HM Treasury

Enhancing the Special Resolution Regime

Government Response to Consultation

July 2024

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Chapter 1
Executive Summary

1.1 On 11 January 2024, HM Treasury published the consultation document “Enhancing the Special Resolution Regime”. The consultation ran from 11 January to 7 March, and HM Treasury received 17 written responses.

1.2 The consultation sought views on the proposals to enhance and keep up to date the UK’s Special Resolution Regime (hereafter referred to as the “resolution regime”) by providing a new mechanism to facilitate the use of certain existing stabilisation powers to manage the failure of small banks and limit risks to public funds.[1]

1.3 Overall, most respondents were generally supportive, with most also supportive of the proposed scope of application and the proposal to recoup any funds used from the entire banking sector on an *ex-post* basis, meaning that additional levies would not be raised unless the mechanism was used.

1.4 As explained more fully in subsequent chapters, comments were made in relation to the safeguards around these proposals, the situations in which the proposed enhancement could be used and the expected costs for industry. Comments were also made about the types of firms in scope of these proposals and the types of firms that would contribute to the costs.

1.5 Following consideration of this feedback, the government has laid before Parliament the Bank Resolution (Recapitalisation) Bill alongside publication of this response to consultation.[2] Broadly, the government intends to maintain the position set out in the consultation with the main modification being that credit unions will not be required to contribute to the costs of recapitalisation should the new mechanism be used. The Bill implements the proposals set out in this response to consultation, specifically by:

- amending the Financial Services and Markets Act 2000 (FSMA 2000) to expand the statutory functions of the Financial Services Compensation Scheme (FSCS). This will enable the FSCS to provide

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[1] For the purposes of this consultation response, the phrase “small banks” or “smaller banks” shall refer to the population of banks and building societies which are not required to hold the Minimum Requirement for own funds and Eligible Liabilities (MREL) above minimum capital requirements and the term “insolvency” refers to the Bank Insolvency Procedure as modified in its application to building societies.

[2] The Bank Resolution (Recapitalisation) Bill can be found on the UK Parliament website, https://www.parliament.uk/business/bills-and-legislation/

funds to the Bank of England upon request to meet certain costs arising from the failure of a bank, and allow the FSCS to recover any funds provided after a failure event through levies on the banking sector;

- providing the Bank of England with the ability to require a bank under resolution to issue new shares, facilitating the Bank of England's use of the funds provided by the FSCS to meet a failing bank's recapitalisation costs; and
- making a number of technical amendments to FSMA 2000 and the Banking Act 2009 to support the measures outlined above and ensure FSCS funds in resolution can be used effectively.

Chapter 2

Policy Background and Objectives

2.1 The UK has a robust resolution regime for banking institutions, which was first implemented in 2009 in the wake of the Global Financial Crisis.[3] The regime made the Bank of England (the Bank) the UK's resolution authority and provided it with a set of options and powers to stabilise banking institutions that fail, in order to protect financial stability, enhance confidence in the financial system and protect depositors, whilst limiting risks to public funds.

2.2 The resolution of Silicon Valley Bank UK (SVB UK) in March 2023 using these powers delivered good outcomes for financial stability, customers and taxpayers, demonstrating the effectiveness and flexibility of the resolution regime.

2.3 Nevertheless, it is right to consider any lessons that can be learned about how best to manage the potential failure of smaller banks. HM Treasury therefore worked closely with the Bank, Financial Conduct Authority (FCA), and FSCS to reflect on this event, as well as the broader period of volatility in the banking sector in Spring 2023. This work sought to ensure that the UK continues to have the best possible arrangements in place to maintain financial stability, enhance confidence in the financial system and protect depositors, while minimising risks to public funds.[4]

2.4 In January 2024, HM Treasury consulted on proposals for a targeted enhancement to the range of options provided by the UK's resolution regime to reflect the conclusions above. The government here sets out its response to the feedback received on those proposals, which was broadly positive. Alongside this response, the government has also introduced the Bank Resolution (Recapitalisation) Bill to Parliament which implements the proposals.

2.5 Overall, these proposals would introduce modest enhancements to the resolution regime to give the Bank of England increased flexibility to manage the failure of smaller banks. The changes avoid

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[3] For the purposes of clarity, the phrase "banking institutions" is intended to refer to banks, building societies and PRA-designated investment firms that are in scope of the regime.

[4] Banking Act 2009: special resolution regime code of practice, Chapter 3: Special Resolution Objectives. https://assets.publishing.service.gov.uk/media/5fda28f88fa8f54d5e4c5478/SRR_CoP_December_2020.pdf

making significant changes to the regime itself and new upfront costs for firms. The enhancements would reinforce the UK's robust regulatory regime and ensure there continue to be sufficient protections for financial stability, customers and public funds when banks fail.

Chapter 3
Summary of responses

3.1 HM Treasury received 17 written responses to the consultation. The responses received for each question have been summarised below. Overall, most responses were broadly supportive of the proposals in principle, whilst noting some points for the HM Treasury to consider further.

Question 1: Do you agree with, or have any comments on, the proposal for the Financial Services Compensation Scheme to provide funding to recapitalise failing small banks, where these firms are placed into resolution rather than insolvency?

3.2 All respondents answered this question. The majority of respondents were supportive of the proposal for the FSCS to provide funding to recapitalise failing small banks where these firms are placed into resolution rather than insolvency.

3.3 Respondents noted a range of benefits of this approach, including greater flexibility for managing small bank failures; more time for the Bank to engage with potential buyers; reduced risk of contagion; and potentially lower costs to industry.

Safeguards and least cost tests

3.4 A number of respondents requested that HM Treasury introduce (or consider introducing) safeguards to limit costs to industry. In particular, respondents proposed measures that would ensure the new mechanism is only used where the costs to the FSCS (and therefore industry) are lower compared to the costs that the FSCS would have incurred if the firm entered insolvency.

3.5 This request took various forms. Some respondents suggested that HM Treasury should adopt a "No Creditor Worse Off" principle for use of FSCS funds in resolution. This would be similar to the principle that exists elsewhere in the resolution regime, whereby resolution action should not leave shareholders and creditors worse off than they would have been if the firm had been placed into insolvency.

3.6 Others proposed requiring the Bank to consider the relative cost of resolution compared to insolvency as part of the public interest assessment carried out when determining whether to take resolution action. Some respondents suggested that the Bank should only be able to use the proposed mechanism if it is expected to be less costly to

industry than insolvency. One respondent also suggested that the mechanism should be subject to *ex-post* scrutiny by the National Audit Office.

Alternative means of funding the proposals

3.7 HM Treasury's proposed approach was for an *ex-post* funding model, although the consultation welcomed feedback on other options, including ex-ante funding or requiring small firms to hold additional MREL.

3.8 Several respondents preferred the proposed *ex-post* approach. These respondents cited two main concerns about an *ex-ante* model: that capital would be held unproductively in a fund rather than lent into the economy; and that it would increase costs for industry (with implications for competitiveness and growth of the UK banking sector). One respondent also concluded that determining contributions that fairly reflected each firm's risk would be challenging.

3.9 In contrast, a few respondents felt that an *ex-ante* approach should be considered further. One respondent suggested that small banks alone could contribute to a fund over time which could be used to support resolution, lowering subsequent levy costs and reducing risks to public funds. Another noted that an *ex-ante* approach better supports the "polluter pays" principle by ensuring the failing bank contributes and that the fund could be built up over an extended period to reduce costs to industry if needed.

