HM Treasury

Enhancing the Special Resolution Regime

Consultation

January 2024

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Chapter 1
Executive summary

1.1 This consultation sets out the government's intention to enhance and keep up to date the UK's Special Resolution Regime (hereafter referred to as the "resolution regime"), providing a new mechanism to facilitate use of certain existing stabilisation powers to manage the failure of small banks and limit risks to public funds. [1]

Lessons learned

1.2 The UK already has a robust resolution regime for banking institutions, which was first implemented in 2009 in the wake of the Global Financial Crisis.[2] The regime made the Bank of England (the Bank) the UK's resolution authority and provides 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.

1.3 Following the failure of Silicon Valley Bank (SVB) in March 2023, which rendered its UK subsidiary Silicon Valley Bank UK (SVB UK) unable to continue operating and therefore non-viable, the Bank deployed its powers under the resolution regime to transfer ownership of SVB UK to HSBC. This process included writing down SVB UK's sole equity shareholder and its regulatory capital. This delivered good outcomes for financial stability, customers and taxpayers, demonstrating the effectiveness and flexibility of the resolution regime.

1.4 It is right to consider any lessons that can be learned about how best to manage the potential failure of smaller banks. HM Treasury has therefore worked closely with the Bank, Financial Conduct Authority (FCA), and Financial Services Compensation Scheme (FSCS) to reflect on this event, as well as the broader period of volatility in the banking sector in Spring 2023. This work has sought to ensure that the UK continues to have the best possible arrangements in place to maintain

[1] For the purposes of this consultation, 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 expression "Bank Insolvency Procedure" includes the Bank Insolvency Procedure as modified in its application to building societies.

[2] 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.

financial stability, enhance confidence in the financial system and protect depositors, while minimising risks to public funds.[3]

1.5 The government has concluded that the events of March 2023 demonstrated the soundness of the existing UK resolution regime as the Bank of England was able to manage effectively the failure of SVB UK, securing good outcomes for financial stability, customers, and taxpayers. However, as noted by the Financial Policy Committee in its July 2023 Financial Stability Report, while an individual institution may not be considered systemic, if a risk is common – or perceived to be common – among similar institutions, the collective impact can pose a systemic risk.[4] The Financial Stability Board (FSB) separately noted that the events of the spring highlight that banks not identified as Global Systemically Important Banks (G-SIBs) can still be systemically significant or critical upon failure.[5]

1.6 Moreover, the UK resolution regime allows the Bank of England to use resolution tools for any bank when the resolution conditions, including the "public interest test", are met (as was the case for SVB UK). The government's view is that, in some cases of small bank failure, the public interest and resolution objectives, particularly in respect of continuity of banking services, may be better served by the use of the stabilisation tools than the Bank Insolvency Procedure. Reflecting this, while there is still a role for the Bank Insolvency Procedure, there is value in ensuring that certain existing resolution tools can be applied to small banks in a way that achieves good outcomes for financial stability while also protecting taxpayers.

1.7 As a result, the government believes that a targeted enhancement to the range of options provided by the UK's resolution regime to reflect the conclusions above would best ensure the UK continues to have a world-leading regime, whilst giving the Bank of England more flexibility to manage small bank failures effectively.

Government proposal

1.8 The government believes that, in certain situations, in view of the options available, it may be in the public interest to transfer a failing small bank into a Bridge Bank or, as happened in the case of SVB UK, to a willing buyer, rather than placing such a bank into insolvency. However, use of the transfer powers can pose risks to taxpayers given the potential need for such a bank to be recapitalised.

1.9 To that end, the government proposes introducing a new mechanism that could be deployed alongside the exercise of the

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[3] 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

[4] Financial Stability Report, July 2023, Bank of England. https://www.bankofengland.co.uk/financial-stability-report/2023/july-2023

[5] 2023 Bank Failures: Preliminary lessons learnt for resolution, Financial Stability Board. https://www.fsb.org/2023/10/2023-bank-failures-preliminary-lessons-learnt-for-resolution/

Bridge Bank and Private Sector Purchaser (PSP) transfer resolution powers. The mechanism provides for greater optionality in terms of sources of capital for a resolved firm and would be used alongside the existing resolution powers. The government expects this would be used primarily to resolve small banks, given larger banks are already required to hold a certain amount of their own equity and debt that can be drawn on to recapitalise them when they fail. The new mechanism would allow the Bank of England to use funds provided by the banking sector to cover costs associated with a resolution, including those associated with recapitalising and operating the failed bank. As with the current depositor protection arrangements, these funds would be provided by the FSCS as needed in the event of a failure, and subsequently funded by a levy on the banking sector.

