This is a corrected version of this letter, with "Friday 10 March" replacing "Friday 10 June" on Page 11 in response to Question 3.

Bank of England

Harriett Baldwin MP
Chair of the Treasury Committee
House of Commons
London
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Andrew Bailey
Governor

22 March 2023

Dear Harriett,

Thank you for your letter of 14 March and your questions on the Bank's resolution of SVB UK, ahead of our scheduled hearing on 28 March.

In addition to responding to your questions below, I wanted to also provide you and the Treasury Select Committee with the Bank's assessment of the UK banking system as a whole.

The Bank's Financial Policy Committee has also communicated a similar assessment to the Monetary Policy Committee ahead of the policy decision taken at its Final Meeting today.

Assessment of the UK banking system

The UK banking system maintains robust capital and strong liquidity positions. It is well regulated – in line with standards implemented by UK authorities that are at least as great as those required by international baseline standards – and subject to robust supervision. The sector's profitability is strong, having improved as interest rates have increased, and it is well placed to continue supporting the economy in a wide range of economic scenarios, including in a period of higher interest rates. The FPC judges that the UK banking system remains resilient.

Recent events in the global banking system

Recent weeks have seen a number of banks fail or come under severe stress. Silicon Valley Bank (SVB), the 16th biggest US bank, failed. Higher interest rates had led to large falls in the value of a large portfolio of long-dated bonds that it was holding, which it had not hedged against falls in value if interest rates were to rise. Given that these bonds had high quality issuers, if SVB had held them to maturity they would have been unlikely to experience any cash losses on either the coupons or the repayment of the principal at maturity. But a rapid and very large increase in depositor withdrawals led to a need to sell assets quickly to pay depositors, which led to losses greater than the bank's capital could absorb, as a result of the low market value of its bonds. Following challenges in raising additional capital, depositor withdrawals accelerated and this led to the failure of the bank and the intervention by the US authorities.

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The smaller US-based Signature Bank was also forced to close following SVB's failure. And some other regional US banks continue to be under stress. These US banks were not subject to the full application of some international regulatory standards on liquidity or capital. Problems with the US parent led to a loss of confidence in Silicon Valley Bank UK (SVB UK), and the Bank of England used its resolution powers for stabilising failing banks to write-down its Additional Tier 1 (AT1) and Tier 2 capital instruments, and transfer the shares in SVB UK to a private sector purchaser, HSBC UK Bank plc. We have provided further detail on this in response to your questions below.

Over the months leading up to SVB's failure, Credit Suisse had been experiencing liquidity stress, the causes of which were unrelated. It had faced significant outflows of client funds as a result of concerns over the firm's risk management practices and profitability. In the week following the failure of SVB, the US Securities and Exchange Commission (SEC) questioned Credit Suisse's financial statements, which led to a delay of the publication of its full financial figures. There was also a widely-publicised statement by a large shareholder of Credit Suisse that led commentators to call into question whether key investors would provide further support to the bank if needed. These events triggered a worsening of the liquidity stress that Credit Suisse had been facing, and an intensification of client outflows, ultimately leading to Credit Suisse being taken over by UBS, following an intervention by the Swiss authorities.

Interest rate risk in the UK banking system

Maturity transformation involves banks raising money through sources of funding that can be recalled over a relatively short time period – such as instant access or term deposits – and using the money to either lend over a longer period – for example through mortgages, unsecured consumer lending or corporate lending – or invest in securities that are longer dated. Frequently, the shorter term liabilities are floating rate or have short fixed rates, and the longer-term assets have rates fixed for longer periods. This exposes banks to interest rate risk.

Banks usually hold a portfolio of high quality bonds and other securities that they use for liquidity management purposes, such as when they face depositor outflows. Investment banks also hold a range of tradeable loans and securities for trading purposes. Assets like these are typically held at fair value by major UK banks, meaning they are reported at their market value in accounts and in the UK changes are immediately reflected in banks' capital ratios as market values move around, which has occurred in recent months as higher interest rates have reduced the value of bonds and other securities that they hold. But bonds held for liquidity management purposes can also be 'hold-to-collect' (on the assumption that they will be held to maturity) and changes in their market value are not taken through profits and capital ratios – unless a firm needs to sell them unexpectedly.

The mortgages that many UK retail banks hold in large quantities tend to be issued with fixed interest rates over two to five years; banks routinely hedge some of their interest rate risks in mortgage lending using interest rate swaps[1]. Corporate lending is more mixed and comes with either fixed or floating rates. Accounting rules allow banks to value assets such as mortgages, corporate loans and bonds that they intend to hold to maturity at their amortised cost when they report them in their accounts.[2] Moves in market interest rates would not be recognised unless the asset is sold or otherwise disposed of. Given their fixed interest rates, the market value of these assets would fall when interest rates rise, which could lead to losses for the bank should they need to liquidate the assets quickly, as in the case of SVB mentioned above. These assets are generally illiquid, though they can be used as collateral for borrowing in a liquidity stress, for example for lending against pre-positioned collateral from the Bank of England as mentioned below. The PRA assess all UK banks on their need to hold capital against the interest rate risk on these banking book assets, including any net open bond positions which are held at cost rather than fair value. This is done via an explicit capital charge in the Pillar 2A part of the capital framework, against 'interest rate risk in the banking book' (IRRBB). It is calibrated on forward-looking estimates of the impact of large shocks to the interest rate yield curve on the net position of their banking book.

Many banks actively manage their interest rate risk – taking into account the maturity and variability of interest rates on their funding and assets as a whole – using derivatives such as interest rate swaps. The derivatives that UK banks use for hedging are subject to strict regulation: interest rate swaps are subject to a clearing mandate, meaning that banks face and pay margin to a central clearing counterparty (CCP).

Interest rates and UK borrowers

Interest rates also affect the resilience of household and corporate borrowers, which influences the losses banks may incur on their credit portfolios in a stressed environment. The FPC has been closely monitoring the impact of higher interest rates on corporate sector interest cover ratios and household debt service ratios as part of its risk assessment.

The FPC judged in the December Financial Stability Report that debt vulnerabilities are likely to increase in the near term. But the major UK banks are resilient, and have been stress tested to more severe scenarios.

The UK banking system is well regulated and subject to robust supervision

Since the global financial crisis of 2008, international authorities have established significantly more robust regulatory standards, including for bank capital and liquidity. The UK authorities have put in place a range of robust prudential standards, designed to ensure

[1] 5 year fixed interest rates are the most common product in the market for new UK mortgages. Around 20% of outstanding mortgages in the UK are on variable rates. Around another 15 to 20% of outstanding mortgages tend to reach maturity in any given year.
[2] The accounting framework which all listed UK banks are required to follow – the International Financial Reporting Standards (IFRS) – is more restrictive on the use of amortised cost accounting for securities than the US Generally Accepted Accounting Principles (GAAP), reflecting differences in banks business models.

levels of resilience which are at least as great as those required by international baseline standards.

These include a liquidity framework and capital requirements that are calibrated to the risks faced by individual firms. These apply to all UK banks, including smaller UK banks and building societies than the major UK banks. Smaller banks and building societies (including UK subsidiaries of foreign banks) make a significant contribution to the real economy as they comprise approximately 25% of total bank and building society lending to the UK real economy [3]. Furthermore, smaller lenders play a proportionately larger role in some sectors such as commercial real estate (CRE), corporate lending and personal loan and overdraft lending. The PRA is currently considering measures to simplify regulatory requirements for the smallest UK banks (the 'Strong and Simple' Framework). However, there is no intention that any such simplifications will weaken the regime for small banks. SVB UK would not have come under the scope of the Strong and Simple Framework.