3.10 A number of respondents were opposed to the idea of requiring smaller firms to meet MREL requirements in excess of their capital requirements, noting that their limited ability to access capital markets would make this very costly for them. They also raised concerns about exposing small banks to refinancing risks and consequently the potential for this to have destabilising effects. A few respondents suggested that many small banks would have to, in practice, meet any requirements using equity. One respondent suggested that HM Treasury should consider ways to make it easier for small banks to access capital markets to help address these issues.

3.11 A few respondents suggested other alternative means of funding the proposals. One respondent suggested that the value of the failed bank's assets should be evaluated a year after the sale and that the Private Sector Purchaser should then pay 50% of any value above the sale price back to the FSCS, industry, or other banks. One respondent suggested that HM Treasury should consider ways to obtain contributions from senior staff who were involved in the bank's failure, arguing that this would create more personal accountability. Finally, one respondent suggested that parts of the FSCS's exposure could be sold in part during the resolution. This suggestion assumes the FSCS acquires an equity stake in the failed bank or a loan asset as a result of

the funds it provides under the proposals, and that this equity or loan asset may be auctioned off to raise funds.

Question 2: Do you agree with the proposal to recoup the funds from the whole deposit-taking class?

3.12 14 respondents answered this question. Seven were broadly in favour of recouping funds from the whole deposit-taking class (i.e. the entire banking sector); four were opposed; and three were neutral. Respondents also gave feedback about the calibration of the proposed levy. For example, several respondents were in favour of recouping funds from all banks, but felt that contributions should be weighted toward or away from particular groups.

3.13 Whilst there was broad support for the proposed approach, several respondents raised questions about the proportionality of larger banks contributing where the new mechanism is used. In particular, some suggested that smaller banks would be the primary beneficiaries as larger banks hold additional MREL to fund their own resolution and would therefore not require FSCS funds if they were to fail. They therefore questioned the fairness of asking larger banks to contribute to the resolution of smaller banks that do not face the costs of additional MREL. Among these, a few respondents suggested that larger banks should not contribute to the costs of these proposals or that the methodology for calculating the levy should be altered to reduce the contribution of larger banks.

3.14 In contrast, one respondent suggested that it would be appropriate for larger banks to contribute as they already contribute to the costs of paying out small bank depositors in an insolvency. They also noted that larger banks may benefit from the proposals as potential buyers of failed small banks.

3.15 Two respondents opposed the inclusion of credit unions in the set of firms that would contribute to the costs of these proposals. They felt that credit unions should be excluded from contributing because these firms are not within the scope of the Special Resolution Regime. One respondent also noted that, while other deposit-taking firms contribute to depositor compensation for credit union failures, these costs are typically low and that contributing to resolution costs may have more acute impacts on credit unions given their size and business models.

3.16 One respondent suggested that branches of international firms should not contribute because they are not within the scope of the Special Resolution Regime.

3.17 One respondent expressed concern that the proposals would reduce market discipline, noting that insolvency creates incentives for customers to choose less risky banks.

3.18 In addition, a few respondents raised concerns about the ability of mid-sized banks that are required to hold additional MREL to afford paying a higher FSCS levy.

Distribution of FSCS levy contributions

3.19 One respondent asked for more clarity on how the cost of the proposed new mechanism would be applied across the industry.

3.20 Two respondents raised concerns about the risk-weighting of the existing methodology for calculating FSCS levy contributions in insolvency, and the appropriateness of this methodology for these proposals. One respondent suggested that the existing methodology does not adequately capture the risk-profile of certain firms relative to others, resulting in some firms' contributions being disproportionate to their risk. Another respondent suggested that banks that do not have to meet MREL requirements in excess of their minimum capital requirements should have a higher risk weight to reflect their greater probability of imposing costs on the FSCS.

3.21 One respondent queried whether the cap on FSCS levies on the deposit-taking class set by the Prudential Regulation Authority would change as a result of these proposals.

3.22 One respondent suggested HM Treasury should ask the PRA to consider a Pillar 2A add-on similar to the pension obligation risk for non-MREL banks that reflects the resolvability and likely cost to industry in case of resolution of each small bank in question.

Question 3: Do you agree with the proposed scope of application for the proposed mechanism?

3.23 13 respondents answered this question. Most were in favour of the proposed scope, a few were opposed, and a few were neutral.

3.24 Those who were not supportive suggested several groups of banks that could be excluded from the scope. Three respondents felt that banks on the MREL "glide path" should be excluded.[5] Two respondents suggested that subsidiaries of third country headquartered banks that are part of a resolution group should be excluded on the basis that their parent companies would be expected to fund their resolution.

3.25 Several respondents asked for more detail on the circumstances in which the proposed mechanism would be used. For example, a few respondents queried whether the mechanism could be used in a multiple failure scenario, with one suggesting that it should not be used in such situations. They asked HM Treasury to consider this further and clarify whether the proposals are expected to be a viable solution in such situations.

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[5] Firms that are transitioning to reach their end-state MREL but have not yet reached it.

3.26 Several respondents queried the frequency with which the government expects these proposals to be used. A few respondents suggested that it should not become the default for managing small bank failures and one asked that the public interest test be reviewed to ensure this would not be the case.

3.27 Several respondents also raised queries about the scope of the costs that could be covered. In particular, respondents asked for more detail about the costs that could be covered as part of HM Treasury and Bank expenses. A few respondents noted that they would oppose the inclusion of litigation costs. Another respondent asked for clarity about what services would be considered essential and would therefore need to be kept running.

3.28 One respondent requested more information about the application of the public interest test in the case of SVB UK.

Question 4: Do you have any other comments on the proposals set out in the consultation?

MREL

3.29 A number of respondents suggested that the Bank should review the indicative thresholds for determining a preferred resolution strategy. The preferred resolution strategies are in turn used to determine the firms that must hold MREL in excess of minimum capital requirements. Some respondents cited concerns that the current indicative thresholds create potential barriers to growth for mid-sized banks and have negative effects on competitiveness and lending activity.

3.30 More specifically, several respondents suggested that these proposals could provide an alternative means of funding resolution for the smaller banks that currently hold MREL in excess of minimum capital requirements.

3.31 Conversely, two respondents suggested that the indicative thresholds should not be altered in response to these proposals. One respondent noted that reducing the MREL requirements for some firms could, in the event of their failure, create contagion risk across firms that are still required to hold MREL in excess of minimum capital requirements.

Cost-benefit analysis

3.32 Many respondents requested that HM Treasury produce some cost-benefit analysis to set out the expected impact on firms. In particular, a number were interested in the expected costs to industry of these proposals relative to an insolvency.

The 5% and 8% rules

3.33 While one respondent was supportive, a few respondents expressed concerns about the disapplication of the 5% and 8% rules in

relation to the new mechanism. Two respondents suggested that, given the mechanism can in theory be used for any failing bank, the 5% and 8% rules should not be disapplied for those banks that have met their end-state MREL (as these banks' shareholders and creditors should be able to contribute at least 8% of the liabilities of the institution). They also felt that, for banks on the MREL glide path, any request for FSCS funds should be limited to the shortfall between their existing and end-state MREL.

3.34 One respondent noted that, if no additional safeguards were put in place to limit the cost to industry to those they would face from an insolvency, they would oppose the disapplication of the 5% and 8% rules.

