 and the City of Glasgow Bank crisis in 1878.

62 A "blank cheque" for an uncertain amount had effectively been provided by the UK Government and, therefore, the UK taxpayers. This action meant that the immediate panic was over but many of the problems had not gone away and the actions (or inactions) of the various parties raise a number of important issues.

63 Approximately five months after the end of the run on Northern Rock, the Chancellor of the Exchequer announced that the bank was to be nationalised with immediate effect. The Prime Minister and the Chancellor have been widely criticised for indecisiveness throughout this period.

V. The failure of the safety net

64 A memorandum of understanding ("MOU") established a framework for co-operation between the Treasury, Bank of England and FSA in the field of financial stability.

65 This is not set out in statutory form.

66 The division of responsibility between the parties is based on four guiding principles: clear accountability; transparency; the avoidance of duplication; the regular exchange of information. The Bank of England is responsible for ensuring the stability of the monetary system, acting in the markets to deal with fluctuations in liquidity, overseeing the infrastructure of the financial system,[47] maintaining a broad overview of the system as a whole and undertaking, in exceptional circumstances, official financial operations, in order to limit the risk of problems affecting particular institutions spreading to other parts of the financial system. This means that the Bank of England is responsible for the stability of the financial system and is to act as lender of last resort but is not involved in the supervision of individual banks. The House of Commons Treasury Committee asks a number of questions about the role played by the Bank of England in providing or not providing financial support. They note that with the benefit of hindsight the central bank should have broadened the range of acceptable collateral earlier than it did but also note that it is not possible to know whether an open market liquidity operation in August would have been successful.[48]

47 Including the domestic and international payment systems.
48 *The Run on the Rock* (Fifth Report Session 2007–2008, vol 1, 24 January 2008) at pp 45–47.

67 The FSA is responsible for the authorisation and prudential supervision of banks[49] and the supervision of financial markets. This means that the FSA is the supervisor and is responsible for licensing banks[50] and for ongoing supervision. It uses a risk-based approach and each bank has a risk rating from high to low impact. Northern Rock had been assessed as a "low-probability risk".[51] According to the House of Commons Treasury Committee,[52] "the FSA did not supervise Northern Rock properly. It did not allocate sufficient resources or time to monitoring a bank whose business model was so clearly an outlier; its procedures were inadequate to supervise a bank whose business grew so rapidly".

68 The Treasury is responsible for the overall institutional structure of financial regulation and informing and accounting to Parliament for the management of serious problems within the financial system and any measures used to resolve them. The Treasury has no operational responsibility for the activities of the FSA or the Bank and "shall not be involved in them". It was the Chancellor's decision to provide a support facility to Northern Rock in September and this has been described by the Select Committee as the right one to take.[53] Not everyone is in agreement with this.

69 The Northern Rock crisis has provided the first real test of this tripartite system established by the MOU. Did it work well? The majority view is clearly that it did not and that significant weaknesses were exposed. Why was this and what should be done? These are questions which as yet have not been fully answered.

70 Apart from the issue of a failure of communication between the relevant parties, the roles played by deposit insurance and emergency liquidity financing became crucial. Prior to the crisis, awareness of the depositor compensation scheme in the UK was very low but when details started to circulate in the media, instead of having a calming effect, the run gathered momentum. Similarly, when it became known that Northern Rock needed emergency liquidity financing, the panic intensified. Both of these aspects need to be considered.

71 The level of protection provided by the Financial Services Compensation Scheme to bank depositors was considered by depositors to be deficient in more than one respect. The first significant weakness

49 *Ibid*.
50 And other financial institutions.
51 The Chair of the FSA, when giving evidence before the House of Commons Treasury Select Committee, has since admitted that it was wrong about this and that the Northern Rock's business model was in fact extreme.
52 *Supra* n 48, at 34.
53 *Supra* n 48, at 55.

was the use of co-insurance and the relatively low level of fully protected deposits.[54]

72 So any Northern Rock depositor with a balance in excess of £2,000 would lose 10% of the excess. The maximum any depositor could receive in compensation was £31,700. Most of the customers involved in the run had balances considerably in excess of £2,000 and many had more than £35,000.

