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BANK RESOLUTION (RECAPITALISATION) BILL - WHERE NEXT FOR THE SPECIAL RESOLUTION REGIME?

On 18 July 2024, the government introduced the Bank Resolution (Recapitalisation) Bill (the **Bill**) in the House of Lords. This implements proposals consulted on by the previous government in January and confirmed in the new Labour administration's response to that consultation. The Bill is marketed as a "*targeted enhancement*" to the UK's special resolution regime (**SRR**), but broader changes appear to be on the horizon.

Brief recap of the SRR

The SRR applies to banks, building societies and PRA-designated (i.e. systemically important) investment firms. It was designed in the wake of the global financial crisis to ensure the Bank of England (**BoE**) could effect a rescue or orderly wind down of a failing bank without recourse to public funds or damage to financial stability.

To support this, the BoE has five 'stabilisation' tools which it can apply to a bank in financial difficulty. The preferred option for the largest banks - those with at least £15-25 billion in total assets - is bail-in. These banks are required to maintain liabilities in excess of minimum capital requirements, known as MREL, which can be written down and converted to equity to recapitalise the institution without taxpayer or third-party funding. Banks primarily satisfy MREL requirements by issuing specific loss absorbing debt instruments.

Small to medium-sized banks, with less than £15 billion in assets but more than 40,000 to 80,000 transactional accounts, are generally expected to be subject to one of the transfer tools, which allow the BoE to transfer the institution to a bridge bank it controls or a private sector purchaser. The smallest banks would usually be placed into the bank insolvency procedure (**BIP**), which is not a stabilisation option but a modified version of the UK's standard insolvency procedure. With a few exceptions, neither set of banks are required to issue MREL and they are therefore generally unable to 'self-recapitalise'.

Why is it being modified?

Silicon Valley Bank (**SVB**) was resolved in 2023 following the failure of its US parent. SVB was a BIP firm, but the BoE altered course over the course of the resolution weekend and used its powers to transfer SVB to HSBC. These actions were required to maintain continuity of banking services for SVB's customers and limit contagion risk, demonstrating that a bank perceived as non-systemic at the level of the financial system could nevertheless pose systemic risk by virtue of its significance to a specific sector of the economy (in this case, UK technology companies). In such circumstances, the BoE might need greater flexibility to use its stabilisation tools to effect a transfer of the relevant institution, rather than place it into a potentially disorderly insolvency procedure - but in doing so, it would need to ensure that taxpayers are not on the hook for the failing bank's recapitalisation, since that bank would not itself be responsible via MREL.

What does the Bill do?

The Bill aims to address this by giving the BoE the power to compel the Financial Services Compensation Scheme (**FSCS**), the industry-funded deposit protection quango, to make a payment to a failing financial institution to recapitalise it. This would only apply if the institution were subject to the BoE's private sector purchaser or bridge bank transfer powers, so in practice is unlikely to be relevant to the 15 or so banks and building societies subject to a bail-in strategy. The FSCS would be able to recover the costs of recapitalisation via increases to the FSCS levy paid by the industry.

The Bill largely follows the proposals consulted on in January. The main change is to exempt credit unions from the scope of any FSCS levy uplift because they are not subject to the SRR.

Who are the winners and losers?

The Bill has a compelling public policy case, advancing financial stability and further protecting the taxpayer against financial crisis-style bailouts. Within the banking sector, however, some stand to lose more than others. The largest banks will now be hit twice, required to issue MREL to finance their own recapitalisation and to fund the FSCS to recapitalise their smaller counterparts. Those small banks will be the greatest beneficiaries, effectively outsourcing their recapitalisation to the rest of the industry and forestalling calls by some politicians for the MREL thresholds to be reduced to catch a greater proportion of the sector.

Those in the middle – the smaller bail-in banks and the challenger and specialist banks pushing up against the £15-25 billion threshold – may be most aggrieved by the Bill. Their multinational peers have the balance sheets and infrastructure to comply with MREL and bail-in requirements and can more easily access capital markets to satisfy those obligations. They may also benefit from FSCS funds if they rescue a smaller bank, as HSBC did with SVB. In contrast, medium-sized institutions are less able to finance MREL or absorb competitors, resulting in a disproportionately disadvantageous 'double hit'.

Where next for the SRR?

Relief may be on the horizon. A number of respondents to the government's consultation used the opportunity to raise issues with the SRR and, in particular, the indicative MREL thresholds which, as mentioned above, may disproportionately penalise medium-sized banks. Similar points were made by a number of Lords during the second reading of the Bill on 30 July, with one bemoaning the "*competitive disadvantage*" MREL causes medium-sized banks.

The government is alive to these concerns. In its consultation response, it indicated that the BoE would consider "*whether any changes to its indicative thresholds would be appropriate*". On 6 August, the BoE delivered, stating in its biennial resolvability assessment framework publication that it would review its MREL statement of policy, which contains the indicative thresholds, in "*certain areas*".

It remains to be seen whether the indicative thresholds will in fact change. Political and industry pressure suggests that they might. If so, a number of banks could be taken out of the scope of MREL altogether, streamlining their operations and removing an impediment to growth. A bill that started life as a targeted amendment may, therefore, end up ushering in more significant changes, both to the medium-sized banks themselves and to the UK financial services economy more broadly.

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