The UK's liquidity framework has been designed in line with international standards and applies to all UK banks and building societies. This includes the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR). The LCR promotes the short-term resilience of the liquidity risk profile of banks, by requiring them to hold a large enough stock of high quality liquid assets to meet their payment obligations in the case of a severe short-term stress. The NSFR is intended to ensure that banks maintain a stable funding profile in relation to the composition of their assets and off-balance sheet activities. The NSFR focuses on protecting against liquidity risks over a longer horizon than the LCR metric.

UK banks are subject to robust supervision. The PRA's supervisory work on UK banks, which includes small banks and building societies, is intended to ensure that firms hold sufficient capital and liquidity to withstand severe but plausible stresses. This includes regular reviews of firms' capital and liquidity positions as well as sensitivities to interest changes on firms' assets and liabilities. As part of PRA rules, firms are expected to manage risks within clearly articulated risk appetites and capital allocated against aggregate risk exposures as part of the UK capital setting framework. This approach mitigates the accumulation of large unhedged risk positions on firms' balance sheets.

Furthermore, the Senior Managers and Certification Regime (SM&CR), provides further safeguards by allocating responsibilities on a bank's business model, financial information and risk management (amongst other things) to the senior executive management and directors of banks which are subject to regulatory approval.

The UK banking system maintains robust capital and strong liquidity positions

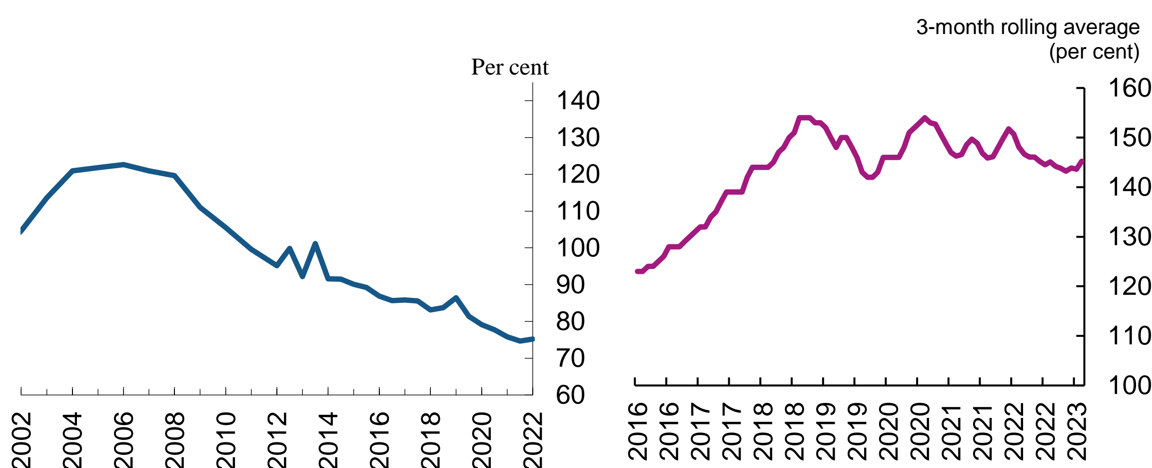
[3] The 2022 Key Elements stated that the major UK banks (ie the eight banks taking part in the 2022 ACS) account for 75% of lending to the UK real economy. This statistic is produced on a consistent basis but has been updated to include end-2022 data.

The UK banking system is well capitalised. The aggregate CET1 ratio for major UK banks stands at 14.6%, and smaller lenders have an aggregate CET1 ratio of around 18%. Asset quality is stronger now than in the run up to the global financial crisis.

Major UK banks have large liquid asset buffers (of £1,399bn), more than six times larger than the total size of major UK banks securities held at amortised cost in the banking book. Around two-thirds of these liquidity buffers are currently either in the form of cash or central bank reserves (£908bn). The loan to deposit ratio of major UK banks has reduced from 120% in 2008 to 75% in the latest reported data (Q4 2022) (Chart 1). In aggregate, major UK banks had a liquidity coverage ratio of 149%, a three-month rolling average LCR of 145% (Chart 2) and an aggregate NSFR of 136% as at February 2023, providing resilience to deposit outflows.

Smaller UK firms typically run larger liquidity surpluses over regulatory standards than major UK banks and around three-quarters of smaller firms' liquid asset buffers are held in Bank of England reserves. In aggregate, Category 2 and 3 UK firms[4] had a weighted average LCR of 246% and an NSFR of 147% as at February 2023, providing resilience to large deposit outflows.

Chart 1: Major UK banks' loan-to-deposit ratio[5] Chart 2: Major UK banks' aggregate LCRs[6]



Source: Published accounts and Bank calculations.

[4] As part of the PRAs risk assessment of firms, the significance of a firm and their potential impact on the stability of the UK financial system is assessed. This 'potential impact' reflects a firm's potential to affect adversely the stability of the system by failing, coming under operational or financial stress, or because of the way in which it carries out its business. All deposit-takers and designated investment firms the PRA supervises fall into the categories based on their impact. For further information on the PRA's categorisation of firms please see: **The Prudential Regulation Authority's approach to banking supervision - October 2018 (bankofengland.co.uk)**.

[5] The loan to deposit ratio is calculated as loans and advances to customers over customer deposits. The series starts in 2000 with annual data until the end 2012. From 2013 the data changes to half-yearly. The peer group includes Barclays, HSBC, Lloyds, Nationwide, NatWest, Santander UK, Standard Chartered, Virgin Money UK (from end-2020) and HBOS (until 2009). Previously, this indicator also included Alliance and Leicester, Bank of Ireland, Bradford & Bingley, Britannia, Cooperative Bank, National Australia Bank, Northern Rock and Santander.

[6] The liquidity coverage ratio is calculated as high-quality liquid assets over stressed net-cash outflows over 30 calendar days. The peer group includes Barclays, HSBC, Lloyds, Nationwide, NatWest, Standard Chartered and Santander UK. The series starts from Dec-2015 from which a 3 month rolling average is derived.

UK banks also have access to a range of liquidity facilities which allow banks who meet the Bank of England's supervisory standards, and who have the right collateral, to access reliable supplies of liquidity by borrowing against their assets at a predictable cost. The Bank operates on an "open for business" basis which means that banks can use the liquidity facilities on a day-to-day basis. But pricing means they are likely to be of particular benefit when an interruption to private markets occurs. The facilities that the Bank offers also include regular multilateral auctions (e.g. the Indexed Long-Term Repo which provides 6 month liquidity on weekly basis, weekly 7 day US dollar repo, and the Contingent Term Repo Facility) as well as bilateral facilities available on demand (such as the Discount Window Facility). The Bank accepts a wide range of collateral which can include assets that are less liquid and harder to sell quickly, such as mortgages or other loans. Banks can "pre-position" these less liquid assets with the Bank of England enabling due diligence and valuation in advance. The additional amount the Bank could lend through its market operations based on excess pre-positioned collateral is around £300bn.

