



HM Treasury

# **Memorandum of Understanding on resolution planning and financial crisis management**

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October 2017





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of the Financial Services Act 2012

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## **Memorandum of Understanding on resolution planning and financial crisis management**

1. This memorandum has been prepared and published in line with the provisions of Section 65 of the Financial Services Act 2012, (the Act) which requires HM Treasury ('the Treasury') on the one hand, and the Bank of England, including in its capacity as the Prudential Regulation Authority (PRA), to prepare and maintain a memorandum of understanding on financial crisis management. This memorandum of understanding therefore establishes the framework for coordination of financial crisis management between the Treasury and the Bank of England. Within this memorandum, a reference to the 'Bank' refers to both the Bank of England and the PRA, except where the context otherwise requires or it is explicitly stated otherwise.
2. The Bank is responsible for protecting and enhancing the stability of the UK financial system. Through the PRA, the Bank will regulate deposit-takers, insurance companies and certain 'investment firms' to promote the stability of the UK financial system and ensure that when individual institutions fail, they do not pose a threat to the stability of the system as a whole. Stability, while important, is only one element of a successful financial sector and economy; and the possibility of failure of individual firms is a vital element of the competitive discipline imposed by efficient markets.
3. When the risk of instability or failure arises, it must be monitored and mitigated so as to minimise the impact on the financial system, and the economy, as a whole. Managing such risks when there is a material likelihood of crystallisation is the process referred to in this memorandum as 'financial crisis management'.

### **Responsibilities**

4. The key principle of financial crisis management is to make clear who is in charge of what, and when. The Bank and the Treasury have clear and separate responsibilities. The Bank has primary operational responsibility for financial crisis management. The Chancellor and the Treasury have sole responsibility for any decision involving public funds. When the Bank has formally notified the Treasury of a material risk to public funds, and either there is a serious threat to financial stability, or public funds are already committed by the Treasury to resolve or reduce such a serious threat and it would be in the public interest to do so, the Chancellor may use powers to direct the Bank.
5. The Bank has primary operational responsibility for financial crisis management. Its responsibilities in a financial crisis stem from:
  - the PRA's monitoring and mitigating of risks to the safety and soundness of individual firms – including through the Proactive Intervention Framework (PIF), which makes clear how and when the PRA will escalate its engagement as risks in relation to a firm increase;
  - its oversight of payment systems, settlement systems and clearing houses, which are systemically important to the financial system, including its power to close an interbank payment system.

- offering, as the central bank, liquidity insurance to the financial system on terms that safeguard the Bank's capital, as described in the Bank's published frameworks;
  - the provision, when authorised by the Treasury, of Emergency Liquidity Assistance (ELA - defined as support operations outside the Bank's published frameworks) to firms that are at risk but are judged to be solvent;
  - the provision, when authorised by the Treasury, of liquidity support via the Resolution Liquidity Framework (RLF) to a firm in respect of which the Bank has exercised its powers under the Special Resolution Regime (SRR) on the firm or its holding company, as set out in Part 1 of the Banking Act 2009 (the 2009 Act);
  - the Bank's powers under the SRR, and its responsibilities as resolution authority under the Bank Recovery and Resolution Directive; and
  - the Bank's obligation, under Section 58(1) of the 2012 Act, to notify the Treasury of a material risk to public funds arising from a potential crisis.
6. The Chancellor and the Treasury have sole responsibility for any decision on whether and how to use public funds, including:
- authorising any proposal by the Bank to provide ELA to one or more individual firms in a support operation that goes beyond the Bank's published frameworks;
  - authorising the use of any stabilisation power which would have implications for public funds, including in respect of a firm to which financial assistance has already been extended by the Treasury;
  - authorising liquidity support via the RLF or any other public sector backstop funding mechanism (which for the purposes of this MoU excludes the Bank's published frameworks); and
  - the exercise of the Temporary Public Ownership stabilisation option in relation to a bank or a bank holding company in accordance with the relevant provisions of the 2009 Act.
7. The Chancellor and the Treasury are also responsible for:
- keeping Parliament and the public informed of action taken to manage a crisis; and
  - ensuring that actions considered or taken are assessed for compliance with the UK's international obligations;