1.10 Separately to this proposal, the bank in resolution would continue to have access to the Bank of England's published liquidity facilities, subject to meeting the necessary eligibility criteria. The Bank of England also has a flexible Resolution Liquidity Framework under which it may provide liquidity support to a bank in resolution secured against a wide range of collateral, if required to allow the firm to make a transition back to market-based funding.[6]

1.11 Introducing this new mechanism would enable use of the Bridge Bank and PSP transfer tools whilst mitigating the risk that taxpayer funds would be needed to cover costs of a small bank failure, by ensuring these costs are first met by the firm's shareholders and certain creditors, and then as necessary by the wider banking sector. This would build on existing depositor protection arrangements, using the FSCS as the source of the funding. Under the government's proposed approach to designing the financing of this mechanism, it would therefore be achieved in a way that does not impose additional upfront financial costs for banks.

1.12 This arrangement would be consistent with, and a complement to, the Bank's resolution powers and would not necessarily be used in all instances of bank failure. The Bank of England would continue only to exercise its resolution powers where it judges this to be in the public interest, having considered the resolution conditions and objectives set out in the Banking Act 2009. If all four resolution conditions, and therefore the public interest test, are not met, firms would instead be placed into the modified insolvency procedure.

1.13 This change also complements ongoing work to improve deposit pay-outs, including work to enhance the ways in which FSCS can make compensation payments (such as electronic payout) and work on ease of exit for smaller firms. To support the new mechanism, changes to PRA Deposit Protection rules would also be needed. In addition, the

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

PRA is due to conduct its regular review of the FSCS deposit limit by 2025.

1.14 Overall, this proposal would introduce sensible and modest enhancements to the resolution regime to give the Bank of England increased flexibility to manage the failure of a small bank, without making significant changes to the regime itself and avoiding new upfront costs for firms. This would in turn 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.

1.15 The government welcomes feedback on this proposal, which it considers to be an effective way of meeting the stated policy objectives in the immediate-term. Subject to this feedback, the government would look to legislate to introduce this new mechanism when Parliamentary time allows. The government is also open to feedback from respondents on alternative means of funding that could help meet the policy objectives over the longer-term, such as for example a pre-funded approach.

Learning lessons internationally

1.16 The government, working with the Bank of England, FCA and FSCS, will also be continuing to engage in international discussions at the FSB to learn the wider lessons of this period of volatility in the banking sector. The government notes that the FSB agreed a wide-ranging programme of work earlier this year, including on the choice of resolution strategies and the interaction between resolution and deposit protection, and will engage closely with that process.

Responding to this consultation

1.17 This consultation will close **at 17:00** on **7 March 2024**. The government is seeking feedback on the proposals set out in the following chapters, and in particular responses to the following questions which are summarised here:

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?**

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

3. **Do you agree with the proposed scope of application for the proposed mechanism?**

4. **Do you have any other comments on the proposals set out in this consultation?**

How to submit responses

1.18 Please submit your responses to bankresolutionconsultation@hmtreasury.gov.uk or post to:

Resolution Policy Unit, Financial Stability Group

HM Treasury

1 Horse Guards Road

SW1A 2HQ

More information on how HM Treasury will use your personal data for the purposes of this consultation is available in Annex B.

Chapter 2
Background

2.1 During the Global Financial Crisis, governments around the globe faced a stark choice between allowing banks to fail in a disorderly way, risking significant financial instability and economic disruption, or using public money to bail them out. Banks had, in effect, become "Too Big To Fail".

2.2 To address this, the G20 agreed on the need to develop a comprehensive programme of reforms globally designed to end "Too Big To Fail". This included introducing frameworks to manage failing banks, known as the resolution regime. The UK's regime was first introduced through emergency legislation and placed on a more permanent footing by the Banking Act 2009. It has since been added to through subsequent legislation. The UK framework implements international standards on resolution as set out by the Financial Stability Board.[7]

2.3 The regime aims to ensure that failure of banking institutions – including banks, building societies and some investment firms – can be managed in an orderly way, providing wide-ranging powers to the Bank of England (the Bank) and others, including HM Treasury, for dealing with firms in failing firms. This includes various "stabilisation options" which can be used to steady a failing firm. The Bank is the UK's resolution authority and is therefore ultimately responsible for planning for and executing a resolution.

2.4 When dealing with a troubled bank, the authorities (the Bank, HM Treasury, Prudential Regulation Authority (PRA), and Financial Conduct Authority (FCA)) must consider the resolution objectives set out in the Banking Act 2009. These include, among others, protecting public funds and ensuring continuity of banking services and critical functions, with the full set of objectives set out at figure 2.A.

