The sale of SVBUK: what next for former shareholders and holders of Additional Tier 1 and Tier 2 capital instruments?

On Monday, 13 March 2023, the Bank of England announced that it had decided to sell Silicon Valley Bank UK Limited (**SVBUK**) to HSBC UK Bank Plc (**HSBC**) for £1,[1] following a liquidity run on its parent in the US, Silicon Valley Bank. Although SVBUK was not a systemically important bank for the financial system of the United Kingdom, the Bank of England, in consultation with the Prudential Regulation Authority, HM Treasury and the Financial Conduct Authority, seemingly took this action to safeguard SVBUK's customers' access to their deposits and preserve its operations.

I. Exercise of stabilisation powers by the Bank of England in the case of SVBUK

Shortly after the California Department of Financial Protection and Innovation announced that it had closed Silicon Valley Bank and appointed the Federal Deposit Insurance Corporation as its receiver,[2] the Bank of England announced its intention to "*apply to the Court to place* [SVBUK] *into a Bank Insolvency Procedure*", absent any meaningful further information.[3] Three days later, however, the Bank of England reversed that decision and decided to exercise its stabilisation powers under the Banking Act 2009 (**Banking Act**), which consisted of two steps.

First, the Bank of England: (i) wrote down to zero the principal amount of all Additional Tier 1 and Tier 2 instruments (**Capital Instruments**), worth over £350 million, (ii) cancelled all liabilities owed by SVBUK in respect of the Capital Instruments, in addition to cancelling the Capital Instruments themselves, and (iii) extinguished all rights that the holders of the Capital Instruments may have had in respect of the Capital Instruments. In doing so, the Bank of England relied on section 6B(2) of the Banking Act, which prescribes a mandatory reduction of capital instruments when the conditions for the exercise of stabilisation powers are satisfied and the bail-in power does not apply. In this specific case, it was determined that: (i) SVBUK was failing or was likely to fail (Condition 1), (ii) it was not reasonably likely that another solution would be found in sufficient time to stabilise SVBUK (Condition 2), (iii) the exercise of the BoE's powers under the Banking Act was in the public interest, in particular the objective to preserve the continuity of banking services in the United Kingdom and its critical functions (Condition 3), and (d) the objectives achieved by mandatory reduction of capital instruments and stabilisation powers would not have been achieved to the same extent by the winding up of SVBUK (Condition 4).

Second and following the mandatory reduction of the Capital Instruments, the Bank of England completed the stabilisation of SVBUK by choosing the first stabilisation option pursuant to section 11 of the Banking Act. Specifically, the Bank of England extinguished any and all rights of

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1 The Bank of England, Statement on Silicon Valley Bank, published on 13 March 2023, available at Statement on Silicon Valley Bank | Bank of England.

2 FDIC, FDIC Creates a Deposit Insurance National Bank of Santa Clara to Protect Insured Depositors of Silicon Valley Bank, Santa Clara, California, dated 10 March 2023, available at FDIC: PR-16-2023 3/10/2023.

3 Bank of England, Statement on Silicon Valley Bank UK, published on 10 March 2023, available at Bank of England statement: Silicon Valley Bank UK | Bank of England.

holders or beneficial owners of SVBUK's shares and simultaneously transferred SVBUK's ordinary shares to HSBC for £1,[4] making HSBC the sole shareholder of SVBUK.[5]

Writing down the Capital Instruments and selling SVBUK for £1 will have a familiar ring to those acquainted with the resolution of Banco Popular, S.A. In the latter case, the Single Resolution Board ordered the Spanish national competent authority to transfer shares in the bank to Banco Santander, S.A. for €1, after converting and cancelling or transferring all CET1, AT1 and T2 instruments. Similarly, in both resolutions, the banks were experiencing an immediate liquidity crisis following liquidity runs, as opposed to being insolvent. Remarkably, while the policymakers have long recognised that "*the toolbox available to Banking Union resolution authorities is seen as more powerful for restoring the solvency of a failing bank, rather than its liquidity*",[6] it is now becoming apparent the same resolution authorities will not hesitate to resolve a bank in a liquidity crisis, first using their write-down and/or conversion powers to ensure that "*all capital is gone on entry into resolution*".[7] This is consistent with the principle that "*shareholders and holders of AT1 and Tier 2 instruments* [bear] *their share of losses*" first,[8] even if initially such instruments were not intended to be written down and/or converted to deal with liquidity crises.

II. What are the next steps for shareholders and holders of AT1 and T2 instruments in the resolution of SVBUK?

The powers of the Bank of England under the Banking Act are extensive and their exercise results in expropriation of property. In order to be compatible with the European Convention on Human Rights, specifically Article 1 of Additional Protocol No. 1, any interference of property rights must be "*proportionate and a balance is [to be] struck between wider public interests and the protection of a person's interests in his property*"; additionally, "*compensation [is] to be paid which is normally required to be an amount reasonably related to the market value of the property in question*".[9]

To be able to determine the market value of the property taken, section 6E of the Banking Act requires the Bank of England to undertake a valuation prior to any mandatory reduction of capital instruments to establish, among other elements, whether the conditions for the making of a mandatory reduction instrument are satisfied and the extent of any such reduction. That valuation should typically be carried out by an independent valuer prior to the write-down and/conversion, although in urgent

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4 SVBUK's shares were transferred "*free from all trusts, liabilities, claims and encumbrances which are hereby extinguished*", but together with "*all rights, benefits or privileges which attach or accrue to or arise from or in respect of*" the shares, and regardless of any restriction on the transfer or holdings of any such shares. See the Silicon Valley Bank UK Limited Mandatory Reduction and Share Transfer Instrument, available at Statement on Silicon Valley Bank | Bank of England.