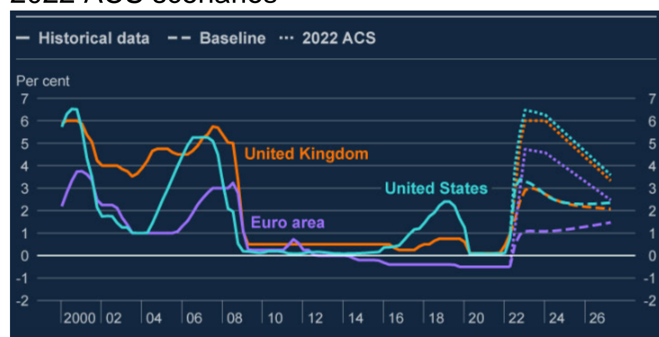
Stress tests show that the UK banking system is well placed to continue supporting the economy throughout a wide range of economic conditions

Banks' pre-provision profitability influences their ability to absorb losses as they arise, by supporting their capital positions over time. Major UK banks posted pre-provision profits of around £56bn in 2022, a year-on-year increase of 37%, supporting UK banks' capital ratios and ability to support the economy.

Stress tests have shown that the banking system is resilient to a wide range of severe economic outcomes. Since 2014, the major UK banks have been tested in a usually annual coordinated exercise to scenarios more severe than the global financial crisis (GFC) as part of the Bank of England's Annual Cyclical Scenario (ACS) stress test programme, as well as during the desk based exercises during the Covid pandemic and the 2021 Solvency Stress Test.

Table 1: Changes to key variables in the 2019 and 2022 ACS stress test scenarios[7]

Chart 3: Policy rates in the UK, US and EA in the 2022 ACS scenario[8]



[7] Source: For further details please see ***Stress testing the UK banking system: 2019 results***.

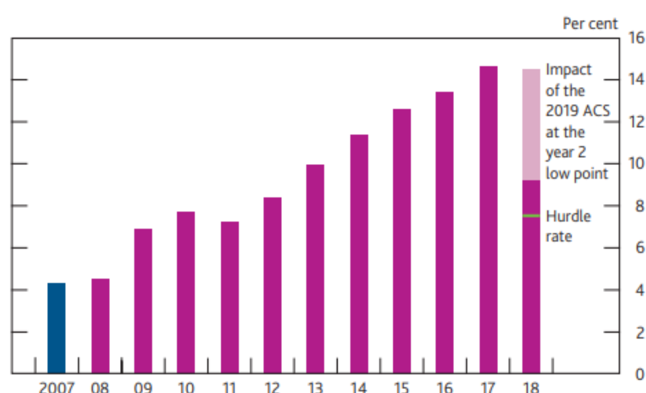
[8] Source: For further details please see ***Stress testing the UK banking system: key elements of the 2022 annual cyclical scenario***

Per cent			
Variable	**2022 ACS**	**2019 ACS**	**Global financial crisis**
UK real GDP	-5.0	-4.7	-5.9
World real GDP	-2.5	-2.6	-1.9
UK unemployment (change)	4.7	5.2	3.2
UK unemployment (peak level)	8.5	9.2	8.4
UK residential property prices	-31	-33	-17
UK CRE prices	-45	-41	-42
UK Bank Rate	5.1	3.3	-5.2
UK equity prices	-45	-41	-40

The last ACS stress test conducted in 2019, included a rapid rise in Bank Rate, reaching 4% after a year, as well as a sharp rise in longer-term bond yields (to almost 7% in the UK), and a large drop in economic activity in the UK (4.7%) and around the world (2.6%) (Table 1). Since then, to assess resilience during the Covid pandemic, the Bank conducted a desk based stress test exercise and a reverse stress test for the largest major UK banks in 2020, followed by a solvency stress test in 2021. The 2022 ACS is currently ongoing, and includes a rise in Bank Rate, which peaks at around 6%, and interest rates around the world increasing materially alongside (Chart 3). The results are due to be published in the July 2023 Financial Stability Report.

Table 2: Contributions to the change in the aggregate CET1 capital ratio in the 2019 ACS[9]

Chart 4: Aggregate CET1 capital ratio of major UK banks since the financial crisis[10]



[9] Source: For further details please see ***Stress testing the UK banking system: 2019 results***.
[10] Source: For further details please see ***Stress testing the UK banking system: 2019 results***.

Percentage points (unless otherwise stated)

	CET1 ratio[b]
End-2018	**14.5%**
Baseline (at CET1 capital/leverage low point)[d][e]	**14.3%**
Impairments	-5.7
of which mortgages	-1.2
of which consumer credit	-1.4
of which lending to businesses	-2.9
of which other impairments	-0.2
Traded risk losses[f]	-2.0
Risk-weighted assets / leverage exposure[g][h]	-1.7
IFRS 9 transitional relief	1.0
Misconduct costs	-0.7
Net interest income	1.3
of which sterling	0.4
of which non-sterling	0.8
Reductions in discretionary distributions in stress	2.2
of which dividends	1.4
of which variable remuneration	0.4
of which AT1 coupons and other distributions	0.4
Expenses and taxes[i]	0.9
Other[j]	-0.3
Stress end low point (before AT1 conversion)	**9.3%**
Impact of AT1 conversion	0.6
Stress end low point (after AT1 conversion)	**9.9%**

Smaller banks that are not part of this annual stress test must carry out their own stress testing. The PRA publishes a pair of scenarios annually to serve as a guide for banks and building societies. These scenarios have typically been derived from the ACS, but might feature some variants. For example in 2022, the PRA published a “rates up” scenario identical to the ACS, and a “rates down” scenario of similar severity. The scenarios serve as a template and severity benchmark for firms to support their own internal capital adequacy assessment process, details of which can be found in a PRA supervisory statement (see **SS31/15**). Smaller firms are also subject to desk-based stress testing by supervision using the firms’ standard regulatory data submissions.

Overall implications for financial stability

In conclusion, the UK banking system is resilient, maintaining robust capital and strong liquidity positions. It is resilient to the current economic outlook and has the capacity to support the economy in a period of higher interest rates even if economic conditions are worse than forecast.

The FPC will continue to monitor developments closely, in particular for the risk that indirect spillovers impact the wider UK financial system. There remain channels through which UK economic conditions could be affected and possible future strains from banks outside the UK. These include any lasting impact on bank funding costs, and the potential for that to increase the cost of borrowing for UK households and businesses.

And – should there be further volatility and/or sharp moves in asset prices – there are risks it could trigger the crystallisation of previously identified vulnerabilities in market-based finance, amplifying any tightening in credit conditions.

The FPC will issue its Financial Policy Summary and Record next week (29 March), covering its latest round of meetings, which will include further information on its overall risk assessment, including its assessment of global risks.

<u>Questions relating to the supervision of SVB UK</u>

1. Can you describe the nature of your supervision of SVB UK, including the resource allocated to it?

Overall approach

The PRA's supervisory approach is grounded in the risks to its statutory objective of promoting the safety and soundness of PRA authorised firms, particularly by seeking to avoid adverse effects on the stability of the financial system of the UK. The PRA has to be satisfied that a firm is capable of meeting threshold conditions on a continuing basis, including the requirement that it is capable of being effectively supervised by the PRA. For international banks, this will depend in part on the risks in the wider group being visible to the PRA, which in turn is conditional on the level of co-operation and information it is receiving from the firm and relevant overseas supervisory and resolution authorities. This is because the PRA needs to understand what risks the UK branch or subsidiary is exposed to and how these are dependent on the business and risk profile of the rest of the firm or the group.

We expect branches to focus primarily on *wholesale banking*. If branches propose to conduct *retail banking* above certain thresholds, we expect them to operate their businesses from UK subsidiaries. The threshold is £100m of FSCS-covered retail and SME deposits.

It is a key principle underlying the PRA's approach that it does not seek to operate a zero-failure regime.

The PRA's directorate that has responsibility for supervising international banks which we host in the UK, which included SVB UK, oversees banks (around 75 subsidiaries and 150 branches) and has a supervisory headcount of 154 FTE.