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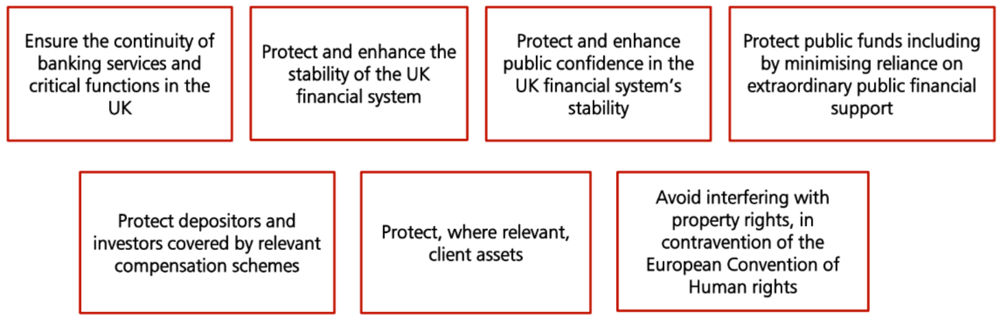
[7] Key Attributes of Effective Resolution Regimes for Financial Institutions. https://www.fsb.org/wp-content/uploads/r_141015.pdf.

Figure 2.A : Special Resolution Objectives



2.5 In addition, a firm is placed into resolution if four conditions have been met, namely that:

- a firm is failing or likely to fail – determined by the PRA in consultation with the Bank;
- it is not reasonably likely that action will be taken that will result in the firm recovering – determined by the Bank, in consultation with the PRA, the FCA and HM Treasury;
- resolution action is necessary in the public interest – determined by the Bank, in consultation with the PRA, the FCA and HM Treasury; and
- resolution objectives would not be met to the same extent by placing the firm into insolvency – determined by the Bank, in consultation with the PRA, the FCA and HM Treasury.

The Bank Insolvency Procedure

2.6 If the first two resolution conditions are met, but the public interest test for using a stabilisation power is not, firms are placed instead into a special insolvency regime if they hold deposits or client assets and normal insolvency if they do not. The Bank Insolvency Procedure is the special insolvency procedure for banks.[8] If a bank enters the Bank Insolvency Procedure, the FSCS will compensate eligible depositors for account balances of up to £85,000 per depositor within seven days, with higher limits for temporarily high-balances (e.g. following a residential home sale). The FSCS is substituted for the depositor as a creditor of the bank during the insolvency process and, if the depositor holds more than £85,000 with the bank, they may in due course make recoveries via the FSCS through that process.

2.7 FSCS compensation is funded through a levy on the financial services industry, as well as recoveries from previous firm failures. In the case of paying out depositors, these levies fall to the banking sector.

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[8] For building societies, the Building Societies Insolvency Procedure is used.

This ensures that the costs of financial firm failures are borne first by shareholders and certain creditors, and then by industry, rather than taxpayers. Therefore, if a bank enters the Bank Insolvency Procedure, the FSCS will pay compensation to eligible depositors and then raise the levy on authorised banks, building societies and credit unions. The FSCS can borrow commercially or, as a last resort, from HM Treasury in the interim to ensure it has the necessary funds to facilitate a pay-out, and will then levy the banking sector to repay any borrowing. Although levies will mostly be raised after a pay-out, the FSCS also levies in advance for anticipated failures of credit unions.

The stabilisation options

2.8 If all four of the resolution conditions are met, the Bank of England can apply the stabilisation powers. These include powers to bail-in a failing firm, or to transfer all or part of the failed firm to a Private Sector Purchaser (PSP) or asset management vehicle (in combination with another stabilisation tool), or a temporary Bank of England-owned Bridge Bank.

2.9 Bail-in exists for the largest and most complex banks. The aim is for the holding company of the failed bank to be recapitalised by writing down eligible creditors and potentially converting their claims into equity. This imposes losses on shareholders and creditors, rather than taxpayers as would happen if the bank was bailed out. Firms subject to bail-in are required to hold a certain amount of debt and equity in excess of minimum capital requirements in advance of a potential failure that can be "bailed-in". This is known as the "Minimum Requirement for own funds and Eligible Liabilities" (MREL).