### **Resolution planning**

8. In order to ensure that its powers under the SRR can be applied effectively, the Bank, as the resolution authority for the United Kingdom, is responsible outside of a crisis for developing resolution plans and conducting resolvability assessments for individual firms.
9. Given the Treasury's responsibility for authorising the use of any stabilisation power where it would have implications for public funds and authorising the use of any public sector backstop funding mechanism, it is important that the Treasury has sufficient notice of each resolution plan that anticipates the use of stabilisation

powers and the provision of liquidity support via the RLF or the use of any other public sector backstop funding mechanism so that it can assess the scale of the risk to public funds which could be associated with the failure of that firm. This information should put the Treasury in a position to provide its views to the Bank regarding any public funds concerns it has with the resolution plan ahead of it being adopted or updated. The Treasury would consider any request by the Bank for an indemnity on a case by case basis.

10. For this purpose, the Act, as amended by the Bank of England and Financial Services Act 2016 places a duty on the Bank to inform the Treasury about a resolution plan or group resolution plan which includes one or more options for the exercise of a stabilisation power. In this respect, the Bank will provide the Treasury with the following before adopting or revising the relevant resolution plan:
  - a copy of the draft resolution plan;
  - the Bank's assessment of the systemic risk of the firm failing and the implications for public funds of the draft resolution plan (including the need for potential delivery of indemnified liquidity support via the RLF or the use of any other public sector backstop funding mechanism) as set out in the draft resolvability assessment;
  - on a proportionate basis, any analysis considered by the Bank (whether or not prepared by the Bank) to be material to the Bank's assessment of the implications for public funds of the draft resolution plan.
11. In accordance with the Bank Recovery and Resolution Directive, the Bank is required as UK resolution authority to review – and where appropriate – update firms' resolution plans at least annually. In addition, new circumstances or risks may give rise to the need for the Bank to reconsider the previously adopted resolution plan for a firm. As these revisions to the resolution plan could have different, possibly greater, public funds implications, the Act also requires the Bank to provide the Treasury with details of any material changes to the resolution plan, ahead of adopting those changes, and any material changes to the Bank's assessments of the matters referred to above. It will also provide the Treasury with any further analysis considered by the Bank to be material to revising its assessment of the implications for public funds of the resolution plan.
12. Where reasonably practicable, the Bank will comply with these statutory requirements before it exercises any of its powers to direct firms to address impediments to resolvability under section 3A of the 2009 Act.
13. The Treasury may direct the Bank not to provide it with the information referred to above for specified firms if the Treasury deems it appropriate to do so for any reason. Under such circumstances the Bank will not provide the Treasury with this information until the direction is revoked by the Treasury.
14. In general terms, these statutory requirements should provide HMT with the information it needs to consider the public funds implications of the resolution plan for a relevant firm. To ensure the Treasury is in a position to discharge its responsibility to take any decision on whether and how to use public funds, it also has a power under section 57A of the Act to require, on a proportionate basis, the Bank to provide

it with information in the Bank's possession which the Treasury considers to be material to the Bank's assessment of the public funds implications of the relevant resolution plan.

15. In providing analysis on a proportionate basis under section 57B(2)(d) of the Act, the Bank will look to provide information or, where appropriate, summaries of information or relevant decisions that will assist the Treasury in understanding the Bank's assessment and in reaching its own assessment of the risks.
16. As is the case in a financial crisis, engagement between the Chancellor and the Governor will be central to institutional coordination on issues related to resolution planning outside of crisis management. In line with the duty in section 64 of the Act on the Bank and Treasury to co-ordinate the discharge of their functions, the Chancellor or the Governor may request a meeting to discuss the public funds risks associated with the potential failure of a firm. Where appropriate, the Treasury junior minister responsible for financial stability, and the Deputy Governors for Financial Stability, Markets and Banking and Prudential Regulation will also attend these meetings. Other arrangements to facilitate coordination may include resolution exercises to simulate the resolution of a financial institution in a crisis, which may be attended by the Chancellor, Governor, relevant Deputy Governors and other officials.
17. Engagement between the Chancellor and Governor will be supported by regular meetings between the Bank's Deputy Governor for Financial Stability and the Treasury's Second Permanent Secretary. In addition, the Bank and the Treasury shall put in place appropriate arrangements at an operational level, including regular and ad hoc meetings to facilitate co-ordination on resolution planning between officials from the Bank and Treasury. Through these arrangements, the Bank will ensure that the Treasury is informed of all firms that are subject to heightened risks, including where a material risk to public funds has not yet crystallised.