Supervision of SVB UK

SVB UK was a Category 3 subsidiary of the US parent bank SVB. It is supervised within a team of 7, of which 0.5 FTEs were exclusively dedicated to SVB UK. That is in line with the PRA's categorisation approach, and consequential resourcing model for supervisory teams, which is based on the risks firms pose to our statutory objectives. The categorisation includes a number of factors, such as the systemic impact of a failure of the firm.

So for example, Category 1 firms (such as HSBC, Lloyds and Barclays etc.) are deemed to be sufficiently material that they would cause a serious systemic impact if they failed, and so

more resource is allocated to their supervision. Lower category firms have a decreasing level of impact on the system in failure[11].

SVB UK was focused on commercial banking in the innovation sector – primarily technology, life sciences and healthcare. Its clients include start-ups, large corporates, and venture capital and private equity funds, as well as the companies in which they have invested. SVB UK had operated in the UK since 2012, first as a PRA-FCA dual-regulated branch, and then since July 2022 as a subsidiary.

SVB was asked to transfer its UK operations from a branch of a US entity to a separate UK subsidiary, which met separate capital and liquidity requirements, as a result of PRA policy[12]. For SVB UK we assessed in 2020 that its business plans would have it reaching the PRA's threshold for becoming a subsidiary by 2022, and so the process commenced.

The PRA requiring SVB UK to become a subsidiary was an important decision. Operating a UK business from a separate entity had a number of consequences for the firm insofar as its regulation, supervision and resolvability were concerned:

- Regulatory consequences of becoming a subsidiary: SVB UK became subject to standalone capital[13] and liquidity[14] requirements, as well as enhanced local governance requirements. These included the establishment of a UK Board and the application of UK corporate governance standards. The firm was also required to submit regulatory returns on its financial position.
- Supervisory consequences of becoming a subsidiary: This provided for an enhanced level of control and information. When supervising branches of international banks, the PRA places significant reliance on a firm's home state supervisor (in this case the US Federal Reserve) sharing information about the supervised entity[15]. The PRA has greater access to information in relation to the financial positions of subsidiaries.
- Resolvability consequences of becoming a subsidiary: These were the most significant. It is likely in most cases to be difficult to resolve a branch independently of the wider entity of which it is a part. Normally it would be subject to home country resolution. As a backstop, the Bank does have powers to independently resolve a branch where cooperation between resolution authorities proves ineffective. However, this is an outcome which the Bank would seek to avoid. The Bank has many more options available to it when conducting the resolution of a subsidiary. Specifically, tor SVB UK, the Bank had established a preferred resolution strategy for the firm – a bank insolvency procedure. The Bank also had available to it other resolution tools, such as stabilisation powers on the basis that it operated as a subsidiary. This included the possibility of establishing a bridge bank. Most significantly, the capital requirements placed on the subsidiary ensured that the Bank

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[11] More detail on the PRA's framework can be found here: **PRA's approach to supervision of the banking and insurance sectors | Bank of England**

[12] This is also set out in SS5/21 **SS5/21 'International banks: The PRA's approach to branch and subsidiary supervision' (bankofengland.co.uk)**

[13] **SS31/15 - The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP) | Bank of England**

[14] **Liquidity | Bank of England**

[15] More detail can be found here: **SS5/21 - International banks: The PRA's approach to branch and subsidiary supervision | Bank of England**

was able to write-down loss absorbing capacity during the resolution, with a view to supporting the sale of the firm.

Supervision of the parent entity in the US

In the US, SVB was subject to primary regulation and supervision by the San Francisco Federal Reserve, which tailors its regime, and associated capital and liquidity requirements, depending on a firm's balance sheet size. Under the Federal Reserve's classification system, SVB was a category IV[16] 'Large Financial Institution' (LFI). It was subject to a more limited set of regulatory requirements, relative to larger banks.

2. Was the concentration of tech firms as depositors in SVB UK recognised as a key risk, and did it lead to a particular supervisory focus on the firm? Do you recognise reports that some tech firms were required by investors to place their deposits with SVB UK as a condition of investment? Were there any other supervisory concerns about SVB UK?

The PRA understood that SVB UK was exposed to concentration risk, as it provided loans to and took deposits from the same relatively concentrated client base in the innovation sector.

Over the last 18-24 months, concentration risk, and overlap of clients on the asset and liability side of the balance sheet, had been areas of focus for supervision. The PRA discussed these with both the firm and the San Francisco Federal Reserve.

The concentration in assets was recognised in SVB UK's capital requirements. In addition to "Pillar 1" capital requirements, which are based on general requirements, firms are subject to additional individual (or "Pillar 2A") capital requirements. SVB UK's Pillar 2A requirement was predominantly driven by concentration risk within its loan book, as well as including a material component for interest rate risk in the banking book (IRRBB). This component was driven by the PRA's assessment of SVB UK's IRRBB framework, which at the point of the firm becoming a subsidiary the PRA assessed to require development. As at end-December, SVB UK's capital surplus over its regulatory requirements was £279m.

3. What caused SVB UK to fail? Can you provide a profile of the balance sheet of SVB UK over time, up to the point of resolution? Can you include in this a breakdown of SVB UK's deposits in the UK and how balances evolved up to the point of resolution? What proportion of SVB UK's deposits were above the FSCS limit?

SVB UK's failure was caused by the failure of its parent in the US. Despite the UK subsidiary being able to meet all demands for outflows on Friday 10 March, it was not clear that the firm would be able to continue meeting liquidity outflows if the run continued beyond that day.

More significantly, it is unlikely that any banking subsidiary could withstand the failure of its parent without a sale. In SVB UK's case, the firm would not have been a viable stand-alone entity because of its reliance on its US parent for technology and systems, including payment infrastructure.

[16] More detail here: **FRB's applicability-thresholds-for-regulatory-capital-and-liquidity-requirements** and **Tailoring Rule visual (federalreserve.gov)**

During 2022, SVB UK's balance sheet was stable at just over £12bn, with deposits of just over £10bn throughout the year. Deposits dropped to just under £10bn in February and were again stable through to 9 March.

On 10 March SVB UK experienced a deposit run. That day, the firm saw £2.9bn in deposit outflows – approximately 30% of the firm's total deposit base (see timing of flows below). These levels of outflows are far in excess of the outflows envisaged by the Liquidity Coverage Ratio. These outflows were in addition to the manageable outflows that the firm had experienced in the first two months of 2023, which had been driven by the increased cash needs of their client base in response to tighter funding conditions and the firm's desire not to top deposit 'best buy' tables.

Simplified balance sheet – all figures in £m [a]					
	Jan 23	**Feb 23**	**8 Mar 23**	**9 Mar 23**	**10 Mar 23**
Cash and cash equivalents	2,768	2,355	2,738	2,576	335
Investment securities	3,417	3,418	3,461	3,447	2,728
Loans to customers	5,508	5,611	5,425	5,440	5,451
Other assets [b]	320	200	197	211	242
Total assets	**12,014**	**11,585**	**11,822**	**11,673**	**8,756**
Deposits from customers	-9,805	-9,738	-9,779	-9,595	-6,688
Demand deposits	*-5,649*	*-5,216*	*-5,215*	*-5,021*	*-2,140*
Evergreen notice	*-3,115*	*-3,405*	*-3,439*	*-3,428*	*-3,414*
Time deposits	*-1,041*	*-1,118*	*-1,125*	*-1,146*	*-1,134*
Other deposits		*-14*			*700*
Repurchase agreements – non trading	-511	-2,112	-397	-423	-403
Other liabilities [c]	-300	-221	-226	-234	-252
Total liabilities	**-10,616**	**-10,171**	**-10,402**	**-10,253**	**-7,343**
Net assets	1,397	1,414	1,420	1,420	1,413

Sources: September '22 – FINREP reporting, Dec '22 draft annual accounts, all others: firm reporting direct to supervision

a)Figures may not sum due to rounding
b)Other assets includes derivative assets, prepayments and accrued income, goodwill and intangibles, and tax assets
c)Other liabilities includes Accrual and deferred income, tax liabilities, and subordinated liabilities.