2.10 If a buyer is forthcoming, the Bank may choose to sell all or part of the failing bank using the PSP stabilisation option. This option allows customers to continue accessing banking services without interruption. If a buyer is not immediately forthcoming, the Bank of England can transfer ownership of all or part of the firm, or of the firm's assets and liabilities, to a Bridge Bank. This entity is owned and controlled by the Bank of England, with the aim of maintaining customers' access to banking services until a sale is achieved.

Resolution strategies

2.11 As set out in its approach to resolution and as required in statute, the Bank sets preferred resolution strategies for individual firms in advance, to assist in its planning for a potential failure.[9] These strategies serve to guide the Bank and firms in planning for a potential resolution, but are not fixed. If the resolution conditions are met at the time of a failure, the Bank of England, in consultation with the PRA and (if public funds are at risk) HM Treasury, will determine the resolution action that best serves its statutory resolution objectives. This could involve the

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

deployment of any of the Bank's resolution powers, singularly or in combination.

2.12 The Bank of England currently sets three broad strategies for firms:

- "bail-in" (where the firm would be recapitalised by writing down existing shareholders and eligible creditors);
- "transfer" (where the Bank would expect to use its powers to transfer all, or part, of the firm's business to a buyer, a bridge bank or an asset management vehicle); and
- the "Bank Insolvency Procedure" (where the firm is placed into a modified insolvency procedure, with the FSCS paying compensation to eligible depositors).

2.13 Firms with a bail-in or transfer strategy are required to hold MREL in excess of minimum capital requirements. This aims to ensure there are sufficient funds to provide for loss absorption and recapitalisation when the firm is placed into resolution to allow the firm to continue operating. This in turn ensures customers of these banks maintain continuity of access to banking services.

2.14 Firms with a Bank Insolvency Procedure strategy are not required to hold MREL in excess of minimum capital requirements, since the starting assumption is that these firms would be wound up under insolvency proceedings (with eligible depositors being paid out by FSCS or transferred).

2.15 In order to guide the setting of individual firms' preferred resolution strategies and therefore the amount of MREL they should hold, the Bank has established indicative thresholds, structured as ranges, so that it can make a firm-specific judgement on setting a stabilisation power preferred resolution strategy. The indicative thresholds are 40,000-80,000 transactional accounts for transfer strategies, and total assets of £15bn to 25bn for bail-in strategies.[10] Below these indicative thresholds, firms are not required to hold MREL in excess of minimum capital requirements.

Silicon Valley Bank UK (SVB UK) and application of the regime to small banks

2.16 In this section and in subsequent sections, the consultation makes several references to "small" or "smaller" banks. For the purposes of this consultation, this means the population of banks and building societies that are not required to hold MREL above minimum capital requirements.

[10] "Transactional accounts" are defined as accounts from which withdrawals have been made nine or more times within a three-month period. See The Bank of England's approach to setting a minimum requirement for own funds and eligible liabilities (MREL).

2.17 The collapse of SVB UK in March 2023, as a result of the failure of its US parent company, demonstrated that it may be in the public interest with respect to the special resolution objectives of the Banking Act 2009 to exercise resolution powers in order to better promote public confidence in the stability of the UK financial system following the failure of a smaller bank which, as discussed above, would ordinarily be expected to be placed into insolvency. By ensuring that all of SVB UK's customers could continue to access their bank accounts, and other facilities without disruption, the Bank ensured the continuity of banking services, and protected depositors. By ensuring that all deposits, including those not covered by the FSCS, remained safe, secure, and accessible, the Bank maintained public confidence in the stability of the UK financial system.

2.18 Over the course of the weekend of 11/12 March 2023, a potential buyer for SVB UK emerged and it became clear that the resolution objectives were best met through the option to transfer SVB UK to a buyer through the PSP stabilisation option. The Bank therefore decided to use its stabilisation powers to sell SVB UK to HSBC.

2.19 SVB UK's resolution delivered a good outcome and demonstrates the critical importance of the resolution regime to the stability of the financial system. The resolution action ensured that economic disruption from SVB UK's failure was avoided, with customers continuing to experience continuity of access to everyday banking services.

2.20 Whilst a good outcome was achieved in this case, SVB UK's resolution does expose the potential challenge of managing the failure of a small bank where resolution action is judged to be necessary in the public interest at the time of failure, but without access to additional capital resources that might be needed to facilitate the resolution. As mentioned, smaller banks are not required to hold additional equity and debt to be bailed-in.