5 The Silicon Valley Bank UK Limited Mandatory Reduction and Share Transfer Instrument, available at Statement on Silicon Valley Bank | Bank of England, paragraph 9(4).

6 SRB, Working Paper Series #1 – March 2022, available at 20220328 SRB staff working paper Estimating liquidity needs in resolution in the Banking Union FINAL_0.pdf (europa.eu), page 3.

7 Total Loss-Absorbing Capacity – the thinking behind the FSB Term Sheet, given by Andrew Gracie on 4 December 2014, available at Total Loss-Absorbing Capacity – the thinking behind the FSB Term Sheet (bankofengland.co.uk), page 3.

8 Bank of England, Executing bail-in: an operational guide from the Bank of England, dated July 2021, available at Executing bail-in: an operational guide from the Bank of England, page 21.

9 HM Treasury, Banking Act 2009: special resolution regime code of practice, dated December 2020 (the "**Code of Practice**"), available at SRR_CoP_December_2020.pdf (publishing.service.gov.uk), paragraph 12.2.

situations that valuation can be provisionally prepared by the Bank of England itself. It is currently unknown whether the Bank of England or an independent valuer carried out this valuation before the Bank of England adopted the mandatory reduction instrument. If not, given the mandatory nature of this valuation, questions regarding the legality of the mandatory reduction instrument might arise.

In any event, the Bank of England will now be required to appoint an independent valuer[10] to carry out a definitive valuation as soon as reasonable practicable, pursuant to section 48X of the Banking Act. If that definitive valuation produces a higher valuation of the net asset value of the bank, the Bank of England may be required to modify any liability which was reduced or cancelled by the SVB's mandatory reduction instrument so as to increase or reinstate the liability.[11]

Separately, the Bank of England will also need to make a compensation scheme order because it used a share transfer instrument to transfer SVBUK's shares to HSBC.[12] A compensation order: (i) seeks to protect the financial interests of shareholders and creditors whose property was subject to a share transfer instrument, and (ii) establishes a scheme for determining whether they should be paid compensation and the way that compensation should be paid (if any).[13] As part of that order, an independent valuer will assess the value of SVBUK's shares immediately before their transfer to HSBC in order to determine whether any compensation is due. Importantly, the order is expected to make rules on how shareholders and creditors can challenge the valuer's determination on any compensation and/or appeal it to a court or tribunal,[14] which may remit the matter back to the valuer for further consideration.[15] It is, therefore, important to pay close attention to the process, including the valuation principles that the valuer will be asked to apply.

Finally, it should be noted that the NCWO (short for "no creditor worse off") safeguard, which seeks to ensure that no shareholder or creditor receives worse treatment than they would have received in an insolvency of the bank in resolution, *"does not apply to the exercise of the Bank of England's mandatory transfer or write-down and conversion powers under sections 6A and 6B*".[16] However, the compensation may be due under the mechanisms mentioned above.

III. What other claims should shareholders and holders of AT1 and T2 instruments issued by SVBUK be considering?

The failure of any financial institution is intrinsically fact-specific and any potential claims should be evaluated in light of the precise reasons that caused that financial institution to fail. As suggested above, depending on the outcome of the valuation process, the affected shareholders and creditors may wish to consider challenging the conclusions reached by the regulators and/or the independent valuer concerning any compensation due for loss of an investment.

10 Under section 62A of the Banking Act.
11 Section 48(Y) of the Banking Act.
12 See sections 50 and 11(2) of the Banking Act.
13 See section 49 of the Banking Act.
14 See section 55(6) of the Banking Act.
15 The Code of Practice, *supra* at footnote 9, paragraph 12.31.
16 The Code of Practice, *supra* at footnote 9, paragraph 12.26.

In parallel, in analysing the reasons for the failure of the institution, investors would be well-served by turning their attention to the resolved bank and evaluating whether they relied on any information it provided, and that has turned out to be incorrect. Specifically, investors should consider checking for any misrepresentations made in the bank's previous annual accounts, financial information or prospectuses that were relied upon when making their initial investments, or for the bank's misrepresentations made to the market. The investors usually also consider claims against the former members of the board of directors for any liability under English law. That liability could be civil or criminal in nature. For example, section 36 of the Financial Services (Banking Reform) Act 2013 provides for the criminal responsibility of senior managers of a bank of investment firm if that manager had taken a decision which caused the failure of the institution and the that decision fell far below what could reasonably be expected of somebody in the manager's position. Ultimately, how meaningful that recourse is for investors is likely to depend on any insurance policies in place which the directors can call upon to meet any financial penalty.

Finally, investors may also consider claims against the bank's auditors, which can sometimes be an appropriate way forward if it becomes apparent that the audited accounts did not accurately reflect the risk the investors were taking. Any such claim should be carefully evaluated to ensure (among other matters) that it can be demonstrated that the auditor did owe a duty of care to the investors, in addition to the failed bank itself.

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If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned in it, please do not hesitate to reach out to:

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