SVB UK's deposit book was predominantly uninsured. However, the firm held £155m of insured deposits from SMEs and £151m in deposits from deposit aggregators that were also eligible for protection subject to the underlying clients of those aggregators meeting the FSCS eligibility limits. As of 10 March, a total of £306m deposits were insured by the FSCS – this equates to 4.6% of a total deposit book of £6.7bn. The firm also held £251m in deposits from e-money and payment service providers.

Changes in SVB UK deposit book over time – all figures in £m	
Timeline	**Total**
June 2021	6,969
December 2021	9,777
June 2022	11,052
September 2022	10,822
December 2022	10,937
January 2023	9,805
February 2023	9,738
CoB 9 March 2023	9,595
09:00 10 March 2023	*9,226*
13:30 10 March 2023	*7,865*
15:00 10 March 2023	*7,587*
CoB 10 Mar	6,688

4. What were the financial interlinkages between SVB UK and its US parent?

SVB UK's regulatory capital resources – i.e. its CET1, AT1 and T2 – were 100% owned by its US parent.

The subsidiary and the parent were also linked operationally as is typical in banking groups. SVB UK was reliant on the group for data as well as technology and systems development and provision. This included the capabilities needed to make payments and online banking.

5. To what extent did you have insight into the health of SVB UK's parent company? When did you first become aware of its problems? Can you describe your relationship with the US regulators regarding SVB, including key interactions since the start of the year?

The PRA has a regular, open, transparent and constructive dialogue with the Federal Reserve Bank of San Francisco, (FRBSF) the principal home state supervisor of SVB. The PRA has regular calls with the FRBSF.

As noted in the response to question 15, SVB in the US had experienced negative net outflows for several quarters to March 2023. This led the firm to announce on 8 March actions intended to strengthen its financial position, including the sale of substantially all of its Available For Sale (AFS) securities portfolio at a post-tax earnings loss of around $1.8bn. The bonds in question (long-term fixed-rate investments) had declined in value as interest rates had moved higher. However, losses were crystallised only at the point the bonds were sold on due to the accounting and capital treatment involved. Following this announcement, the liquidity pressures that led to the parent's failure unfolded rapidly on Friday 10 March.

The PRA spoke to the FRBSF, the Federal Reserve Board, and the FDIC on Friday morning. The US authorities informed us that they had concerns that the parent did not have sufficient liquidity to be able to meet the outflows expected that day. The US authorities also noted that discussions were underway as to whether the parent should be allowed to access the Federal Reserve's liquidity facilities. Discussions continued throughout the morning and early afternoon, with the Bank's Resolution Directorate leading on communication with the US resolution authority, the Federal Deposit Insurance Corporation (FDIC), and the PRA leading on communication with the Federal Reserve. At 2.15pm on Friday, the US authorities informed the PRA on a phone call that they had decided to put the parent into receivership.

Questions relating to the resolution of SVB UK

6. On Friday 10 March 2023 you put out a statement clarifying that SVB UK had no critical functions and that you intended to place it into insolvency. What led to you favouring that approach?

The Bank, as the UK's Resolution Authority, has a number of different tools and powers under the Banking Act 2009 to achieve our special resolution objectives and the Bank's statutory financial stability objective, to protect and enhance the stability of the UK financial system. As we set out in Box 1 of the Bank of England's Approach to Resolution[17], the main tools are bail-in, transfer to a private sector purchaser (PSP), transfer to a bridge bank and modified insolvency. Each resolution will be different, and the Bank retains discretion when deciding how best to resolve a firm in pursuit of the special resolution objectives, based on the circumstances at the time and whether the statutory resolution conditions which apply to implement a particular resolution strategy are met in a given case.

The exercise of any stabilisation power – including the power we eventually used on 13 March to transfer SVB UK to HSBC – requires, among other things, statutory tests to be met which can be summarised as a "public interest test". The factors which inform this public interest test include: ensuring the continuity of UK banking services; protecting and enhancing the stability of the UK financial system, as well as public confidence in its stability; protecting public funds; and protecting FSCS-covered depositors. On Friday 10 March, at which point no purchaser had been identified in light of the rapid turn of events, our

[17] Bank of England's Approach to Resolution

judgement was that the use of BIP would not cause a loss of public confidence in the stability of the UK financial system. We consulted HM Treasury, the PRA and FCA on this judgment, and they agreed. SVB UK had a limited presence and balance sheet in the UK and no critical functions supporting the UK financial system. The Bank judged, therefore, that the special resolution objectives would be appropriately served by a BIP.[18]

This also provided greater clarity on an end-point that the Bank was confident could be delivered. It was important for the Bank to make a clear public announcement on Friday night, to support confidence going into the weekend and indicate that we judged that a Bank Insolvency Procedure could take place without wider contagion across the banking sector.

Subsequently, as outlined in greater detail in the response to Question 7 below, when HSBC was identified as a purchaser the Bank determined that it would be in the public interest with respect to the special resolution objectives of the Banking Act 2009 to execute a PSP resolution in order to better promote public confidence UK in the financial system.

7. What subsequently led you to judge that the use of stabilisation powers was warranted?

As noted above, the UK resolution regime allows the Bank to sell all or part of a failed bank to one or more willing private sector purchasers where certain statutory conditions are met, including that it is necessary having regard to the public interest in the advancement of one or more of the special resolution objectives. The Bank is required to consider whether those statutory conditions are met at the point of failure, taking into account the circumstances at the time.

Following the Bank's public statement on Friday 10 March, the Bank became aware of a number of parties with a potential interest in purchasing all or part of the failed bank. We judged that it was important for any potential sale to be urgently implemented before SVB UK's opening time on Monday 13 March in order to further the special resolution objectives. In particular, implementing the sale before opening of business would provide continuity of access to banking services to SVB UK's customers which would better promote public confidence in the UK financial system, than entry of the firm into the Bank Insolvency Procedure. As such, HSBC emerged to be the only credible bidder who would be able to implement the sale in time.

Given this, in the early hours of Monday 13 March, the Bank determined (following consultation with the FCA, PRA and HM Treasury, as required by statute) that the statutory conditions for exercising stabilisation powers were met, such that the shares in SVB UK should be transferred to HSBC. This reflected the fact that a credible purchaser had emerged since Friday 10 March and the implementation of the sale would better promote public confidence in the stability of the UK financial system.

[18] Subject to the approval of the Court, a Bank Insolvency Procedure in respect of SVB UK would have facilitated payments by the FSCS to eligible depositors as quickly as possible up to the protected limit of £85,000 or up to £170,000 for joint accounts. SVB UK's assets and liabilities would have been managed in the insolvency by the bank liquidators with recoveries subsequently distributed to its creditors (including the FSCS as a preferential creditor in respect of amounts paid to eligible depositors).

8. Can you summarise the nature of the interactions with HM Treasury over the period of the intervention? Did any of the actions of or requests made by HM Treasury seem unusual given the bank was not systemically important? What role, if any, did you play in the Chancellor's statement on 12 March 2023?

