HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

Lord Vaux of Harrowden
House of Lords
London
SW1A 0PW

21 August 2024

Dear Lord Vaux,

Thank you for your contribution to the Second Reading debate on the Bank Resolution (Recapitalisation) Bill on 30 July 2024. In that debate, you raised a number of questions which I sought to answer in my closing speech. However, there were some questions about which I said I would write to you. I am copying this letter to those who spoke in the debate and a copy will be deposited in the Library of the House.

First, you asked about the factors that the Bank of England (the Bank) considers when deciding which firms should maintain a Minimum Requirement for Own Funds and Eligible Liabilities (MREL) above minimum capital requirements, noting that Silicon Valley Bank (SVB) UK was not considered systemic prior to its failure. The Bank sets a preferred resolution strategy, and determines the MREL a firm must maintain for all firms in the UK, within the framework set by Parliament. That said, the actual approach taken to resolve a firm will depend on the circumstances at the time of its failure. Each firm's preferred resolution strategy is informed by a number of factors considered by the Bank. Amongst other factors, key factors are the size of the firm and extent to which the firm provides significant amounts of transactional banking services or other critical functions. Indicatively, the Bank considers that provision of greater than 40,000 – 80,000 transactional accounts, or a balance sheet size of greater than £15bn - £25bn may mean that insolvency does not achieve the resolution objectives. Firm failure scenarios can be highly idiosyncratic and situation specific, and therefore it may not always be possible to anticipate all issues and factors that might lead to a failure ahead of time. This Bill therefore intends to provide the Bank with additional flexibility in such situations.

Second, you asked whether, given that resolution is pursued in the public interest, public funds should be used rather than money from industry. Minimising risks to public funds is a

key objective both of this Bill and of the resolution regime overall. The Bank is required to have regard to the objective to protect public funds when determining whether or not resolution action is in the public interest. The extent to which risks to taxpayers are limited is therefore a key indicator as to whether resolution can be justified in the public interest. It is worth adding that the banking sector is already required to contribute to the costs of a small bank entering insolvency through funding a pay-out of covered depositors, ensuring these costs do not fall to taxpayers. The Bill therefore aims to apply the existing mechanisms and principles of the bank failure regime to situations in which it is in the public interest for a small bank to enter resolution.

Third, you asked about the position of the FSCS in the creditor hierarchy if the firm were to enter insolvency after being recapitalised using FSCS funds and placed into a Bridge Bank. The Bill extends the FSCS's role to include providing funds at the Bank's request and the Bank is responsible for using these funds to recapitalise the firm. As the Bank of England would be the sole shareholder of the Bridge Bank, it is possible that the Bank would receive recoveries in a subsequent winding up of the Bridge Bank if all other claims were met. The Bill provides for these to be returned to the FSCS. Separately, if the firm entered insolvency from a Bridge Bank, and there were still eligible depositors, the FSCS would pay compensation to eligible depositors and take on their position in the creditor hierarchy as it usually does. The FSCS would therefore have a claim on the firm relating to the payment of compensation but not for the provision of funds under this Bill.

Fourth, you also asked whether there is any mechanism for recovering funds from a Private Sector Purchaser if the sale price is thought to have been below market value. A sale of a failed bank is an infrequent event, and any acquirer will be carefully judging the riskiness of buying the failed firm and therefore how much it is appropriate to pay. There will be circumstances where this risk results in gains to the acquirer, and losses to the acquirer. In all circumstances, the integration and restructuring of a failed bank will be a complex undertaking. Once a sale has been agreed, the legislation does not provide for the Bank to clawback funds from the buyer. If this were possible, without consent and agreed as part of the sale, it 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 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.

Finally, you asked whether there is a process for recovering bonuses and dividends that were paid before the firm failed. The Bank and PRA do not have the power to require dividends to be returned. While PRA rules allow firms to reduce bonus payments or require staff to return bonus payments in certain circumstances, these do not apply to smaller firms and so are less

relevant to the group of firms this Bill is primarily concerned with. However, existing legislation on fraud and malpractice would also continue to apply where these proposals are used. It is also worth noting that the Bank is required to ensure that shareholders are the first to bear losses. This means that shareholders, which often includes senior staff, would contribute to the costs of the firm's failure.

I trust I have answered your questions thoroughly although please feel free to write to me if there are related matters I have not addressed. Thank you for taking the time to raise them. I look forward to your continued engagement on the Bill.

Yours,

Lord Livermore

FINANCIAL SECRETARY TO THE TREASURY