The proposal for ‘Heightened Supervision’: A Critical Assessment.

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The Role of the FSA

The risk based approach and statutory objectives.

To what extent does the risk based approach capture problems when the regulated firm is at risk of insolvency? Is there a need for a structured early intervention system? Does the proposed approach of ‘Heightened Supervision’ fit the bill of an early intervention model?

Early Intervention

As Shavell notes ‘[o]ne important dimension of law enforcement is the timing of legal intervention:’ ‘The Optimal Structure of Law Enforcement’, 36, *The Journal of Law and Economics* (1993) 255 at p. 257.

Early Intervention

'…experience in various countries has shown that regulators tend to intervene too late rather than too early'. E H G Hupkes, The *Legal Aspects of Bank Insolvency: A Comparative Analysis of Western Europe, the United States and Canada*, The Hague, Kluwer Law International (2000)

Does ‘Heightened Supervision’ fit the bill?

The proposal for ‘Heightened Supervision’ is an extension of the existing FSA risk based approach to regulation.

The FSA role in dealing with a bank in distress

The FSA is responsible for pulling the trigger to put the deposit taking institution in to the special resolution regime

The trigger is pulled once the FSA considers the bank is ‘failing or likely to fail to meet its threshold condition

Some Implication of adopting ‘Heightened Supervision’ and the Trigger

The interplay of corporate and regulatory obligations provides a complicated set of circumstances for regulated firms.

What is a reasonable amount of time between faced with a bank in distress and the decision to pull the trigger?

Trading Insolvent, Corporate Solutions and the Risks

…whenever a company is in financial trouble and the directors have a difficult decision to make whether to close down and go in to liquidation, or whether instead to trade on and hope to turn the corner, they can be in a real and unenviable dilemma. *Re Continental Assurance Co of London plc [2001] Park J.*

Trading Insolvent, Corporate Solutions and the Risks:

'…Directors may properly take the view that it is in the interests of the company and of its creditors that, although insolvent, the company should continue to trade out of its difficulties. They may properly take the view that it is in the interests of the company and its creditors that some loss-making trade should be accepted in anticipation of future profitability.' *SecStT&I v. Taylor [1997]*

A couple of concluding points

Heightened Supervision is not a form of structured early intervention, its more akin to what the US would refer to as informal enforcement sanctions.

The interplay between Heightened Supervision and Market Abuse Rules needs to be handled sensitively.

More research needs to be carried out on early intervention.