The resolution framework requires co-operation and co-ordination between the Bank and HM Treasury, and a **Memorandum of Understanding (MoU) on resolution and financial crisis management is in place** in line with the provisions of Section 65 of the Financial Services Act 2012. This MoU sets out that the Bank and HM Treasury have clear and separate responsibilities. The Bank has primary operational responsibility for financial crisis management. The Chancellor and HM Treasury have sole responsibility for any decision involving public funds.

As such, there was regular contact and co-ordination throughout Friday and the weekend between Bank / PRA, FCA, and HM Treasury officials, and at Governor / Ministerial levels, in line with the provisions of the MoU. There was also regular contact and co-ordination with the Financial Services Compensation Scheme (FSCS). The Bank and HM Treasury shared with each other drafts of our respective public statements before they were released.

Close co-operation between these authorities is paramount given their respective responsibilities regarding decision making. The Banking Act 2009 sets out four conditions for resolution. The first condition, whether the firm is failing or likely to fail, is assessed by the PRA in consultation with the Bank. The remaining conditions – (2) whether it is not reasonably likely that action can be taken by or with respect to the bank to avert its failure, (3) whether the exercise of a stabilisation power is necessary in the public interest in advancement of one or more of the Bank's special resolution objectives, and (4) whether one or more of the special resolution objectives would not be met to the same extent by winding up the bank – are decisions made by the Bank, in consultation with the PRA, HM Treasury and FCA. If those conditions are determined to be met, the Bank may proceed with exercising a stabilisation tool, or combination of stabilisation tools. If conditions (1) and (2) are met but conditions (3) and (4) are not met, the Bank may apply to Court to place the firm in a BIP.

9. Which of the special resolution objectives were supported by pursuing a sale of SVB UK as opposed to insolvency?

The sale of SVB UK supported the achievement of the special resolution objectives including the protection of depositors, ensuring continuity of banking services, and, in particular, protecting and enhancing public confidence in the stability of the UK financial system.

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 the protection of depositors covered by the FSCS. 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.

10. SVB UK has been sold to HSBC for £1. How did the process for selecting HSBC as the purchaser work, and how was the price determined? Was a valuation of SVB UK undertaken? Who has lost out from this transaction?

Following the publication of the Bank's statement of intent to apply to Court to place SVB UK into the BIP, SVB UK engaged the services of a third party to conduct a process for a going concern sale of the bank. All credible interested parties were offered access to a data room to assess the prospects for a purchase.

All credible interested parties were asked to submit offers by early Sunday evening. As noted above, it was important for any potential sale to be urgently implemented before SVB UK's opening time on Monday 13 March in order to further the special resolution objectives. In particular, implementing any sale before then would provide continuity of access to banking services to SVB UK's customers. As such, the urgency of the situation meant it was necessary to take a decision overnight regarding the preferred resolution strategy and bidder.

No bidder was willing to offer more than nominal compensation for SVB UK's equity. Given, the Bank had judged that SVB UK was failing without reasonable prospect of recovery as of Friday, the Bank considered the bids in the context of whether the sale would better advance the special resolution objectives than entry of SVB UK into the Bank Insolvency Procedure. The Bank considered that HSBC's bid was the only one that was credibly executable before markets opened on the morning of Monday 13 March. HSBC's level of capital and liquidity resources greatly reduced the risks to public funds, stability and confidence, and therefore to the Bank's special resolution objectives. Their operational resources, also helped to secure the continuity of banking services and promote confidence. And as noted below, effecting the sale under the resolution regime enabled HM Treasury to adjust aspects of ring fencing legislation, in order to facilitate the sale before markets opened.

The Bank undertook a provisional valuation of SVB UK. SVB UK's AT1 and Tier 2 regulatory capital instruments were mandatorily written down and the whole of SVB UK's equity was transferred to HSBC at 7am on 13 March with HSBC paying £1 as part of its bid. As such, for SVB US– the sole shareholder and the holder of all of SVB UK's regulatory capital instruments – its interests in SVB UK were extinguished following the execution of the resolution. Depositors and creditors other than SVB US were protected by the resolution action, as were taxpayers given that no public money was involved in the resolution of SVB UK.

11. Why did HSBC require exemptions from the ringfencing regime as part of this resolution and how will they work? What does this mean for the prudential regulation of HSBC?

The UK resolution framework anticipates that HM Treasury may need to amend the law where necessary for the purpose of resolution powers being used effectively. This is an important feature of the Banking Act 2009. Use of a 'Section 75 order' is something that Parliament envisages may need to be used in a resolution, depending on the circumstances faced. On ring-fencing, legislation also provides a four year exemption to the definition of a ring-fenced bank in the case of a transfer under the Banking Act 2009.

The Government has used its powers under the Banking Act 2009 to make changes, amongst others, to facilitate HSBC providing liquidity support to SVB UK. The Government has also indicated that it intends to extend the ring-fencing exemption provided for in legislation beyond the existing four year period.

The PRA will work with HM Treasury on implementing any further changes to the application of the ring-fencing regime that the Government brings forward, in a manner consistent with the safety and soundness of HSBC.

The prudential regulation of HSBC, which has a $3tn group balance sheet, will be largely unaffected by the addition of a further £9bn of assets. Where it concerns the UK ring-fenced bank and application of the ring-fencing rules, the PRA has a range of tools that it can and will draw on to ensure the effective supervision of HSBC and protection of retail deposits.

12. How have US authorities reacted to your resolution solution?

The US authorities welcomed the Bank's successful resolution of SVB UK. Coordination at all levels between the UK and the US authorities, including between the Governors, the FDIC Chair, and Federal Reserve Vice-Chair for Supervision, was very close throughout Friday and the weekend.

This reflects the strong working relationships between the Bank and our counterparts in the US that we have maintained and developed over many years through our extensive engagement on UK financial stability, supervision and resolution issues. This has included the development of resolution plans for our largest cross-border banks, high level crisis management scenario-based exercises, and collaboration via fora such as the Financial Stability Board.

The Bank was accordingly well-placed to cooperate and collaborate at such pace with its US counterparts to secure a successful, coordinated and cooperative resolution of SVB's operations.

13. What lessons should be learnt from this resolution? Has it made you reconsider the effectiveness of your bank insolvency procedures?

The UK resolution regime worked as intended. I am grateful to staff across the Bank, HM Treasury, other UK authorities and our counterparts in the US, and to all third parties involved for working together to execute the resolution transaction.

Considerable work had to be completed at pace in a very short space of time. This required staff to work day and night throughout the weekend to ensure that the resolution could be completed successfully in time for markets opening on Monday morning. The events resulting in the failure of SVB UK unfolded within hours on Friday.

The advance contingency preparations that the Bank, working together with other UK authorities, had undertaken for exercising stabilisation powers urgently and at short notice stood us in good stead, and helped effect a successful resolution. We will of course learn lessons from our execution to enhance operational readiness for the future, and ensure the Bank continues to stand prepared to deliver a resolution whenever it is needed.

A key point was the importance of the Bank having made a clear public announcement on Friday night, to support confidence going into the weekend, that we judged that a Bank Insolvency Procedure could take place without wider contagion across the banking sector.

Questions relating to lessons for prudential regulation and financial stability

14. How much direct exposure did the UK financial system have to SVB UK? Is there any risk of contagion to other UK banks or financial institutions?

The loss of confidence in, and material deposit outflows from, SVB UK was ultimately due to problems faced by its US parent. The UK banking system continues to be resilient, maintaining robust capital and strong liquidity positions.