73 A further problem was the potential delay in payment of compensation. Ninety days allowed by the legislation with up to 180 in "exceptional circumstances".[55] These two weaknesses were clearly thought to be unacceptable by most depositors and actually appear to have assisted in promoting the run on the bank.

74 Reform of depositor protection in the UK has already begun. As of 1 October 2007, the co-insurance element has been removed and 100% cover is now provided up to £35,000.[56]

75 The role of lender of last resort belongs to the Bank of England for historical reasons.

76 It is not formally set out in law and never has been. It has always been at the discretion of the Governor of the Bank of England. The workings of this facility had not previously been called into question to any extent but in this case the fact that assistance was being provided to Northern Rock actually had the effect of intensifying the crisis. It has traditionally been the policy of the Bank of England to keep the fact that it is providing support secret at the time. Sir Edward George, the former Governor, has stated, "If people know that we are so concerned about systemic fragility that we have judged it necessary to provide support, that could lead to a wider loss of confidence. They would wonder how far that support would be extended, and we could rapidly find ourselves in the position where we were in practice underwriting all the liabilities of the banking system."[57] This is exactly what happened. The policy of confidentiality at the time of lending with disclosure post-crisis is clearly preferable but in this case there were doubts over the legality of this policy.[58]

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54 Until relatively recently, the UK scheme applied co-insurance on all deposits.

55 Directive 94.19/EC.

56 Further reform is under consideration at present.

57 E George, "The Pursuit of Financial Stability" (1994) *Bank of England Quarterly Bulletin* at 60–66.

58 It seems likely that these doubts were misinformed but clarification of this is necessary. This is a matter which needs to be resolved to remove any legal uncertainty.

77 As has already been seen, the UK does not have any special insolvency regime for banks. When there is a need for the use of an insolvency procedure, banks are subject to the same range of legal provisions as are available to any other type of corporation.

78 The law in the UK does not at present provide for the possibility of an administrative procedure being used and the general insolvency law, which is judicial in nature, must be used if informal methods have failed to prevent the bank from becoming technically insolvent.[59]

79 If Northern Rock had crossed the insolvency threshold, the FSA would have had to either apply to the court for the appointment of an administrator, as in Barings, or the appointment of a liquidator, as in BCCI. It is far from clear why the use of an administration order was not considered.

80 If the bank had been found to have been hopelessly insolvent then in any liquidation proceedings any unpaid depositors, including, of course, all those who were subject to co-insurance would be unsecured creditors and this has the effect of increasing costs and causing delays in the winding up.[60]

VI. The position in Singapore

81 The MAS is both the central bank of Singapore and the supervisor and regulator of Singapore's financial services sector which, of course, includes banks. It is responsible for formulating and executing Singapore's monetary policy, and it is the issuer of Singapore's currency. It looks after the country's foreign reserves and is also responsible for the issue and management of government securities. It also acts as supervisor and regulator of Singapore's entire financial services sector which involves the prudential supervision of individual banks.[61]

82 The nature of the Singaporean approach which uses a unified body to be both central bank and supervisor avoids the problems of the tripartite approach in the UK. In Singapore, there is no question of a breakdown in the flow of information between separate parties, nor is there ambiguity about who has responsibility for what.

83 The Banking (Amendment) Bill 2006 was part of a continuing process to strengthen the regulatory system and this is very much in keeping with Singapore's development as a major international financial

59 See, generally, the Insolvency Act 1986.
60 This exposes a further weakness of co-insurance.
61 Source www.mas.gov.sg.

centre. Prior to this, Singapore had also introduced a deposit insurance scheme and this will be considered later. A particularly positive feature of the action taken by the Singaporean authorities is that reform is taking place, not in the wake of a banking crisis, but at a time when there has been financial sector stability and when such matters can be thought out carefully and slowly.[62]

84 While the Bill introduced a wide range of reforms, what is being focused on here is the enhanced role the MAS has been given in the bank resolution process. The Singapore authorities recognised the need for the MAS to be in a position to act quickly and decisively whenever a bank was found to be in financial difficulties, and also that the existing law was deficient. The existing provisions did not provide the MAS with adequate powers to act to take control of a distressed bank and to undertake what would be necessary to allow it to attempt to achieve an effective resolution.