3.35 One respondent also asked about the rationale for removing the 5% rule and questioned whether it would be preferable to set a higher cap rather than disapplying it altogether.

Accountability

3.36 One respondent asked how the Bank would calibrate the size of its request for FSCS funds, noting that the Bank may be incentivised to request more than necessary to ensure the safety of the failing bank. One respondent asked how the Bank would be held accountable for its use of FSCS funds.

Operationalisation and implementation

3.37 One respondent suggested that the resolution strategies of smaller banks should not be changed.

3.38 A few respondents suggested that resolution planning for smaller banks may need to be altered to ensure these proposals could be used effectively. That said, one respondent noted that any additional planning or reporting requirements for banks that are not required to hold additional MREL should be proportionate. This respondent felt that smaller banks would not have sufficient resources to meet requirements similar to the Resolvability Assessment Framework and suggested that banks could instead be required to have the means in place to undertake planning requirements if needed.

3.39 A few respondents asked for more detail on how excess funds would flow back to the FSCS. One also queried how the FSCS would decide what to do with any funds it received.

3.40 One respondent asked how long a failed bank could remain in a Bridge Bank and the circumstances in which it could transition from a Bridge Bank to insolvency.

3.41 One respondent suggested that HM Treasury should consider whether there are any impediments to the use of transfer tools which could be addressed, noting Competition and Markets Authority (CMA) requirements around mergers and acquisitions as one possibility.

3.42 One respondent suggested a further resolution objective, to promote diversity of firms, should be added to the Special Resolution Regime.

3.43 One respondent asked for more information about the timings of when banks would be expected to pay where the new mechanism is used.

3.44 One respondent raised concerns about the potential for overlapping governance in resolution, and differing interests between HM Treasury, the Bank and the FSCS to create difficulties over a resolution weekend. They suggested that the FSCS's role should be limited to executing the decisions of HM Treasury and the Bank to limit this risk.

3.45 One respondent noted that, if these proposals were used, the Private Sector Purchaser would benefit from the contributions of other firms.

Miscellaneous comments

3.46 One respondent suggested these proposals should result in a commensurate reduction in the Bank Levy to ensure that banks are not paying for the same risks twice. The same respondent also suggested using Bank Levy funds in place of the proposal.

3.47 One respondent noted a risk to the UK's international competitiveness if other jurisdictions are not adopting similar measures.

3.48 A few respondents emphasised that the authorities must consider how to adapt the resolution framework to account for technological change and, particularly, increased speed of deposit withdrawals.

3.49 One respondent suggested that the government should take steps to ensure the PRA's supervision of smaller banks is robust, in order to reduce the likelihood of these proposals being used. Two respondents also noted that the proposal should be aligned with the approach to capital requirements being considered by the PRA under its "Strong and Simple" regime for smaller banks. One respondent suggested that firms that might be considered systemic should not be part of the "Strong and Simple" regime.

3.50 One respondent asked that HM Treasury publish the proposed legal text that would implement the enhancement.

3.51 One respondent suggested that depositors should only be protected up to £85,000 where these proposals have been used.

3.52 One respondent suggested that the liquidity options for banks in distress could be increased in light of these proposals because the Bank might feel more confident of being repaid. One respondent suggested that, alongside these proposals, the PRA should set expectations or

requirements on banks to pre-position greater collateral to ensure increased liquidity during a stress. This could ensure a minimum level of contingent liquidity in the sector. The respondent noted that this would have the benefit of providing a stronger pool of suitable buyers for failed banks.

3.53 One respondent suggested that, in order to better prevent bank runs, the Bank could have a contingent liability facility capable of guaranteeing all of a bank's deposits.

3.54 One respondent noted that the PRA is due to review the FSCS deposit coverage limit by 2025. They noted that their preferred outcome would be an inflation-based increase to the current limit.

3.55 Two respondents advocated for greater transparency for small banks, for example, through the introduction of public disclosure requirements for small banks akin to that of larger banks.

3.56 One respondent suggested that the government should also consider potential improvements to the Bank Insolvency Procedure (BIP).

Chapter 4
Government response

4.1 The government has carefully considered the responses to the consultation. The government welcomes the broadly positive feedback to these proposals. As set out in Chapter 3, while most responses were supportive in principle, respondents also recommended some points for further consideration. These points are addressed below.

Scope of application

4.2 Several respondents suggested ways in which the scope could be narrowed, such that the enhancement is used for a smaller set of banks. They suggested this could be achieved through the exclusion of banks on the glide path towards an MREL in excess of minimum capital requirements, banks that are required to hold MREL in excess of minimum capital requirements, and subsidiaries of third country firms.

4.3 Noting that the expectation is that the mechanism would generally be used to support the resolution of small banks, the government considers it appropriate for the mechanism to be, in principle, applicable to any banking institution within scope of the resolution regime. This would give the Bank, in consultation with the relevant authorities, the flexibility to respond to any limited instances where the mechanism may be appropriate for other banks. It is also important to note that the mechanism is a tool to facilitate resolution action and is therefore not available unless the resolution conditions have been met to allow the Bank to exercise its resolution powers. The mechanism would therefore only be available where the stabilisation options are used to transfer the failing firm (or part) to a private sector purchaser or a bridge bank. The use of these powers would have been assessed to be necessary having regard to the public interest in advancing the special resolution objectives and where it is deemed that one or more of the special resolution objectives would not be met to the same extent if the bank entered insolvency.

4.4 The government notes that it intends for subsidiaries of third country banks to be in scope. While it is possible the parent company may be able to recapitalise its subsidiary outside of resolution, there may be circumstances in which this is not possible (as was the case with SVB UK). It is important that the Bank has the necessary tools to deal with a failing firm regardless of its home jurisdiction. In practice, the mechanism uses the Bank's transfer and write-down powers so the parent company would suffer losses on its investment in the subsidiary.

4.5 The government notes that several respondents asked for more detail about the circumstances in which the proposals are expected to be used. As set out in the consultation, these proposals primarily aim to give the Bank greater flexibility for managing small bank failures. The resolution of SVB UK demonstrates that the circumstances at the time of a firm's failure may require the use of resolution tools in a way that varies from *ex-ante* planning. As such, it is not possible for the government to set out definitively the circumstances in which the mechanism would be used. It remains the case that the Bank would only exercise its resolution powers where it judges this, in consultation with the relevant authorities, to be necessary, having considered the resolution conditions and objectives set out in the Banking Act 2009.

4.6 The government notes the suggestions about the process for determining whether a bank enters resolution, including suggestions that the public interest test and criteria for determining if resolution action is necessary should be reviewed and an additional resolution objective (to promote diversity of firms) should be added.

4.7 As set out in the consultation, the successful resolution of SVB UK demonstrated the effectiveness of the resolution regime and the government believes that the existing framework provides a robust but flexible framework for making these decisions. These proposals are intended only as a modest enhancement and, as such, the government judges that it would not be appropriate to make fundamental changes to the underlying bank resolution framework.

4.8 As set out by the PRA, a key principle underlying its approach is that it does not seek to operate a zero-failure regime.[6] Rather, it works with the Bank as the UK's resolution authority to ensure that any firms that fail do so in an orderly manner. The relevant insolvency procedures therefore remain an important part of the toolkit for dealing with the failure of small banks. In this regard, and alongside the proposals set out in the consultation, the government is supportive of the Bank's work with the FSCS and PRA to improve depositor outcomes in insolvency. This includes work to build the FSCS's capability to pay compensation more quickly through electronic means as an alternative to a cheque in the post.