### **Resolution policy**

18. The Bank performs a critical role in determining the UK's approach to resolution by formulating and implementing policy in the UK and internationally.
19. Resolution policy decisions aim, among other things, to reduce risks to public funds in the longer term. As a result, the Bank and Treasury will work to ensure that risks to public funds are considered as part of policy development.
20. For this purpose, the Bank will provide the Treasury with drafts of any document, statement or other announcement in relation to the Bank's formal resolution policy affecting firms in general which it proposes to issue in its capacity as resolution authority. Save in exceptional circumstances, the Bank will provide such information at least 14 days in advance of the proposed publication date. As a practical matter, this will not include speeches given by Bank staff or informational material on existing policy published by the Bank.

### **Notification by the Bank of a risk to public funds**

21. Operational responsibility for mitigating and managing risks to financial stability rests with the Bank. Where the Bank is able to manage a financial crisis without public funds being put at risk, it will have autonomy in exercising its responsibilities, in line with the relevant statutory provisions. The Bank will keep the Treasury informed of



such actions and their outcomes in a manner proportionate to the severity of the situation.

22. When the Bank, however, considers there to be a material risk of circumstances arising in which public funds would be at risk, close co-ordination is required to ensure that the Bank and the Treasury are able to fulfil their individual responsibilities effectively. Both the Bank and the Treasury have particular responsibilities to ensure this co-ordination is effective.
23. In addition to its obligations in respect of resolution planning, the Bank has a statutory duty under Section 58(1) of the 2012 Act to notify the Treasury immediately when there is a material risk of circumstances arising in which public funds would be put at risk.
24. The 2012 Act establishes that these circumstances are those in which:
  - the Treasury might reasonably be expected to regard it as appropriate to provide financial assistance to or in respect of a financial institution;
  - the Treasury or the Bank might reasonably be expected to regard it as appropriate to exercise any of their respective powers under the SRR and the Treasury might reasonably be expected to regard it as appropriate to incur expenditure in connection with the exercise of those powers; or
  - the scheme manager of the Financial Services Compensation Scheme might reasonably be expected to request financial assistance from the Treasury (including via the National Loans Fund) for the purpose of that scheme.
25. In addition, where the Bank proposes to make ELA or liquidity support via the RLF available to one or more financial institutions it will notify the Treasury and seek the Treasury's approval.
26. In determining whether a notification of a risk to public funds is needed in respect of an individual firm, the starting point for the assessment will be the published generic risk "stages" identified in the PRA's PIF. However, the PIF stages will not be used as a formulaic test. Notification may be required at earlier or later stages of the PIF, depending on the probability, nature and severity of the risk to public funds. The same will apply to assessment of non firm-specific or systemic risks: the precise notification threshold will depend on a range of factors relating to the nature and probability of the risk to public funds.
27. The assessment will not, however, depend on the amount of public funds at risk. The principle that the Chancellor and the Treasury are responsible for any decision involving public funds, regardless of the amount concerned, is absolute.
28. Notification will be made in sufficient time for the Treasury to make a fully informed decision about the potential use of public funds. This will include sufficient time to allow the Treasury to commission the Bank to develop alternative mitigation options. If in doubt, the Bank will tend towards notification.
29. If the Treasury independently identifies an issue which it believes may result in a threat to financial stability or a risk to public funds, it may ask the Bank to assess whether this issue requires a notification.

30. When the Bank notifies the Treasury under Section 58(1), the Bank will, as soon as possible thereafter and on a timetable agreed with the Treasury, provide:
- an explanation of the risk to public funds;
  - identification of the options the Bank is considering to mitigate the risks to stability including, where relevant, resolution options under consideration;
  - an assessment of the potential systemic or firm-level impact of each option; and
  - identification of specific risks to public funds arising from any action being considered, including inaction.
31. The Bank and the Treasury will agree a suitable frequency for updates, reflecting the severity and immediacy of the risk to public funds given the specific crisis. The Bank will also notify the Treasury when a risk is deemed to have passed.