2.21 If a credible buyer is not forthcoming, the only option currently available to preserve immediate continuity for customers of smaller banks is to transfer the firm (or some or all of its business) to a Bridge Bank. In either case, to achieve stabilisation, a failed bank may need additional capital – for example, in order for the bank to meet minimum capital requirements for authorisation or to cover the costs of restructuring. At present, these costs (as well as any costs of operating a Bridge) may, at least initially, have to be borne by taxpayers as HM Treasury would be the only available source of these funds to meet these costs. This means taxpayers are exposed in the event that a small bank failure is judged to require resolution action but the firm does not possess internal resources to provide recapitalisation.

2.22 It also means that, where small bank failures could have highly disruptive impacts on their customers, customers of those banks are at a disadvantage in terms of continuity of access to their banking services compared to customers of larger banks, where it is more likely that continuity of services would be maintained because those banks are required to hold MREL that can be used to absorb losses and recapitalise themselves.

Chapter 3
Proposals

3.1 In light of the challenges posed by small bank failures where resolution is judged as necessary, the government is proposing to enhance the resolution regime. This proposal, in short, would establish a new mechanism that could be used alongside the existing stabilisation powers to meet costs (as defined below) that might arise where smaller banks are placed into resolution. It would introduce an addition to the existing regime to give the Bank of England more options for managing the failure of small banks, without making significant changes to the regime overall.

3.2 These proposals are consistent with the FSB's ongoing work to learn the lessons of the 2023 bank failures, including SVB UK's parent company. This work has highlighted the potential for smaller banks to have significant impacts on parts of the financial system and set out some areas for further exploration. The government will continue to engage with the FSB as this work develops.

Overview

3.3 Where a failing small bank meets the required tests for resolution action, the Bank would be able to use its powers to transfer the shares and/or property (assets and liabilities) of the firm to a Bridge Bank or commercial buyer, as it can now. Alongside use of these stabilisation powers, a new mechanism would be created to allow funds provided by the banking sector to be utilised to provide for certain costs that arise during a resolution. These costs are set out below, which the Bank would estimate upfront ahead of placing a bank into resolution:

- the costs of recapitalising the failed bank, which would be calculated in a comparable way to the shortfall amount under section 12AA of the Banking Act 2009
- 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.

3.4 This would reduce the likelihood of these costs needing to be met by the taxpayer, whilst ensuring that customers have continuity of access to banking services. The diagram at Annex A provides an overview of how this new mechanism would work, with the details set out in the following paragraphs.

3.5 Any lending to a bank in resolution to provide liquidity would continue to be provided by the Bank under the terms of the resolution liquidity framework. The Bank has a published approach to providing liquidity in resolution.[11]

Funding the new mechanism

3.6 The government's proposal would utilise the FSCS to provide these funds, by requiring the FSCS to make funding available at the Bank's direction. Any money requested by the Bank but not expended would be returned to the FSCS.

3.7 In practice, the government's preferred approach would involve the FSCS providing the funds through an ex-post levy on the banking sector, in the same way that it currently funds a pay-out or transfer of covered deposits after a firm is placed into insolvency. As with a depositor pay-out, the funding gap that arises while the levy is collected would be met using any available FSCS funds or, where necessary, through the FSCS's existing ability to borrow commercially. The FSCS is able to levy from the sector up to an annual cap set by the PRA, which currently stands at £1.5 billion. As a last resort, where using available FSCS funds or commercial borrowing is insufficient or not possible, the FSCS could make a request to borrow from HM Treasury. The FSCS would then subsequently recoup any funds provided through levies on the banking sector after the event, subject to the levy cap.

3.8 To achieve the approach set out above, the government would legislate to expand both the FSCS's statutory functions and its levy-raising powers, to allow it to provide funding and levy for this new purpose. The proposed legislation would also provide for the FSCS to potentially receive some funds from any proceeds that arise from a sale of the failed bank. If received, this would be used to reduce future levies, or be repaid to levy-payers.

3.9 The government judges that this is both a pragmatic and fair solution in the immediate term. The FSCS already has the operational capability and infrastructure to both provide funding and recover its costs through levies. Moreover, sourcing the funds ultimately from the banking sector on an ex-post basis is consistent with the approach to funding depositor pay-outs. This

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

is judged to be a fair and necessary approach to ensure risks to taxpayers are minimised as far as possible.

3.10 Whilst the government considers this approach to be the most proportionate and effective solution to meet the policy objectives in the immediate term, alternative approaches could also be considered in the longer term. One option would be for the government to consider establishing a mutualised fund to be built up in advance and drawn on in the event of resolution. The Bank of England, could, alternatively decide to alter their policy and require small banks to issue MREL in excess of minimum capital requirements.