4.9 With respect to the suggestion that these proposals could reduce market discipline if depositors expect their bank to enter resolution, the government considers this to be a manageable risk when set in wider context, given that insolvency remains an important part of the toolkit. Further, any use of the transfer tools would entail the write-down of regulatory capital, which is an important means of maintaining market discipline.

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[6] The Prudential Regulation Authority's approach to banking supervision, paragraph 18: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/approach/banking-approach-2023.pdf

Safeguards

4.10 As set out in Chapter 3, a number of respondents proposed additional safeguards to limit and assess costs to industry. Having carefully considered these suggestions, the government judges that the existing public interest test remains the appropriate mechanism for deciding whether a failing bank enters insolvency or resolution. Introducing a specific requirement for the Bank to choose the least costly option, on top of the existing public interest test, could prevent the Bank from taking the most appropriate action to advance its broader resolution objectives.

4.11 These suggestions stemmed from understandable concerns that the proposed mechanism may result in higher costs for industry relative to the counterfactual. Recognising these concerns, the government intends to update the Special Resolution Regime (SRR) Code of Practice to provide greater clarity about how the Bank will take account of the costs to the FSCS when considering whether to use the new mechanism in its assessment of the resolution conditions and objectives (the government also intends to update the Code to ensure ex-post transparency, as set out further below).

4.12 It is also important to note that, as set out in the cost-benefit analysis published alongside this consultation response, the government expects that use of FSCS funds to place a small bank into resolution will usually result in lower overall costs for firms than placing the firm into insolvency. There are two main reasons for this: first, the FSCS's initial outlay to effect the recapitalisation is likely to be considerably lower than the amount required to pay out all covered depositors; second, the recapitalisation and continuation of a failing firm avoids the potentially long and costly process of recovering value through an insolvency estate.

4.13 In addition to that practical point, the existing resolution regime already includes important safeguards which are relevant in the context of the proposed mechanism. These include the process and consultation required through the Resolution Conditions Assessment, and the PRA's consideration of the affordability of any levy raised by the FSCS, including its size and timing. The Banking Act also requires that the Bank ensure shareholders and creditors of the failed institution bear losses which would reduce the size of the request to the FSCS.

4.14 The Resolution Conditions Assessment requires the Bank as Resolution Authority to consult the PRA, the FCA and HM Treasury (the "authorities") and ensures a robust consideration of the most

appropriate option to achieve the resolution objectives.[7] As part of this process, the Bank, in consultation with the relevant authorities, is required to consider whether insolvency would achieve the resolution objectives to the same extent as use of stabilisation powers. Finally, it is also worth noting that, prior to a failure, the PRA would consider the extent of potential levies on the banking sector arising from a bank insolvency.

4.15 The government therefore considers that these safeguards remain adequate in the context of the proposed mechanism.

Ex-post scrutiny

4.16 The government considers that scrutiny of the authorities' actions in the context of bank failure is important. There are several measures in place to provide *ex-post* scrutiny of the use of resolution powers. For example, sections 79A and 80 of the Banking Act 2009 require the Bank to report to the Chancellor of the Exchequer where it has used resolution powers to transfer a bank to a Private Sector Purchaser or a Bridge Bank. The report must comply with any requirements specified by HM Treasury, which could include requiring the Bank to disclose the estimated costs to industry of the options that were considered.[8] This would ensure transparency and allow scrutiny of the Bank's decision.

4.17 In addition to the existing provisions, to reflect the points raised in consultation, HM Treasury intends to update the SRR Code of Practice to reflect the introduction of the new mechanism. This is anticipated to include explicit confirmation that, after a resolution in which the proposed new mechanism had been deployed, HM Treasury would expect to stipulate that reports required under the Banking Act 2009 will require the Bank to disclose the estimated costs to industry of the options that were considered. HM Treasury would expect to make such reports publicly available, including laying them before Parliament where required to do so under the Banking Act. The government judges this strikes the appropriate balance between ensuring transparency over costs while maintaining flexibility to respond to specific circumstances.

Other comments relating to scope of application

4.18 A few respondents asked for clarity about whether the proposals could be used to manage multiple firm failures at once. The

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[7] For further details on the Resolution Conditions Assessment, please see The Bank of England's Approach to Resolution, available at: https://www.bankofengland.co.uk/paper/2023/the-bank-of-englands-approach-to-resolution

[8] For an example, please see the Report under Section 80(1) of the Banking Act 2009 on the Dunfermline Building Society (DBS) Bridge Bank, July 2010: https://www.bankofengland.co.uk/-/media/boe/files/financial-stability/resolution/previous-resolutions/dbs-bridge-bank-report-july-2010.pdf

government confirms that they could be used in this way. As set out above, these proposals primarily intend to increase the Bank's options for managing small bank failures. Any use of the proposed mechanism would always be subject to the resolution conditions assessment and the PRA would make a determination about whether the FSCS can levy. The FSCS would be able to request to borrow from the National Loans Fund, if required. It is worth noting that, if the proposals were not used, the failing bank would be placed into insolvency which also entails costs for industry, via the FSCS levies to recoup the net costs (including financing costs) of covered depositor payout. As per the government's cost-benefit analysis published alongside this response to consultation, the upfront costs associated with the BIP could be substantially higher than the costs of placing it into resolution.

4.19 One respondent queried which services would be viewed as essential when applying this mechanism. The government notes that, under the resolution conditions assessment, this would be a judgement for the Bank in consultation with the other authorities to make at the point of exercising its powers, in line with the resolution objectives.

4.20 One respondent requested more detail about the rationale for allowing the mechanism to be deployed alongside the Private Sector Purchaser tool. While the government acknowledges that there may be circumstances where the Private Sector Purchaser would recapitalise the failing firm itself, there may also be circumstances in which this is not possible. Where additional capital would be required to conclude a sale, if these proposals could only be used alongside the Bridge Bank tool, the Bank would then have to place the failing firm into a Bridge Bank in order to recapitalise it and then transfer it to the Private Sector Purchaser from the Bridge Bank. This would be more costly and incur greater operational risk than injecting the necessary funds and transferring the firm to the Private Sector Purchaser. As such, the government believes that it is appropriate that these proposals could be deployed alongside the Private Sector Purchaser tool. However, the availability of the Bridge Bank stabilisation option or insolvency as alternative options provide an important safeguard against any inappropriate use of the new mechanism alongside the Private Sector Purchaser stabilisation option.

Recouping funds from the entire deposit-taking class

4.21 Although the majority of respondents were supportive of recouping funds from the entire banking sector through the existing FSCS levy methodology, the government notes that several respondents raised concerns about the inclusion within the payment perimeter of particular types of deposit-taking entities, including larger banks, credit unions and branches of third country banks.

4.22 In general, the government believes there are benefits to mirroring the existing process for recouping the costs of paying out

depositors in insolvency and maintaining a broad-based levy. The government appreciates the view of some respondents that those within scope would be the primary beneficiaries of these proposals but maintains that the wider sector would still stand to benefit from efforts to protect and enhance financial stability and the reduced risk of contagion. A broad-based levy would also help ensure that the proposals remain affordable for the sector. In particular, as noted in more detail in the cost-benefit analysis, the exclusion of larger banks would raise concerns about affordability for other banks, which would in turn increase risks to public funds and the overall viability of the mechanism.