85 The Banking Act, originally of 1970, has been amended on a number of occasions and most recently with this Banking (Amendment) Bill 2006 which, *inter alia*, has introduced Part VIIA entitled *Transfer of Business and Shares and Restructuring of Share Capital.*[63] The amendments have been significant in relation to the additional powers given to the MAS to take control of a bank and arrange for its business, in whole or in part, to be transferred to another bank.

86 While the MAS has responsibility for the promotion of the stability of the financial system, it does not aim to prevent the failure of any financial institution and it recognises that such a "zero-failure" regime is neither feasible nor desirable.[64] This is in keeping with international best practice. The Singapore authorities entered into a consultation process before the preparation of the Bill. It was noted that where a bank is in financial difficulties the appropriate remedial action needs to be expeditious to ensure that losses to depositors, and other creditors, are minimised. Such expeditious action should also help to preserve the stability of the system as a whole. It was recognised in the consultation process that, at least in relation to a number of other

62 This is in contrast to most countries where new banking laws tend to be introduced as a result of failures exposed by a financial crisis. At present, the UK is an example of such a situation.

63 Part VIIA introduces both a voluntary procedure for the transfer of a bank as well as a mandatory procedure. The voluntary procedure is contained in Div 1 ss 55B and 55C. The compulsory procedure for the transfer of the business of a bank in Div 2 ss 55D to 55G and the compulsory procedure for the transfer of shares in a bank is in Div 3 ss 55H to 55J. Div 4 contains provisions for the compulsory restructuring of share capital of a bank – ss 55K to 55M.

64 MAS Annual Report 2006/2007.

jurisdictions, the MAS had relatively limited powers in this respect and that new and more appropriate powers would be desirable. The new provisions in the Banking Act give the MAS both a more significant role to play in the resolution process and a new range of options.

87 The new provisions give the MAS a more significant role to play from the moment it is discovered that the bank is sufficiently distressed financially to require some degree of intervention by the regulator. In particular, the MAS has a significant part to play in bank insolvency proceedings, which includes the right to be heard in the proceedings and the right to approve the liquidator.

88 Of particular importance is that the new provisions are aimed at providing a range of resolution options which had not been previously available and these are under the control of the MAS which is given the power to direct the sale of the business of a bank and to issue new shares, restructure capital and to sell existing shares to new investors.[65] The exercise of these powers is subject to the approval of the Minister in charge of the MAS.

89 Before exercising its powers to do any of the above, the MAS is required to satisfy itself that any such transfer would be appropriate, taking into account the interests of the depositors of both the transferor and transferee banks and the overall stability of Singapore's financial system. The rights of those who will be affected by such action are protected by giving them the right to be heard by the Minister before the transfer is approved. This requirement can be overridden where it would not be practicable or desirable. Effectively, this would be in the situation where speed is absolutely of the essence.

90 The Deposit Insurance Act 2005 introduced, for the first time, a scheme to protect the core savings of small depositors in Singapore in the event of a bank failure. All banks operating in Singapore are required to join the scheme[66] and, unlike the scheme in the UK, it is pre-funded with all banks being required to make contributions to the scheme.[67] The scheme does not cover business deposits or deposits not in Singapore dollars. The coverage provided is S$20,000 per depositor.[68] The conditions for a compensation payment being made are that the

65 The first of these apply to any bank whereas the other three are available only to banks incorporated in Singapore.

66 It is possible for an application to be made to be exempted from the scheme but this is extremely unlikely to be used in practice. See s 6 of the Deposit Insurance Act 2005.

67 See ss 21–24 of the Deposit Insurance Act 2005 for full details.

68 Set-off between accounts is applied so where a customer has both money on deposit and a loan from the bank a net payment will be made.

court has made an order for the winding up of a bank[69] or that the MAS has determined that a scheme member that is insolvent and is unable or likely to become unable to meet its obligations is about to suspend payments. The legislation does not provide for how quickly compensation be made payable but the Singapore Deposit Insurance Corporation provides that it is willing to pay out "as soon as possible". The deposit insurance agency will act as a pay-box and will not have any role to play in the resolution of a failed bank other than to make payments to insured depositors and then to act in its role as subrogated creditor in any subsequent liquidation proceedings.