3.11 While these approaches would have the advantage that a failed firm would contribute towards some of the costs of its failure as larger firms do, they raise wider policy and feasibility questions. In practice, small banks have very limited or no access to capital markets to issue MREL-eligible debt to investors and would therefore need to meet MREL requirements with equity. Requiring such firms, in effect, to maintain higher equity capital ratios, would impose disproportionate costs on small firms, and in turn have a negative impact on competition. Building up a pre-fund, financed by levies on the banking sector, would in aggregate be less costly to the sector as a whole than imposing individual MREL-type requirements on small banks. It would also provide a contingency for use in any future failures that might require additional capital resources. However, it would reduce the amount of capital each individual contributing firm has to absorb losses and support productive lending and investment.

3.12 As set out above, the government's intention is to legislate to deliver a solution whereby the banking sector contributes funds on an ex-post basis, which can be implemented with only minor operational changes to the current system. The government remains open to feedback from respondents on alternative means of funding that could help meet the policy objectives, noting these would be more operationally complex to deliver and involve a longer lead in time to implementation. In addition, more broadly the government will continue to keep UK arrangements under review in light of ongoing work on lessons learned both domestically and internationally.

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?

Liability for the levy and impacts on firms

3.13 In recovering funds through levies as outlined in this proposal, the FSCS would levy the entire deposit-taking class as defined in the Depositor Protection Part of the PRA Rulebook.[12] This mirrors the arrangements in place if the failed bank were to enter the Bank Insolvency Procedure, where the FSCS would pay compensation to the depositors and then levy the entire deposit-taking class to recoup the funds.

3.14 Whilst the purposes for which the FSCS can levy and use levy funds would be modified, the FSCS's annual levy limit for the deposit-taking class, currently set at £1.5 billion, would continue to be set by the PRA based on their assessment of what is affordable for the sector. Moreover, the same overall cap would apply to use of both the new mechanism and paying depositors in insolvency. Similarly, and as with a depositor pay-out, the annual levy that the banking sector would be liable to pay would not be affected unless the new mechanism is used. This means that there would be no immediate changes to the amounts levy-payers are expected to pay compared to now. As such, where the mechanism is used in relation to a small bank these proposals are unlikely to impose additional upfront costs on levy-payers.

3.15 Use of the new mechanism may reduce the immediate costs borne by the sector in FSCS levies compared to the Bank Insolvency Procedure, in the event of a bank failure. This is because the immediate depositor compensation costs (e.g. upfront cash required and interest expense to fund the payout) could be substantially higher than the costs of recapitalisation. Moreover, recapitalisation followed by a sale or orderly wind down is most likely to preserve more value in the firm than entry into insolvency. The overall relative cost and benefit profile would, however, depend on the amount that flows back to industry through sale proceeds and potential recoveries made in insolvency.

3.16 More broadly, the sector would benefit from reduced disruption from small bank failures, including a reduced risk of contagion. This enhancement to the resolution regime could also increase public confidence in the banking system which could, in turn, encourage investment. The government therefore anticipates that these benefits would accrue not just to banks in scope of the new mechanism, but those out of scope too, including credit unions and larger banks. Levying the whole deposit-taking class as now also remains consistent with the approach taken for

[12] This includes any Deposit Guarantee Scheme member, i.e., any of the following: a UK bank; a building society; a credit union; a Northern Ireland credit union; or an overseas firm if: (a) the firm has a Part 4A permission that includes accepting deposits; and (b) deposits are held by a UK establishment of the firm.

funding all resolution financing contributions from FSCS under the existing regime.

3.17 As with any legislative proposal, the government would in due course look to undertake a full impact assessment to assess the costs and benefits to firms.

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

Firms in scope of new mechanism

3.18 The government's expectation is that these proposals for enhancing the resolution regime would generally be used where a small bank is placed into a Bridge Bank, given the potential risks to taxpayers involved in this scenario. As such, the Bank may work with industry to ensure that the new mechanism is operational and integrated into their existing resolution planning that they conduct with firms.

3.19 As noted, the Bank would also have the ability to use the new mechanism where it is deploying the Private Sector Purchaser (PSP) option in relation to a small bank. This is because, in some circumstances, the availability of this funding could facilitate a sale to a buyer without placing the bank into a Bridge Bank, ensuring there is a credible source of funding to recapitalise a small bank in this scenario and securing the success of a sale. This would achieve the ultimate aim of selling to a buyer without incurring the additional costs associated with use of the Bridge Bank tool. The government therefore judges that it is sensible to include this option, even if it is not the primary intended use of the new mechanism.