4.23 It is important to note that, in cases where these proposals are used, the counterfactual is for the failed bank(s) to enter insolvency. As a result, the sector is already liable to contribute to the costs of a small bank failure. As set out in the cost-benefit analysis, while highly case-specific, the upfront costs of an insolvency are generally expected to be greater than those under the proposals.

4.24 However, the government recognises the concerns raised about the contribution of credit unions towards the costs of these proposals. Credit unions are not currently within scope of the special resolution regime, meaning that the Bank cannot use its resolution powers in relation to them.

4.25 The government can therefore confirm that the Bill will ensure that credit unions will not be required to contribute to the costs of recapitalisation should the new mechanism be used. The government notes that credit unions currently contribute only 0.24% of total FSCS levies. Therefore, any impact on the calibration of levies for the rest of the sector as a result of exempting credit unions from contributing towards costs for the new mechanism would be negligible. Although it is a matter for the PRA, the government expects that the FSCS levy methodology will remain the same in other respects.

4.26 As set out in Chapter 3, one respondent suggested that UK branches of third-country firms should not contribute to the costs of the new mechanism because they are not within scope of the special resolution regime. However, the government notes that, under section 89JA of the Banking Act 2009, the regime applies to branches with some modifications. As such, the government believes it is appropriate for UK branches of third-country firms to contribute.

4.27 A wider recalibration of the FSCS levy (i.e., alterations to the methodology used in relation to an insolvency) is outside the scope of these proposals. However, the PRA considers feedback on the deposit framework on an ongoing basis and welcomes any suggestions for improvement to the methodology.

4.28 As per its Safety and Soundness objective, proportionality and affordability are key considerations for the PRA in setting the FSCS levy framework. This may provide some reassurance to those respondents

who raised concerns about the affordability of a higher FSCS levy for mid-sized banks that are approaching, or have exceeded, the bank's indicative thresholds for setting a stabilisation power preferred resolution strategy.

4.29 The PRA is also responsible for setting the limit up to which the FSCS can levy the deposit-taking class within a year. This is currently set at £1.5 billion and one respondent queried if this will be changed. The PRA reviews the limit on an ongoing basis and will continue to set this limit in line with its safety and soundness objective.

MREL

4.30 While this proposal is primarily intended for those banks that are not required to maintain MREL in excess of minimum capital requirements, the government notes that a number of respondents made comments about the Bank's wider MREL policy and the appropriateness of the current indicative thresholds for determining a preferred resolution strategy. The preferred resolution strategy of a firm informs whether it is required by the Bank to maintain MREL in excess of minimum capital requirements.

4.31 The approach to determining preferred resolution strategies and MREL policy, including the indicative thresholds, is determined by the Bank within the framework set by Parliament. The Bank revised its approach in 2021. The Bank did not at that time choose to make changes to the indicative thresholds themselves, but did make several changes to ensure that firms that grow and are forecast to exceed the indicative thresholds have sufficient time to transition. These changes aimed to provide an appropriate degree of protection for public funds while ensuring a proportionate approach for growing firms.

4.32 In concluding its 2021 review, the Bank committed to consider whether recent innovations in technology in the banking system could mitigate disruptions that may occur in the insolvency of a failing mid-tier bank whose business model is dominated by transactional account banking. The FSCS has developed a digital payment portal for customers. In the event that a deposit-taker enters insolvency, the FSCS may now pay compensation directly into an account that the customer has with another bank or building society. This means, in some instances, the FSCS can offer electronic payment as an alternative to a cheque, providing faster compensation for many customers.

4.33 The Bank will consider, in light of the reforms proposed in this consultation, other wider developments, and taking into account the responses to this consultation, whether any changes to its indicative thresholds would be appropriate.

4.34 While acknowledging that issuing MREL could be costly for small banks because they may have limited access to capital markets, one respondent suggested that HM Treasury should consider ways to improve small banks' access to such markets. HM Treasury and the FCA

are already in the process of a significant programme of capital market reform to optimise the capital raising process for firms in the UK.

Costs within scope of these proposals

4.35 Several respondents asked for more detail about the costs that could be covered as part of HM Treasury and Bank expenses and whether costs of litigation were within scope of the proposals. As set out in the consultation, the following costs would be within scope:

- the costs of recapitalising the failed bank;
- the operating costs of a Bridge Bank; and
- HM Treasury and Bank costs in relation to the resolution, including legal and other professional expenses, costs of valuation and other associated costs.

4.36 The government notes that a range of costs in relation to the resolution may fall to both HM Treasury and the Bank. Given this, and the uncertainty and complexity of a resolution scenario, the government does not intend to prescribe an exhaustive list of these potential costs in legislation. The government does note that costs might include, but would not be limited to: legal fees; consultancy fees; accountancy fees; costs incurred by and in appointing an independent valuer; and Insolvency Practitioner fees and preparatory costs.

4.37 The government wishes to clarify that while preparing to take resolution action, any costs incurred exclusively in preparing in parallel for an insolvency process would not be within scope of the new mechanism.

4.38 The government notes that costs arising from litigation could materialise whilst a bank is in a Bridge Bank. Whilst in the Bridge, the bank would need to be recapitalised to cover any shortfall in funds, including to meet any costs arising from litigation. These costs would count as recapitalisation costs and would therefore fall within scope of the new mechanism, supporting the policy objective of avoiding the costs of recapitalisation falling to the taxpayer. It is, of course, worth noting that any decision to use FSCS funds to cover these costs would be a judgement taken at the time, noting the point that the alternative would be to use public funds instead. It is also worth noting that the existing two-year time horizon for a Bridge Bank, with the option of extending this where certain conditions are met, would still apply. Once this period expires, the Bridge Bank must be wound up under insolvency proceedings if a private sector buyer cannot be found. These time limits may also serve to minimise levy payers' exposure to potential litigation costs.

4.39 Where litigation has been brought against the bank in resolution, the government would generally expect that any costs arising from that litigation after the firm has been sold to a Private Sector Purchaser would rest with the buyer.

4.40 With respect to the concern of one respondent about the Bank's accountability for the funds, the government notes that the Bank can only exercise stabilisation powers when it is in the public interest to do so and that requirements on the Bank to report on the use of its powers would continue to apply. These provisions require the Bank to report to the Chancellor of the Exchequer where it has used resolution powers to transfer a bank to a Private Sector Purchaser or a Bridge Bank, with the report meeting any requirements set by HM Treasury. As such, the government is satisfied that there are sufficient means of holding the Bank accountable for its use of its powers and, in turn, its use of any funds provided by the FSCS.

Impact assessment and cost-benefit analysis

4.41 The government agrees with respondents on the importance of a thorough impact assessment. The government has therefore published a cost-benefit analysis alongside this consultation response which will provide greater clarity about the expected costs and benefits for firms, noting this will always be highly case specific.[9]

Alternative methods of financing the proposals, including prefunding

4.42 The government continues to believe that sourcing funds from the banking sector on an *ex-post* basis is the most proportionate and effective solution to meet the policy objectives in the immediate term. This approach avoids additional upfront costs and ensures that the banking sector only pays when it needs to. It is also consistent with the approach to funding depositor pay-outs.

