HM Treasury

BANKING LIAISON PANEL
09 February 2024

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Prudential Regulation Authority	Jonathan Sepanski
Financial Services Compensation Scheme	Josh Rendall, Jonathan Pallant, Tim Furness
Association for Financial Markets in Europe	Sahir Akbar
Allen & Overy	Jennifer Marshall (CLLS Insolvency Law Committee)
Baker McKenzie	Sarah Smith (CLLS Financial Law Committee)
Building Societies Association	Aisling Morgan, Ruth Doubleday
CLLS Financial Markets Law Committee	Brian Gray
Freshfields	Michael Raffan
International Swaps and Derivatives Association	Graham Bryant
Interpath Advisory	Mike Pink
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Agenda item 1 – Updates to the Banking Liaison Panel Terms of Reference

1. The Treasury gave an overview of some changes to the Terms of Reference for the Banking Liaison Panel. The Treasury explained that

these changes reflected that the Panel would be convened on an *ad hoc* basis rather than quarterly as previously, that the yearly reporting requirement on its activities would be removed and that the summaries of its discussions may now be published on a discretionary basis.

2. The Treasury further explained that a change would also be made to remove matters relating to the resolution of clearing houses from the remit of the Panel, as there is now a separate resolution regime for these firms with its own liaison panel.

Agenda item 2 – Updates to the Special Resolution Regime Code of Practice

3. The Treasury gave an overview of some changes to the Special Resolution Regime Code of Practice. The Treasury explained that these changes reflected the fact that the Special Resolution Regime no longer applies to investment firms that are solo-regulated by the Financial Conduct Authority (FCA)and that it no longer applies to clearing houses, which are covered by the Central Counterparties (CCP) Resolution Regime.

4. The Treasury further explained that, following a suggestion by the International Monetary Fund (IMF), the changes also clarified the role of Treasury ministers in authorising the use of any public funds in a resolution.

5. Finally, the Treasury noted that the changes also clarify the role of Treasury ministers in authorising the recognition of foreign resolution decisions, given that responsibility for setting foreign policy and meeting international obligations rests with the government.

Agenda item 3 – HM Treasury's consultation on Enhancing the Special Resolution Regime (published on 11 January 2024)

6. The Treasury set out the context for the proposals contained in the consultation. It noted that the resolution of Silicon Valley Bank (SVB) UK in March 2023 demonstrated the effectiveness of the existing resolution regime but also that it can sometimes be in the public interest to use resolution tools to manage the failure of small banks rather than allowing them to enter insolvency. The Treasury noted that in cases where there is no willing buyer for a small bank, the next available option to preserve continuity of access to deposits and banking services for customers would be to use the Bridge Bank stabilisation option. This option carries risks for public funds in the event that there is a need for a bank to be recapitalised, since smaller banks are not required to hold additional Minimum Requirements for own funds and Eligible Liabilities ("MREL") resources in excess of capital requirements to be "bailed-in".

7. The Treasury summarised its proposed solution as set out in public consultation whereby, in the event of a small bank failure, FSCS funds could be used if the firm is being placed into a Bridge Bank or sold to a private sector purchaser. These funds could be used to recapitalise the firm, cover the operating costs of any Bridge Bank and recover any expenses incurred by the Bank of England and the Treasury. The Treasury explained that the FSCS funding mechanism would mirror the existing arrangements for paying out compensation for depositors in insolvency whereby, in the first instance, the FSCS would initially use its own financial means up to £1.5 billion, and then, for any amount in excess of that, it could request to borrow from the Treasury. The FSCS would then levy all UK deposit-takers after the event to recover its costs and pay back any loans.

8. The Treasury highlighted some key elements of the proposals, most notably:

    - this mechanism would be primarily intended for small banks, i.e. those that do not hold MREL in excess of capital requirements;

    - there would be no additional upfront costs for industry, as the sector would only be levied if the mechanism is used;

- the proposals are intended to be a modest enhancement to give the Bank of England more flexibility, whilst leaving the fundamentals of the resolution regime unchanged, with any decision to use the mechanism still subject to the usual resolution conditions assessment, as now; and

- it is not intended for the mechanism to be used for all small bank failures as, in cases where it is not in the public interest to use resolution powers, the firm would still be placed into insolvency.

9. The Panel noted that there would be a spectrum of views across the sector. It was noted some parts of the sector may have concerns of being seen to effectively "pay twice" for recapitalising a small bank on top of their own MREL costs. In response, the Treasury noted that the deposit taker class was already required to fund covered deposit payouts in the case of an insolvency. One Panel member registered their strong preference for the proposals compared to the alternative of a pre-funded mechanism, noting that option could tie up potential capital with an impact on lending.

10. Relatedly, two Panel members highlighted the moral hazard concerns with large banks bearing some costs in relation to the failure of small banks, whilst one Panel member suggested the mechanism should only be deployed for certain banks and not where the cause of failure is misconduct or operational failure. Moreover, one Panel member highlighted the need to ensure credit unions are aware of the impact of these proposals on them. One member referred to the idea of a least-cost test and suggested a comparable feature may be desirable for the UK's proposals, to ensure resolution action is taken when it is in the public interest.

11. Members across the Panel expressed a desire to see some cost-benefit analysis of the proposals. One Panel member acknowledged there is a possibility the proposed mechanism would be net-positive in terms of costs, compared to the costs incurred in the counterfactual of

an insolvency. The Bank of England noted that whilst upfront costs to the banking sector should be lower compared to a pay-out of depositors, there could be some unavoidable limitations to any cost-benefit analysis, including uncertainty of outcomes in a counterfactual insolvency. This is because the ultimate outcome of an insolvency is dependent on recoveries from the estate of the failed firm, which would be very specific to the firm failure in question.

12. One Panel member asked for clarification on the perimeter for deploying this mechanism and whether there were any thresholds to ensure this would only be used in relation to the failure of small banks, noting the disapplication of the 8% and 5% rules suggested there may be nothing to preclude using this mechanism for large bank failures. They also noted there are many subsidiaries of large EU-headquartered banks and suggested that, given the size of their parent companies, these subsidiaries should not be in scope of this mechanism.

13. The Treasury clarified that the consultation only proposes disapplying the 8% and 5% rules in relation to this new mechanism, rather than their wholesale removal from the resolution regime. The Treasury explained that the proposed mechanism would be linked to the transfer tools only – Private Sector Purchaser and Bridge Bank – and would still be subject to the resolution conditions, including the public interest test. Whilst preferred resolution strategies are set by the Bank of England, the Treasury expected that the largest banks' preferred resolution strategies would remain a bail-in. The Treasury noted that it welcomed feedback on whether these safeguards would be sufficient.

14. One Panel member noted that the Bank Levy exists as a way of raising funds from the sector and asked whether the government had considered this as an alternative option. The Treasury noted this query.

15. One Panel member requested that the calculation of FSCS levies to fund the proposals should be made on the basis of risk-weighting

of firms rather than just size of firms. The Treasury confirmed that the proposals envisaged using the existing basis for calculating FSCS levies, noting that this already contains an element of risk-weighting.

16. Two Panel members asked about implementation timelines for these proposals and what the legislative vehicle would be. The Treasury responded that, subject to the feedback received, the government intends to legislate for the proposals when Parliamentary time allows and that further details on this would be disclosed at the earliest opportunity.