SVB UK did not provide critical functions supporting the UK financial system. It did not hold significant deposits from financial institutions, and the UK banking and insurance sectors had limited direct and indirect exposures to SVB UK. As such, the direct risk of spillovers to UK banks or other financial institutions from the failure of SVB UK was limited. The UK authorities have put in place a range of robust prudential standards since the global financial crisis, designed to ensure levels of resilience which are at least as great as those required by international baseline standards.

Overall, the UK banking system is well capitalised and funded, and remains safe and sound. Major UK banks and building societies posted pre-provision profits of around £56bn in 2022, a year-on-year increase of 37%. And consensus forecasts suggest banks' profitability will increase further in 2023. This profitability has been in spite of losses being recognised on the fair value of assets. Banks' asset quality also remains relatively strong. In turn, higher profitability has supported capital ratios: the aggregate CET1 ratio for the major UK banks and building societies stands at 14.6%, and smaller lenders have an aggregate CET1 ratio of 18.3%.

Past stress tests of the UK banking system have shown it is resilient to a wide range of severe economic outcomes. These have included testing the impact of higher Bank Rate on the credit quality of banks' assets and their net interest income. The FPC is assessing major UK banks and building societies against a further severe shock in the 2022 annual cyclical scenario (ACS) stress-test, the results of which will be published in summer 2023.

Major UK banks and building societies typically account for around two-thirds of the bonds they hold in their banking books and almost all of the bonds they hold in their trading books on a fair value basis, meaning losses on those assets have already been recognised in banks' capital positions. UK banks also typically have proportionally smaller amortised cost bond portfolios compared with US banks. On average major UK banks' and building societies' bond portfolios held at amortised cost make up around 3% of their total assets.

The UK banking system continues to maintain ample liquidity. Major UK banks and building societies have large liquid asset buffers, around two-thirds of which in aggregate are currently either in the form of cash or central bank reserves. Smaller firms typically run larger liquidity surpluses over regulatory standards, and around three-quarters of smaller firms' liquid asset buffers are held in cash. Net stable funding ratio rules mean that a significant proportion of UK bank liabilities are accounted for by stable forms of funding such as longer-term wholesale debt. Major UK banks and building societies also have a more diversified deposit base, without concentration in deposits from the innovation sector of the like seen at SVB UK.

The wider SVB episode highlights the importance of ensuring that banks are sufficiently capitalised against risks from changing interest rates. The PRA considers this risk from several angles. Our response to Question 16 below sets out more detail on this.

There remain channels through which UK financial stability could be affected, including any lasting impact on bank funding costs and the potential for those to increase the cost of borrowing for UK households and businesses. And should elevated market volatility and sharp moves in asset prices persist, it could trigger the crystallisation of vulnerabilities in market-based finance previously identified by the FPC.

The FPC is continuing to closely monitor these events, and the extent to which they may impact the wider UK financial system.

15. Are you concerned about potential wider contagion from the fallout of the failure of SVB in the US?

UK banks and insurers had limited exposure to SVB UK – UK banks had a total of $55mn in exposure to that firm. Direct exposures of UK banks and insurers to other US regional banks are negligible. SVB was the only US regional bank with a UK footprint.

Other US banks' equity prices and wholesale funding costs were impacted following the announcement of the closure of SVB US and Signature Bank, a smaller US bank. Falls were seen in the equity prices of other US banks and in particular amongst other US regional banks perceived to have similar reliance on uninsured deposits or unrealised losses on bond portfolios. Share prices of banks in other jurisdictions also fell. Banks' credit default swap (CDS) spreads and measures of their wholesale funding costs increased on aggregate, typically by more than those of other corporates.

More generally, the failure of SVB US and subsequent events have resulted in significant market volatility. As well as bank equities, other risky asset prices have also fallen sharply, with spreads on high-yield and investment-grade advanced economy corporate bonds increasing. There has been strong demand for 'safe haven' assets, such as advanced economy government bonds, causing large falls in yields.

On 16 March, having observed a particularly sharp fall in its market valuation, Credit Suisse announced that it would access a Covered Loan Facility as well as a short-term liquidity facility from the Swiss National Bank, in order to strengthen its liquidity pre-emptively. Even before the recent episode of market volatility, Credit Suisse had experienced significant outflows of client funds following concerns about the firm's risk management practices and weak earnings. The firm had reported a net loss of CHF4bn for 2022 Q3 and CHF1.4bn for 2022 Q4. These losses were largely due to write-offs and weak performance in the firm's investment banking division. Credit Suisse had also delayed the publication of its 2022 Annual Report which, when it was released on 14 March, stated that 'material weaknesses' had been identified in the firm's internal controls over financial reporting as of 2021 and 2022. Pre-existing firm-specific concerns resulted in Credit Suisse's equity price and CDS spreads being particularly affected in the days after the failure of SVB.

In order to ensure stability for the bank's customers and for the financial centre, on 19 March the Swiss Financial Market Supervisory Authority FINMA approved the takeover of Credit Suisse by UBS. This takeover was made possible with the support of the Swiss Confederation, FINMA, and the Swiss National Bank. The Bank welcomes the comprehensive set of actions set out by the Swiss authorities in order to support financial stability. We had been engaging closely with international counterparts throughout the preparations for the 19 March announcements and will continue to support their implementation. Once again, Bank staff worked at pace throughout the weekend to deliver this.

16. Have you identified other branches, subsidiaries or UK banks with similar vulnerabilities to SVB UK (or SVB US)?

The UK regulatory regime captures for UK firms the vulnerabilities associated with SVB US (which in turn led to the loss of confidence in and material deposit outflows from SVB UK despite being subject to the below requirements), especially by virtue of applicable liquidity and capital requirements.

Liquidity and funding requirements

The SVB episode confirms the importance of robust regulation and supervision relating to liquidity and funding, including standards such as the internationally agreed Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR), as well as requirements relating to good risk management such as banks' ability to monetise liquid assets sustainably.

Capital against interest rate risk

The wider SVB episode highlights the importance of ensuring that banks are sufficiently capitalised against risks from changing interest rates. The PRA considers this risk from several angles: the treatment of unrealised gains and losses when assessing bank regulatory capital resources; yield curve shock scenarios (for minimum capital requirements); and stress testing (which informs capital buffers). The PRA will continue to monitor and assess firms' capital against such risks based on their individual circumstances.

The first angle is the treatment of unrealised gains and losses in the accounting framework and, by extension, bank regulatory capital resources. The PRA requires banks to deduct from their regulatory capital resources any unrealised losses on securities that are measured at fair value. This treatment applies to both small and large banks, with no optional regulatory derogation to exempt small banks from this requirement.

The second angle is the capital required to be held against interest rate risk within the regulatory regime. As per its published policy, the PRA applies an explicit capital charge (in Pillar 2A) against IRRBB to ensure that shocks to the interest rate yield curve are capitalised in minimum capital requirements, which firms must meet at all times. In addition, the PRA requires stress tests for both small and large banks. The PRA applies proportionality by reviewing the stress tests and re-setting capital at a lower frequency for smaller banks, but small firms are still required to update their stress tests annually.

These stress scenarios usually include a severe interest rate rise or fall, which a firm needs to be able to survive without breaching minimum requirements.

17. The approach of the Bank and Treasury to this resolution appears to have been driven by the specific customer base of SVB UK. What does this mean for your approach to the regulation and resolution of other specialist banks, including those that have customers from strategically important sectors?