Preferred resolution strategies and preparing for resolution

4.43 A few respondents noted the possible implications of these proposals for resolution planning for smaller banks. The government notes this proposal is primarily intended for small banks that are not required to maintain MREL above minimum capital requirements. These firms are generally subject to different *ex-ante* requirements on preparing for resolution than large banks (e.g., firms with a bail-in preferred strategy).

4.44 As set out in the Bank's Approach to Resolution, firms are required to be able to submit 'resolution packs' containing information on their financial, legal and operational structures, as well as the critical

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[9] Bank Resolution (Recapitalisation) Bill: Cost-Benefit Analysis, https://www.gov.uk/government/consultations/enhancing-the-special-resolution-regime-consultation

functions they provide.[10] These resolution packs may be supplemented with specific information requests tailored to the firm.

4.45 The Bank also has its own information gathering power for this purpose, which enables it to request specific information reasonably required in connection with its functions as resolution authority. Information gathering in this way may be particularly relevant for contingency planning as a firm moves towards possible failure. The Bank can also use other powers to commission reports and investigations by skilled persons or advisers.

4.46 As a result of the resolution planning process, firms may also need to put in place certain arrangements. For example, contractual arrangements to provide for continuity. These generally apply where the Bank has determined that a stabilisation power preferred resolution strategy is appropriate.

4.47 The approach to determining preferred resolution strategies is determined by the Bank within the framework set by Parliament. As set out under "MREL" (paragraphs 4.30 – 4.34), the Bank will consider, in light of these proposals and other, wider developments, and taking into account the responses to this consultation, whether any changes to its indicative thresholds for determining a preferred resolution strategy would be appropriate.

4.48 The government notes that one respondent suggested that these proposals could be accompanied by changes to the PRA's policy relating to liquidity. The PRA's policy relating to liquidity is outside the scope of these proposals. However, the PRA considers feedback on its policy on an ongoing basis and welcomes suggestions for improving it. The Governor of the Bank, Andrew Bailey, has also spoken about the role of liquidity policy in the context of bank failures.[11]

4.49 The government notes that two respondents advocated for greater transparency for small banks, for example, disclosure requirements akin to those for larger banks. There are several different disclosure requirements that may apply to banks at different times and reflecting the circumstances of each bank. For example, those relating to listed financial instruments and those that the PRA may determine as part of its disclosure policy. The government does not propose to bring forward disclosure requirements specific to this proposal, beyond those requirements that may apply within the broader existing framework for market disclosure in the UK. Although the PRA's policy

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[10] The Bank of England's approach to resolution, https://www.bankofengland.co.uk/paper/2023/the-bank-of-englands-approach-to-resolution

[11] Loughborough lecture: Banking today – speech by Andrew Bailey (February 2024), https://www.bankofengland.co.uk/speech/2024/february/andrew-bailey-lecture-at-loughborough-university

relating to disclosure is outside the scope of these proposals, the PRA considers feedback on its policy on an ongoing basis and welcomes suggestions for improving it.

Calibrating the request for FSCS funds

4.50 The government notes that a few respondents queried how the Bank would calibrate a request for FSCS funds. The intention is that the methodology and approach for calibrating the amount requested would use a target capitalisation of the firm, comparable to how the shortfall amount is set out in section 12AA of the Banking Act. As now, therefore, the amount requested would aim to restore the capital ratio of the firm in resolution to the extent necessary to sustain sufficient market confidence and enable it to continue to meet, for at least one year, the conditions for authorisation and to continue to carry out the activities for which it is authorised. It is also important to note that, as now and as set out in the Banking Act 2009 and the SRR Code of Practice, the Bank would still be required to ensure that shareholders and creditors bear losses when a bank fails, including by writing down regulatory capital.

4.51 Relatedly, the government intends to amend the legislation regarding the shortfall amount so that the contribution of FSCS funds is explicitly taken into account. Aside from this, the methodology for determining the shortfall amount will remain unchanged, and will continue to be based on the amount required to:

- restore the institution's Net Asset Value to zero;
- restore the firm's Common Equity Tier 1 capital ratio;
- sustain market confidence; and
- enable the institution to meet its authorisation conditions for at least one year and continue to carry out authorised activities.

4.52 When considering the amount required to sustain market confidence, the Bank would make a broad judgement informed by, for example, the valuation and the capital position of the institution after resolution compared to the current capital position of peer institutions.

Disapplication of the 5% and 8% rules

4.53 As set out in Chapter 3, the government notes that a few respondents expressed concerns about the disapplication of the 5% and 8% rules for larger banks.

4.54 The government believes that the 5% and 8% rules should be disapplied when the new mechanism is used. This is because the small banks for which the new mechanism is primarily intended are unlikely to be in a position to meet these rules. In the event that the new mechanism was used for banks that are required to hold MREL in excess of capital requirements but have not yet met their end-state

requirements, the government believes that the 5% and 8% rules should still be disapplied. These firms may have insufficient resources to write-down without creating other risks to the resolution objectives through writing down more senior creditors. If the 8% rule were disapplied and shareholders and creditors did not contribute an amount equal in value to 8% of the firm's liabilities, 5% of its liabilities would then be unlikely to be sufficient to recapitalise the firm and restore market confidence. The application of the 5% and 8% rules could therefore impede the use of the new mechanism in instances where it would otherwise be in the public interest to use it.

4.55 For banks that have met their end-state MREL requirements to support a bail-in resolution strategy, the new mechanism is not expected to be necessary as these firms are likely to have sufficient resources to absorb losses and recapitalise themselves. However, the government is in agreement with respondents who noted losses should be imposed on shareholders and creditors in line with their position in the insolvency creditor hierarchy and notes that requirements for the Bank to write-down regulatory capital where possible would still apply.

4.56 There are also several other measures in place to ensure that shareholders and creditors absorb losses where possible. The 5% and 8% rules are therefore only one safeguard among several. As set out in the SRR Code of Practice, sections 6A and 6B of the Banking Act 2009 require the Bank to ensure that shareholders and creditors bear losses when a banking institution fails. This involves cancelling, diluting, or transferring common shares so that shareholders are the first to bear losses. Where necessary, the Bank must also reduce the value of particular types of instruments (known as Additional Tier 1 and Tier 2 instruments) or convert such instruments into shares. These provisions would apply to these proposals.

4.57 As set out above, requirements on the Bank to report on their use of their powers would continue to apply. This includes section 79A and 80 of the Banking Act 2009, which require the Bank to report to the Chancellor of the Exchequer where they have used resolution powers to transfer a bank to a Private Sector Purchaser or a Bridge Bank, with the report meeting any requirements set by HM Treasury. This would allow *ex-post* scrutiny of the Bank's decisions in relation to the resolution.

4.58 One respondent suggested setting a higher limit for the contribution of resolution financing arrangements, rather than simply disapplying the 5% rule. However, the utility of measures based on the value of a firm's liabilities (as the 5% and 8% rules are) is not as strong for smaller banks as it is for large banks. As such, the government does not think it would be appropriate to amend the level of the 5% rule.

4.59 Taking that all into account, the government intends to disapply the 5% and 8% rules when the new mechanism is used. This will be achieved primarily through amendments to the SRR Code of Practice.

The Bill also delivers this policy outcome by scoping use of the new mechanism out of section 78A of the Banking Act 2009, which requires the Bank of England to inform HM Treasury where conditions for financial assistance are met.