3.20 The new mechanism could be applied in principle to any banking institution within scope of the Special Resolution Regime and where the Bridge Bank or PSP options are being deployed. It is worth noting that any decision to place a firm into resolution and use the new mechanism would always be subject to the resolution conditions and would take into account the special resolution objectives. Noting this point, the government expects the mechanism would generally be used to support the resolution of small banks and only once shareholders and any capital resources have been written down, where a judgement is reached that the use of insolvency would be too disruptive and hence those conditions are satisfied. However, there may also be some limited instances where the new mechanism might be appropriate for other firms. This could include, as an example, firms that are still in the process of reaching their end state MREL requirements. Ultimately the decision would rest with the Bank having assessed the resolution conditions in consultation with the relevant authorities.

3.21 The new mechanism would not be used to manage the failure of credit unions since the Special Resolution Regime does not apply to these firms.

3.22 The new mechanism would similarly not be used to manage the failure of a third-country branch operating in the UK. This is because the responsibility for resolving such a firm ultimately lies with the relevant home resolution authority. In addition, the UK already has a number of separate powers that it can use with respect to branches if the conditions in the Banking Act 2009 (as amended) are met.

3.23 For the avoidance of doubt, resolution supported by the new mechanism is not intended to replace the Bank Insolvency Procedure in all cases, and any decision to deploy stabilisation powers would remain subject to the resolution conditions as now. The Bank Insolvency Procedure remains an important means of managing bank failures and HM Treasury and the Bank remain committed to improving outcomes for customers whose banks enter insolvency. This includes supporting the FSCS to implement electronic pay-out for depositor compensation, allowing customers faster access to compensation. As noted elsewhere in this consultation, the Bank would continue to assess the most appropriate response to bank failures on a case-by-case basis, recognising that the nature and effects of a bank failure can be hard to anticipate in advance.

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

Exit from Bridge Bank

3.24 Where the Bridge Bank stabilisation option has been deployed, the firm in the bridge would, in accordance with the usual process, be sold to a buyer or, if that were not possible, wound down. Any proceeds from the sale to the private sector or recoveries from the winding down would be applied in accordance with the provisions of a Resolution Fund Order made by HM Treasury.

3.25 The government would expect such an Order to provide for funds to be applied to meet any compensation costs for the transferors at the time of the Bridge Bank transfer and against any outstanding costs and expenses of HM Treasury and the Bank of England in relation to the Bridge Bank process or resolution (to the extent that these costs are not met by the request for FSCS funds). Where funds remain, the government expects that the Order would provide for them to be sent to FSCS to offset future levies or repay industry.

3.26 If the firm was wound down, depositors would have been given time to move their deposits to other institutions to minimise wider disruption.

Use of the PSP tool

3.27 If the mechanism were used in conjunction with the PSP tool, the government expects to make arrangements to allow sale funds to flow back to FSCS after payment of any compensation liabilities and expenses, as well as other costs arising from the resolution that were not met through the request for FSCS funds.

Other issues

3.28 No changes are being proposed to either the resolution conditions or the resolution objectives, to facilitate the use of the new mechanism.

3.29 The government is considering making some limited changes to the stabilisation powers, as set out in the Banking Act 2009, so that where the new mechanism is used, the recapitalisation can be effected by the relevant stabilisation power.

3.30 The government also intends to make some changes to the conditions for using financing arrangements in a resolution, which would apply to this new mechanism. Specifically, there are two conditions set out in the Special Resolution Regime Code of Practice which state that:

- "Resolution financing arrangements may only be used… where the shareholders and creditors of the failing institution have made a contribution equal in value to at least 8% of the liabilities of the institution". This is known as the "8% rule".
- "The contribution of the resolution financing arrangements may not exceed an amount equal to 5% of the liabilities of the institution". This is known as the "5% rule".[13]

3.31 These conditions are designed to have additional safeguards in place to limit risks public funds when banks are placed into resolution. However, the government has considered carefully whether these conditions remain appropriate in relation to the new mechanism.

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[13] Special Resolution Regime Code of Practice, paragraph 11.5. https://www.gov.uk/government/publications/banking-act-2009-special-resolution-regime-code-of-practice-revised-march-2017

3.32 As mentioned earlier in this consultation, small banks are not required to hold additional loss-absorbing capacity in the form of MREL above minimum capital requirements. Consequently, small banks are unlikely to meet the 8% and 5% thresholds since they won't hold sufficient MREL. The government's view, on balance, is that these conditions are therefore not appropriate for the cohort of firms for which the new mechanism is expected to be used, and applying these conditions when the new mechanism is used is likely to prevent it from being deployed effectively, carrying risks for the successful resolution of smaller banks.