### Financial crisis management

32. As noted above, where the Bank is able to manage risks to financial stability without public funds being put at risk, it will do so on an autonomous basis. Once a risk to public funds has been notified, the Bank will continue to lead the operational response, working closely with the Treasury to develop options to mitigate the risk.
33. During a potentially fast-moving crisis, it will become especially important to ensure close and effective coordination so as to maintain coherence in the overall crisis management process. At the heart of institutional coordination during a live crisis will be frequent contact between the Chancellor and the Governor. However, the Chancellor and the Governor may agree to establish ad hoc or standing committees at other levels to support this process.
34. The Treasury will provide the Bank with clear information on particular issues of interest or concern to the Treasury which relate to resolving the crisis in the public interest. If requested by the Bank, this will include the Treasury's view on the type and the level of public funding commitments that, consistent with the 2009 Act, it is likely to authorise. This information will be provided in sufficient time to assist the Bank in developing and implementing resolution options. It will not, however, constitute Treasury pre-approval of a specific public fund envelope within which the Bank may operate. Any decision with public funds implications will still require explicit Treasury authorisation. Within this framework, the Bank will be responsible for developing options for managing or resolving the risk to public funds consistent with its statutory responsibilities as the resolution authority. The Bank will provide the Treasury with information needed on the options for managing the situation, including on options commissioned by the Treasury. This will be provided in sufficient time to allow the Treasury to make a fully informed decision about any use of public funds.
35. The Bank will take account of the Treasury's need to use public funds in a way which meets standards of regularity and propriety and provides good value for money.
36. The Chancellor and Treasury Accounting Officer will take responsibility and ultimate control over all decisions involving the use of public funds. The Treasury will take decisions on the use of public funds in a timely manner, to allow the Bank (and any other agencies or authorities involved) to implement the chosen course of action, within the constraints imposed by legislation (including EU legislation).

37. The Treasury's involvement after notification will increase in proportion to the magnitude of the risk to public funds up to the point where, having consulted the Governor, the Chancellor is satisfied that there is a serious threat to financial stability, or that it would be in the public interest to do so, given public funds already committed to resolving the crisis. At this point, the Chancellor will have the ability, if necessary in the public interest, to exercise the power of direction provided for in the Act and set out below.

#### The Chancellor's power of direction over the Bank

38. The Bank has primary responsibility for financial stability and operational responsibility for managing financial crises. But consistent with the Treasury's overall responsibilities, the Chancellor may, in some circumstances during a financial crisis, use additional powers to direct the Bank. This is provided for in Section 61 of the Act, which allows the Chancellor to direct the Bank to:

- conduct special support operations for the financial system as whole, in operations going beyond the Bank's published frameworks;
- provide ELA in a support operation going beyond the Bank's published frameworks to one or more firms that are not judged by the Bank to be solvent and viable;
- provide ELA in a support operation going beyond the Bank's published frameworks to one or more firms on terms other than those proposed by the Bank; and
- implement a particular SRR stabilisation option.

39. Where the Chancellor directs the Bank to conduct a support operation, either to the financial system as a whole or to one or more individual firms, the Bank will act as the Treasury's agent. The Bank will set up a Special Purpose Vehicle (SPV), separate from the Bank's balance sheet, to effect the support operation. The Bank and the Vehicle will be indemnified by the Treasury. Where the Treasury has determined that the operation needs to be carried out covertly, the Bank will execute the operation in a way which best ensures that the existence of the operation does not become public.

40. The Treasury will decide whether the Vehicle shall be financed through the issuance of government securities, by a loan from the Bank with share capital provided by the Treasury or via another mechanism. When the Vehicle is financed by a loan from the Bank or would otherwise affect the Bank's balance sheet, the Bank will decide, consistent with its operational independence in monetary policy, whether and how to offset the resulting expansion of central bank reserves.