Bank Levy

4.60 The government notes one respondent's call for the Bank Levy to be reduced to ensure large banks do not pay for the same risk twice.

4.61 Bank Levy receipts are a part of general taxation and paid into the Consolidated Fund. This reflects the Levy's original purpose to ensure that, in the aftermath of the Global Financial Crisis, banks continued to make a fair and sustainable tax contribution that reflected their importance to the financial system and wider economy. However, as set out in the SRR Code of Practice, subject to approval from HM Treasury, the government would make equivalent funds available immediately to the resolution authority, if they were required. This ensures there are effective public backstop mechanisms in place to support the failure of financial firms when needed, though it would ultimately be classified as a use of public funds.

4.62 It is the government's view that the proposed funding mechanism for the purposes of this consultation should instead be FSCS levies, which are charged on the entire banking sector.

4.63 The primary policy intention is for the proposed enhancement to the resolution regime to be used to support the resolution of small firms, the government views it as important that small banks contribute to the costs. As such, the Bank Levy would not be an appropriate funding mechanism as it is only paid by banking groups and building societies with total equity and liabilities exceeding £20 billion.

4.64 As such, the government considers that utilising the *ex-post* FSCS levy across the banking sector, which avoids new upfront costs on the sector, is a fair approach to funding costs of placing small banks into resolution. It is important to stress that these costs would only arise in the event the mechanism is used, and in turn would help minimise potential market disruption associated with insolvency and the costs of paying out covered deposits, which carries benefits to the wider financial services sector.

4.65 That said, the government does recognise the concerns raised about the interactions between the new mechanism and the Bank Levy. The government therefore intends to update the SRR Code of Practice on this matter once the new mechanism has been implemented. In addition, the government keeps all parts of the tax system under constant review.

Role of FSCS

4.66 The government notes that several respondents raised queries about the role of the FSCS in these proposals. This included concerns that alterations to the FSCS's remit could lead to overlapping responsibilities and complicate a resolution, queries about how funds could be returned to the FSCS and what the FSCS would do with these funds, and queries about when the FSCS would levy the sector. The government would therefore like to provide more clarity about the FSCS's role in these proposals.

4.67 The intention is that the FSCS would continue to play an operational role in these proposals, as it does during a Bank Insolvency Procedure. Under these proposals, the FSCS would be required to provide funds to the Bank, or to another person, according to the Bank's request. The Bank would have an obligation to consult the FSCS before requesting the funds. As set out above, the Bank would engage with the PRA to understand the implications of any levy raised by the FSCS on industry. The government therefore believes that the roles of the respective authorities during a resolution would remain clear and does not foresee these proposals creating confusion.

4.68 As noted in the consultation, legislation will provide for the flow of funds back to the FSCS in certain situations. The government intends that the proceeds of a sale should be used to meet costs, expenses and liabilities incurred by HM Treasury and the Bank. Any balance, up to the amount that the FSCS had provided, would then be returned to the FSCS. There may also be some scenarios in which, after a transfer, the Bank determines that it does not need the full amount of the funds it had requested from the FSCS. This might occur if, for example, the expenses incurred by HM Treasury and the Bank were lower than expected. In these situations, legislation will provide for these funds to be returned to the FSCS.

4.69 Once any surplus funds have been passed to the FSCS, they would either return these to levy payers or use the funds to offset future levies in the deposit-taking class. The process for this would be determined by the FSCS based on what they feel is most practical at the time, as is the case when the FSCS passes recoveries onto levy payers or off sets future levies.

4.70 Regarding the timing of payments from firms, these proposals would not alter the process for FSCS levy collection and arrangements would be the same as if the FSCS had paid out depositors in insolvency. In these situations, the FSCS would usually levy within 3 months of paying out. However, this is subject to the PRA determining that doing so would be affordable for firms and this period could be extended if necessary.

4.71 Respondents noted the possibility that these proposals would create a competing claim on the FSCS if they were to be used while an insolvency was in progress and on balance considers this a manageable risk. It is already the case that the FSCS may be called upon to provide compensation to depositors of multiple firms if more than one firm were to be placed into the Bank Insolvency Procedure and/or multiple credit union failures were to take place concurrently. When it comes to financial resources, the FSCS can borrow commercially or as a last resort through the National Loans Fund if its own resources are not sufficient. This means that use of these proposals would not limit the resources available for a concurrent insolvency. When it comes to the FSCS's management and administrative resources, the government will work with the FSCS and the PRA throughout the implementation of these proposals to ensure that it has the resources required to implement these proposals if needed. It is also important to note that, if these proposals were not used, the failed firm would be placed into insolvency, which may well create a larger competing claim on FSCS financial and administrative resources than use of these proposals.

Other comments

4.72 The government notes the suggestion of one respondent that the value of the failed firm's estate could be evaluated one year after a sale with half of any additional value over and above the sale price being returned to the FSCS. The government believes that this approach could complicate efforts to achieve a sale and potentially delay the transfer of the firm to a commercial buyer. Such a delay could increase the costs for industry (for example, if it extended the time the firm spent in a Bridge Bank) and reduce the ability of these proposals to meet the policy objectives i.e., to protect depositors and financial stability and reduce risks to public funds. It is also important to note that, when seeking a buyer, section 11A of the Banking Act 2009 already requires the Bank to follow a competitive process by seeking a market for any sale where circumstances allow. Further, as set out in paragraph 9.38 of the SRR Code of Practice, in most cases an auction would be arranged to determine the sale price.

4.73 The government also acknowledges the suggestion that it should consider ways to obtain contributions from senior staff involved in the firm's failure. The government notes that existing legislation on fraud and malpractice would continue to apply where these proposals are used. It is also worth noting that shares are often used as a form of remuneration for senior staff at financial firms. As set out in the Banking Act and Code of Practice, the Bank is required to ensure that shareholders are the first to bear losses. This would include senior staff to the extent that they own shares in the firm.

4.74 One respondent asked how long a failed firm could remain in a Bridge Bank, noting that this tool is intended to be used where no private sector purchaser has been found. They also asked how any

decision to transition from a Bridge Bank to insolvency would be made. It is important to note that the Bridge Bank tool can only be used with a view to selling the bank or its business in due course, or winding it down. For example, there might be situations in which the limited timeframe of a resolution weekend is not sufficient for the firm to be transferred to a Private Sector Purchaser, but a sale is a reasonable prospect if the firm is placed into a Bridge Bank. The intention is for the Bridge Bank stabilisation option set out under Section 12 of the Banking Act to remain unchanged under these proposals. As such, the existing two-year time horizon for a Bridge Bank, with the option of extending this where certain conditions are met, would still apply. Under the Banking Act, the Bank would refer to the special resolution objectives when making decisions in relation to the Bridge Bank.

4.75 The government notes one respondent's suggestion that, once the firm has entered the Bridge Bank, it may be possible to sell the financial position or auction parts of the FSCS's exposure. As set out above, the FSCS's role in these proposals would be limited to providing funds at the Bank's request, and the FSCS would not have a claim on the failed bank. If the failed bank were placed into a Bridge Bank, it would then be wholly owned by the Bank who would be free to pursue a sale in whatever way they deem most appropriate.

4.76 Although one respondent suggested that these proposals could reduce the desirability of the UK as a location for international banks, the government's view is that these proposals are a targeted enhancement to the resolution regime which would reduce risks to financial stability and should therefore increase confidence in the UK banking sector.