The UK's resolution framework worked as intended. The Banking Act 2009 sets out "special resolution objectives" for the resolution framework, and confers powers on the Bank to achieve them. Although the Bank adopts a "preferred resolution strategy" for each firm within scope of the resolution regime (which is a planning assumption that we would generally follow if the bank fails), in the event of an actual bank failure the Bank is required to consider in light of the circumstances at the time whether, amongst other conditions, the exercise of a stabilisation power is necessary having regard to the public interest in the advancement of one or more of the special resolution objectives. This determination is necessarily broad, point-in-time judgment-based, and involves consultation across the UK authorities including HM Treasury, the PRA and the FCA.

Importantly, the Bank retains discretion and flexibility, within the framework set by the Banking Act 2009, to determine which statutory powers are appropriate to exercise when deciding how best to resolve a firm in pursuit of the special resolution objectives, based on the circumstances at the time.

The Bank's judgement as to the exercise of stabilisation powers in this particular case is set out in the responses to questions 7 and 9.

18. On 12 March, the Chancellor said that "The government is working at pace on a solution to avoid or minimise damage to some of our most promising companies in the UK and we will bring forward immediate plans to ensure the short term operational and cashflow needs of Silicon Valley Bank UK customers are able to be met." What precedent did this statement by the Chancellor set regarding the credibility of deposit protection limits and bank insolvency in the UK?

The special resolution objectives incorporate, amongst other things, the continuity of banking services, the protection of depositors to the extent that they have deposits covered by the FSCS, and the protection and enhancement of public confidence in the stability of the UK financial system. The Bank's judgement as to the exercise of stabilisation powers in this particular case is set out in the responses to questions 7 and 9.

No bank insolvency would ever be entirely costless, including to depositors with balances greater than the FSCS coverage limits. Accordingly, there will be lessons learnt from the experience of the SVB UK resolution which we will take further work forward on.

19. Are you concerned about the signals given by the US approach to managing the failure of SVB, including guaranteeing all depositors? Is there a danger of moral hazard from depositors expecting similar treatment in the UK in cases where a sale is not achievable?

A blanket guarantee of all depositors is not costless. It reduces the risk sensitivity of a bank's funding, could result in moral hazard, and any costs would ultimately need to be borne by the taxpayer. The UK deposit guarantee limit is set at a level which balances financial stability, moral hazard, and adequate depositor protection.

Moreover, the UK's bank resolution framework has a clear statutory order in which shareholders and creditors would bear losses in a resolution or insolvency scenario. The FSCS offers a guarantee to insured deposits and the UK's resolution and prudential frameworks further reduce the risks to all depositors by ensuring that regulatory capital and MREL instruments provide a cushion of loss absorbency ahead of depositors bearing any loss.

In the case of SVB UK, this approach was successful. Our resolution action ensured that regulatory capital instruments, comprising CET1, AT1 and T2 instruments, were written down in full and the whole of the firm's equity was transferred for a nominal sum of £1. This ensured that all depositors were fully protected, and provided with continuity of access to all banking services on Monday 13 March.

20. What wider lessons, if any, has the Bank learnt from this episode regarding prudential regulation or financial stability?

The Bank and its policy committees will consider the lessons learned from the SVB episode, as well as other recent and current events in banking markets. In general, the UK's regulatory framework has proved robust to the issues around SVB UK. There are some areas we are likely to reflect on further, including in discussions with colleagues in international fora, relating to:

- The overall functioning of the prudential and resolution regimes
- Liquidity and funding requirements
- Capital against interest rate risk
- Approach to international branches and subsidiaries
- The PRA's 'Strong & Simple' regime

Overall functioning of the prudential regime

The SVB episode has highlighted the importance of maintaining the enhanced standards introduced after the global financial crisis, both for prudential regulation and resolution. The implementation of robust standards, including on capital and liquidity, has resulted in a more resilient banking system and has enhanced regulators' ability to mitigate shocks.

The PRA is committed to maintaining these high standards, which are a cornerstone of UK financial stability, and to completing the implementation of the final piece of the internationally agreed Basel III standards.[19]

The PRA intends to make use of its enhanced responsibilities under the Financial Services and Markets Bill[20] by acting in an accountable, responsive and accessible way.[21] While the PRA will change its approach to facilitate its proposed new secondary competitiveness objective proactively[22], it will do so in the context of advancing its primary objective to enhance the safety and soundness of the firms it regulates as required by the hierarchy of objectives that will be set by the legislation.

The UK is an important part of a deeply interconnected global financial system, and therefore the risks that we face often emerge beyond our borders. We remain committed to working closely with our international partners, so we are able to address shared challenges.

Liquidity and capital requirements

The SVB episode confirms the importance of robust regulation and supervision relating to liquidity and funding, and the importance of ensuring that banks are sufficiently capitalised against risks from changing interest rates. These topics are covered in detail in Question 16 above.

Approach to international branches and subsidiaries

Banking is an international industry, and the UK is a significant international financial centre. The PRA is open to hosting branches or subsidiaries of international banks, recognising the benefits this brings.

As per its published policy,[23] the PRA has different expectations for international businesses that engage in retail banking activities. Above certain thresholds,[24] the PRA considers authorising firms as subsidiaries rather than permitting them to operate through a UK branch,[25] thereby increasing the separation of the UK retail business from risks arising overseas.

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[19] **CP16/22 – Implementation of the Basel 3.1 standards | Bank of England**
[20] To be implemented under the ongoing FSM Bill.
[21] **DP 4/22 - The Prudential Regulation Authority's approach to policy (bankofengland.co.uk)**
[22] To facilitate the UK economy's international competitiveness and its growth over the medium to long term, subject to alignment with international standards.
[23] **SS5/21 - International banks: The PRA's approach to branch and subsidiary supervision | Bank of England**
[24] Above £100m of retail and small company transactional or instant access account balances covered by the FSCS or more than 5,000 retail and small company customers with accounts that are used for transactional purposes.
[25] For firms that operate through a UK branch, the branch forms part of a legal entity incorporated outside the UK. It follows that its operations are necessarily dependent on those of the legal entity as a whole. It is subject to prudential regulation by its home state supervisory authority according to where it is based.

Due to its increasing retail banking activities, and in line with the PRA's policy described above, SVB UK became a full UK subsidiary in August 2022. As a result, SVB UK became subject to standalone capital and liquidity requirements, enhanced local governance with the setting up of a UK Board, and additional regulatory reporting requirements. These overall enhanced requirements better enabled the PRA to monitor SVB UK and take appropriate mitigating actions. It also enabled the Bank as Resolution Authority to execute a transfer of the UK business on a standalone basis.

Strong & Simple regime

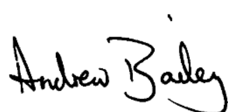
As part of its 'Strong & Simple' initiative, the PRA is currently developing a prudential framework that would be available to small domestic firms which are not internationally active and which have simple business models (simpler-regime firms).[26]

Specifically looking at SVB UK, analysis suggests that the firm would not have been in scope of the simpler regime, as it would not have fulfilled a number of the proposed scope criteria. For example, the firm's US parent was too large for SVB UK to have been in scope[27].

The PRA has been clear that, in designing the 'Strong & Simple' framework, it is committed to maintaining strength and resilience for these firms. This episode reaffirms the importance of ensuring that simplifying is not associated with a weakening of prudential standards.

I hope the information provided above is helpful to the Treasury Select Committee ahead of our scheduled hearing on 28 March.

Yours sincerely,



[26] **CP4/23 - The Strong and Simple Framework: Liquidity and Disclosure requirements for Simpler-regime Firms | Bank of England**

[27] The parent company's size is nearly ten times larger than the type of firm the proposed Simpler Regime is designed for.