3.33 As such, the government proposes to disapply these conditions when the new mechanism is used, and the government intends to amend the Code of Practice to make this clear. Section 78A of the Banking Act 2009 would also be amended to disapply the requirement for the Bank of England to notify HM Treasury of whether the "8% rule" has been fulfilled in the event that the new mechanism is used.

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

Next steps

3.34 Once the consultation has closed, HM Treasury will consider the feedback received and issue a consultation response. Subject to and depending on the feedback received, the government would look to legislate to implement the new mechanism when Parliamentary time allows.

3.35 Once the proposals have been legislated for, the government will continue to work with the Bank, PRA, FCA, and FSCS to ensure that the proposals are fully operational and ready to be deployed. This will include making any necessary changes to the Special Resolution Regime Code of Practice.

3.36 As noted, these proposals are intended to provide the Bank with greater flexibility to manage small bank failures in the near term. The government will continue to work with the Bank to reflect on the effectiveness of the resolution regime to ensure it remains world-class and fit for purpose, including participating in discussions internationally.

Annex A: Deployment diagram

Figure 1: Bridge Bank

1. Failed firm is placed into a Bridge Bank over resolution weekend.
2. Bank of England requests funds from FSCS.
3. FSCS provides funds to the Bank.
4. Failed firm is recapitalised by the Bank using funds.
5. Over time, funds are repaid to FSCS using industry levies.
6. Firm is sold onwards or wound-down, with surplus funds flowing back to FSCS.

Figure 2: Private Sector Purchaser (PSP)

1. Bank of England identifies a private sector purchaser.
2. Bank of England requests funds to the FSCS.
3. FSCS provides funds to the Bank.
4. Funds are used to recapitalise the failed firm to action a sale.
5. Over time, funds are repaid to FSCS using industry levies.
6. Firm is sold onwards, with surplus funds flowing back to FSCS.

Annex B: Privacy statement

Processing of personal data

This section sets out how we will use your personal data and explains your relevant rights under the UK General Data Protection Regulation (UK GDPR). For the purposes of the UK GDPR, HM Treasury is the data controller for any personal data you provide in response to this consultation.

Data subjects

The personal data we will collect relates to individuals responding to this consultation. These responses will come from a wide group of stakeholders with knowledge of a particular issue.

The personal data we collect

The personal data will be collected through email submissions and are likely to include respondents' names, email addresses, their job titles and opinions.

How we will use the personal data

This personal data will only be processed for the purpose of obtaining opinions about government policies, proposals, or an issue of public interest.

Processing of this personal data is necessary to help us understand who has responded to this consultation and, in some cases, contact certain respondents to discuss their response.

HM Treasury will not include any personal data when publishing its response to this consultation.

Lawful basis for processing the personal data

Article 6(1)(e) of the UK GDPR; the processing is necessary for the performance of a task we are carrying out in the public interest. This task is consulting on the development of departmental policies or proposals to help us to develop effective government policies.

Who will have access to the personal data

The personal data will only be made available to those with a legitimate need to see it as part of consultation process.

We sometimes conduct consultations in partnership with other agencies and government departments and, when we do this, it will be apparent from the consultation itself. For these joint consultations, personal data received in responses will be shared with these partner organisations in order for them to also understand who responded to the consultation.

As the personal data is stored on our IT infrastructure, it will be accessible to our IT service providers. They will only process this personal data for our purposes and in fulfilment with the contractual obligations they have with us.

How long we hold the personal data for

We will retain the personal data until work on the consultation is complete and no longer needed.

Your data protection rights

Relevant rights, in relation to this activity are to:

request information about how we process your personal data and request a copy of it
object to the processing of your personal data
request that any inaccuracies in your personal data are rectified without delay
request that your personal data are erased if there is no longer a justification for them to be processed
complain to the Information Commissioner's Office if you are unhappy with the way in which we have processed your personal data

How to submit a data subject access request (DSAR)

To request access to your personal data that HM Treasury holds, please email: dsar@hmtreasury.gov.uk

Complaints

If you have concerns about Treasury's use of your personal data, please contact our Data Protection Officer (DPO) in the first instance at: privacy@hmtreasury.gov.uk

If we are unable to address your concerns to your satisfaction, you can make a complaint to the Information Commissioner at casework@ico.org.uk or via this website: https://ico.org.uk/make-a-complaint.

HM Treasury contacts

This document can be downloaded from www.gov.uk

If you require this information in an alternative format or have general enquiries about HM Treasury and its work, contact:

Correspondence Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 5000

Email: public.enquiries@hmtreasury.gov.uk