4.77 The government notes one respondent's suggestion that the Private Sector Purchaser would benefit from contributions of other firms. In selling the firm, the Bank aims to attain a competitive sale price, given the circumstances of the firm and the uncertainty the Private Sector Purchaser would face when acquiring a firm at short notice. As set out in paragraphs 9.37-41 of the SRR Code of Practice, in most cases an auction would be arranged to determine the sale price. Further, the sale would be made on commercial terms, having regard to the circumstances. A derogation from these requirements would only apply if the Bank determined that following these requirements would be likely to undermine one of the resolution objectives, and particularly if it would present a threat to financial stability or undermine the sale and the use of the onward transfer tool.

4.78 Under these proposals, once HM Treasury and Bank expenses have been met, the sale proceeds would flow back to the FSCS who would then account to industry. It is also important to note that other firms would benefit from the reduced contagion risk and, in many cases, the lower costs of placing the firm into resolution rather than insolvency.

4.79 The government acknowledges one respondent's suggestion that a contingent liability facility which allowed the Bank to guarantee all a firm's deposits could stem a bank run. The government believes that this is not necessary, as the resolution regime strikes the right balance in protecting depositors, financial stability and public funds. The UK has a robust approach to deposit guarantees, via the FSCS, which remain available where required.

4.80 The government notes the suggestion that depositors should only be protected up to £85,000 per eligible depositor where these proposals are used. The government believes that imposing a limit on the size of transferred deposits would undermine the core policy objectives of these proposals i.e., to protect covered depositors and financial stability and reduce risks to public funds. It would also deviate from the existing use of transfer tools under which there is no such limit.

4.81 With respect to the PRA's supervision of smaller banks and its alignment with these proposals, it is important to note that the PRA conducts its supervisory role independently of HM Treasury. When a bank experiences difficulty, the authorities manage this through the going concern regime where possible, with insolvency or resolution as a last resort. The Small Domestic Deposit Takers (SDDTs) regime, also known as Strong and Simple, is intended to simplify capital requirements and reduce small banks' operational costs, making it easier for small banks to operate and remain resilient. The eligibility criteria for this regime have been carefully considered and were finalised in December 2023. The PRA has also recently finalised policy on solvent exit planning for non-systemic banks and building societies.[12] This aims to increase the likelihood that such a firm could execute a solvent exit successfully which would in turn reduce the likelihood of the firm entering insolvency or resolution.

4.82 The government also acknowledges the suggestion that the PRA should consider a Pillar 2A add-on reflecting the risk that the firm poses to FSCS funds but notes that the calibration of capital requirements is a matter for the PRA.

4.83 The government notes the suggestion that changing technology has increased the speed of bank runs, with implications for the approach to resolution. The government will continue to engage at an international level, such as through the Financial Stability Board, to learn the lessons of the banking turmoil of Spring 2023. This includes any lessons that can be learned about the implications of technological change for resolution.

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[12] PS5/24 – Solvent exit planning for non-systemic banks and building societies: https://www.bankofengland.co.uk/prudential-regulation/publication/2024/march/solvent-exit-planning-for-non-systemic-banks-and-building-societies-policy-statement

4.84 One respondent suggested that HM Treasury and the Bank should address any impediments to the use of transfer tools, particularly the possibility of the Competition and Markets Authority (CMA) opening a merger investigation. HM Treasury and the Bank routinely work together to ensure that the resolution regime can be implemented effectively in a variety of circumstances, including carefully considering any impediments that may arise.

4.85 One respondent noted that the PRA is due to review the FSCS deposit coverage limit and suggested that they would like to see the limit rise with inflation. The PRA is required to review the FSCS deposit coverage limit every five years. The next review is due by 2025 at the latest, with inflation being one of the factors that the PRA may take into account. Any changes to the limit must be approved by HM Treasury and the government would expect to carefully consider any potential changes proposed by the PRA.

4.86 The government notes that one respondent requested more information about the application of the public interest test in the case of SVB UK. The Governor of the Bank responded to questions from the Treasury Select Committee on this topic and his responses can be found on the UK Parliament website.[13]

4.87 The government notes that one respondent encouraged the government to publish draft legislation. The government has laid before Parliament the Bank Resolution (Recapitalisation) Bill which implements the proposals set out in this response to consultation.

Other issues (not raised by respondents)

4.88 Whilst not raised by respondents, the government notes that as set out in the consultation, any legislation implementing these reforms will need to ensure that the appropriate stabilisation tools can be applied effectively. To that end, the government can confirm a number of provisions set out in the Bank Resolution (Recapitalisation) Bill related to how the mechanism will be applied.

4.89 Firstly, the Bill includes an explicit ability for the Bank to require a bank under resolution to issue new shares, as a complement to its existing powers. This will ensure that the Bank can move swiftly to ensure FSCS funds are able to recapitalise the failing bank in question.

4.90 Secondly, the Bill will scope FSCS funds provided under the new mechanism out of the definition of extraordinary public financial support in the Banking Act 2009. This reflects that the new mechanism is intended to reduce risk to the kind of public funds described within this definition. It will also enable the Bank to discharge its some of its

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[13] Please see the reports on the responses published on the UK Parliament website: https://committees.parliament.uk/committee/158/treasury-committee/news/194348/bank-of-england-and-government-respond-to-treasury-committee-on-collapse-and-rescue-of-silicon-valley-bank-uk/

functions as Resolution Authority effectively and ensure use of the new mechanism can be taken into account when discharging those functions. This includes, as noted in paragraphs 4.33 and 4.47, the Bank's approach to setting preferred resolution strategies and MREL.

4.91 Finally, the Bill ensures that FSCS funds provided under the new mechanism are included within the scope of Compensation Scheme Orders and Resolution Fund Orders, which the Treasury is required to make when the Bank of England exercises its Private Sector Purchaser and Bridge Bank stabilisation powers. This will ensure that FSCS funds are explicitly taken into account when determining whether compensation or proceeds of sale are due to transferors.

Chapter 5
Next Steps

5.1 Following consideration of this feedback, the government has laid before Parliament the Bank Resolution (Recapitalisation) Bill alongside publication of this response to consultation.[14] The Bill implements the proposals set out in this response to consultation, specifically by:

- amending the Financial Services and Markets Act 2000 (FSMA 2000) to expand the statutory functions of the Financial Services Compensation Scheme (FSCS). This will enable the FSCS to provide funds to the Bank of England upon request to meet certain costs arising from the failure of a bank, and allow the FSCS to recover any funds provided after a failure event through levies on the banking sector;
- providing the Bank of England with the ability to require a bank under resolution to issue new shares, facilitating the Bank of England's use of the funds provided by the FSCS to meet a failing bank's recapitalisation costs; and
- making a number of technical amendments to FSMA 2000 and the Banking Act 2009 to support the measures outlined above and ensure use of FSCS funds in resolution can be used effectively.

5.2 Subject to consultation with the Banking Liaison Panel, the SRR Code of Practice will then be updated to reflect that these proposals have taken effect.

5.3 The PRA and FCA will also consult on any relevant updates to their rulebooks resulting from these proposals.

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[14] The Bank Resolution (Recapitalisation) Bill can be found on the UK Parliament website, https://www.parliament.uk/business/bills-and-legislation/

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This document can be downloaded from www.gov.uk

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