41. The 2009 Act contains a number of provisions covering the Treasury's role in the SRR where public funds are at risk. The Bank may not exercise a stabilisation power without the Treasury's consent, if the exercise would have implications for public funds. In addition, if the Treasury has provided financial assistance to resolve or reduce a serious threat to financial stability, the Bank may only exercise its stabilisation powers where recommended to do so by the Treasury on the grounds that such an exercise is necessary to protect the public interest.

42. In general terms, these provisions are sufficient to allow the Treasury to fulfil its role in protecting public funds when use of the SRR is being considered in a crisis. Notwithstanding this, the power of direction in the 2012 Act will cover the SRR to put beyond legal doubt the Chancellor's ability to require the Bank to take specific action when public funds are at risk. This is a backstop power, and it is not anticipated that its use will be considered in the majority of crisis situations.
43. As with directions involving liquidity, when the Chancellor directs the Bank to implement a specific option under the SRR, the Treasury will provide the Bank with indemnities covering any risks arising from actions it had taken under direction from the Treasury.
44. The power of direction may be exercised if and only if:
- the Bank has notified the Treasury of a material risk of circumstances arising in which public funds will be at risk in accordance with section 58 of the Act; and
  - the Chancellor, having consulted the Governor, is satisfied that the direction is either a necessary response to a serious threat to financial stability or, where financial assistance has already been provided in respect of a firm to resolve or reduce such a serious threat, necessary to protect the public interest.
45. Upon a direction being given, that direction, along with any response the Bank may wish to make, will be laid immediately before Parliament. The only circumstance in which the direction would not be immediately laid before Parliament will be when such disclosure would reveal the existence of a support operation that the Treasury had decided needs to be covert in order to preserve financial stability. In that case, the Chancellor will notify the Chairs of the Treasury Select Committee and the Public Accounts Committee in confidence immediately. The direction and any Bank response will be laid before Parliament when the Treasury, having consulted the Bank, has decided that the need for confidentiality of the support operation has passed.
46. This power of direction is not available in relation to (1) supervisory decisions taken by the PRA or by the rest of the Bank in its regulation of systemic post-trade infrastructure; (2) policy decisions made by the MPC and FPC; (3) changes to the Bank's published framework for providing liquidity support to the financial system.

#### Other aspects of co-ordination

##### *Other organisations*

47. In some cases, the Financial Conduct Authority, the Financial Services Compensation Scheme or other organisations may need to be involved in the monitoring and assessment of risks, or the planning and implementation of financial sector interventions. The Bank and Treasury will involve these organisations as necessary.

##### *Compliance with international obligations*

48. Action to manage a potential financial crisis may give rise to considerations of compliance with the UK's international obligations, particularly those arising from European law. The Government is legally responsible for ensuring that this compliance is achieved. The Bank and the Treasury will therefore coordinate activity

to ensure that actions considered or taken are assessed for compliance with those international obligations.

49. In particular, use of the Special Resolution Regime or other interventions in respect of failing firms may require the European Commission to be notified of, and approve, the measure on State aid grounds, whether or not public funds are deployed. The Treasury is responsible for developing the UK policy and framework for State aid in financial services. The Bank will develop options for intervention or resolution that are consistent with this framework, and will prepare initial State aid notifications in consultation with the Treasury. The formal State aid notification to the European Commission will be made by the Treasury acting on behalf of the UK Government. The Bank will support the Treasury in securing State aid approval when the issue has arisen from its actions.

#### *Communicating with Parliament and the public*

50. Treasury Ministers are responsible for keeping Parliament informed of action taken to manage a financial crisis – including action taken by the Bank without any public funds implications. Consistent with the principles described above, the Bank will keep the Treasury informed to the degree needed for Ministers to fulfil this function.
51. The Bank and the Treasury will also work closely together to ensure that wider communication – including provision to the markets of information relating to regulatory reporting events, and communication to the general public about the progress of a financial crisis and the steps being taken to manage them – is carried out effectively.
52. Within that, the Bank is responsible for communications to the market: about the use of its balance sheet; about measures concerning critical financial infrastructure arising from its oversight under the 2009 and 2012 Acts; through the PRA, about the PRA's regulation and supervision of individual firms; and about any measures taken by the Bank under the SRR, excepting any use of public money by the Treasury in association with those measures.



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