91 The main issue to consider here, especially in light of the problems at Northern Rock, is will the amount of coverage provided to the individual depositors be sufficient to assist in the control and prevention of a bank run. Singapore has not made the mistake of introducing co-insurance. The other main issue, as the Northern Rock case demonstrated, is the speed with which compensation payments will be made. As noted above, this is not set out with sufficient clarity and this is a matter which arguably should be clarified.

VII. Conclusions

92 Singapore is developing as a major international financial centre and for it to continue to flourish its financial architecture must be thought of as sound. The recent events in the UK have demonstrated the fragility of banks. That one troubled bank could have caused such a huge amount of turmoil in one of the world's leading financial centres was both unexpected and a matter of extreme concern. In the UK, the Northern Rock case has led to immediate action by the relevant authorities with changes already having been made to strengthen the depositor compensation scheme. There is now a consultation process led by the Bank of England and the Treasury: *Financial Stability and Depositor Protection: Strengthening the Framework*,[70] which is expected to lead to changes to the financial sector safety net which will be aimed at strengthening the overall framework. The House of Commons Treasury Committee has published a detailed report, *The Run on the Rock*,[71] which provides criticisms of many aspects of the way in which the parties to the safety net worked together and some criticisms of part of the system itself.

93 It is recognised in the consultation process that action needs to be taken to strengthen the stability of the UK financial system and this is

69 Which is a member of the scheme.
70 Cm 7308, January 2008.
71 *Supra* n 48.

to include strengthened risk management by banks.[72] It is also proposed to strengthen the regulatory and supervisory framework including changes being made to the framework for the provision and disclosure of liquidity assistance. As in Singapore, it is thought that it is not possible or desirable to ensure that no bank will ever fail in any circumstance. It is proposed to introduce changes which will include a type of special resolution regime which will allow for failing banks to be resolved in a quick and effective manner.[73] Another important issue that is recognised in the consultation document is that effective compensation arrangements in which consumers have confidence are needed.[74] There appears to be little, if any, disagreement about the need to strengthen the compensation regime.

94 The Treasury, the Bank of England and the FSA all support the continuation of the tripartite arrangement. If this is to continue, however, changes to the existing position are necessary. There are proposals to strengthen the MOU and to provide a statutory basis for the Bank of England's financial stability role.

95 It should not be forgotten that the existing insolvency laws were never actually tested in the Northern Rock case. There were many commentators who felt that Northern Rock should have been subject to the administration order process at a relatively early stage but this was not done. The reasons why are unclear. One feature may have been a lack of understanding of the process by the relevant politicians. The Prime Minister is reported as having likened the use of administration to a "route to a fire sale",[75] thereby demonstrating a lack of understanding of the UK's primary corporate rescue procedure. That administration has been used successfully on a number of occasions to assist with insolvent banks seems to have been forgotten. The best known use of the administration order procedure, and no stranger to Singapore, was for Barings Bank in 1995.

96 The Northern Rock crisis has been an extremely negative experience for the UK's financial sector and only time will tell what damage may have been done to the reputation of London as one of the world's major financial centres.

97 Singapore, unlike the UK, has been pro-active in reviewing its existing framework at a time when the financial sector was stable. This, as has already been seen, has led to the recently introduced legislative amendments under which the MAS will have a crucial role to play in the

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72 *Supra* n 48, at p 3.
73 The proposals for the special resolution regime are contained in ch 4.
74 See ch 5.
75 *Financial Times* (London) (17 January 2008).

bank resolution process.[76] This is a welcome development. The new procedures on bank resolution look robust and appropriate and the powers given to the MAS should permit action to be taken expeditiously.

98 In the light of the run on Northern Rock would it be worth reconsidering the cover provided under the Singapore scheme? The scheme aims to pay out quickly which is a positive factor but the exact details are unclear and is the level of compensation at S$20,000 sufficient to satisfy Singaporean depositors and to help prevent bank runs?

99 The financial crisis in the UK and the lessons that hopefully can be learned from it should provide the opportunity for a growing financial centre like Singapore to appraise its financial safety net to ensure that weaknesses, such as those identified earlier in this article, either do not exist or are eradicated. However, as has been seen, there is an ongoing process of monitoring in Singapore and complacency has not been a feature of the approach taken by the MAS. This is important as the future of Singapore, as a leading global financial centre, depends on it being perceived internationally as a safe place to do business.

76 The Banking (Amendment) Act 2007.