

Appendix 2: The Bank of England's Statement of Policy on Funding in Resolution

1 Background and statutory framework

1.1 This Statement of Policy (SoP) is issued by the Bank of England (the Bank), as UK resolution authority, in accordance with section 3B(9) of the Banking Act 2009 as amended (the Banking Act). The SoP sets out how the Bank expects to use its power under section 3A(2) of the Banking Act to direct a 'relevant person' to take measures to address impediments to resolvability, specifically in relation to their capabilities and arrangements to support funding in resolution.

1.2 A 'relevant person' means:

- (a) an institution¹ authorised for the purpose of the Financial Services and Markets Act 2000 (FSMA) by the Prudential Regulation Authority (PRA) or Financial Conduct Authority (FCA);²
- (a) a parent of such an institution which (i) is a financial holding company or a mixed financial holding company; and (ii) is established in, or formed under the law of any part of, the UK; or
- (b) a subsidiary of such an institution or of such a parent which (i) is a financial institution³ authorised by the PRA or FCA; and (ii) is established in, or formed under the law of any part of, the United Kingdom.

1.3 The intended process around using this direction power is set out in the Bank's SoP on its power to direct institutions to address impediments to resolvability.⁴ In short, this process involves the Bank:

- (a) determining that there is a substantive impediment to the resolvability of an institution;
- (b) where a substantive impediment is identified, notifying the institution of the impediment. The institution will then have four months to make its own proposal to remove the identified impediments; and
- (c) if the Bank remains dissatisfied with the measures proposed by the institution, directing the institution to take specific action to remediate the impediment.

1.4 This SoP sets out objectives and principles that firms are expected to meet in order to avoid a determination that they have insufficient capabilities and arrangements to support effective resolution and that these constitute an impediment to resolvability.

¹ For the purposes of this SoP the term 'institution' means UK-incorporated banks, UK-incorporated building societies and those UK-incorporated investment firms that are required to hold initial capital of €730,000, in particular those that deal as principal. References to 'institution' shall be taken to also include 'relevant persons'.

² The PRA and FCA are the UK competent authorities. According to Article 2 of the Bank Recovery and Resolution Directive (2014/59/EU) and Article 4 of the Capital Requirements Regulation (EU No. 575/2013), as amended by Regulation (EU No. 2019/876), 'competent authority' means a public authority or body officially recognised by national law, which is empowered by national law to supervise institutions as part of the supervisory system in operation in the Member State concerned.

³ The term 'financial institution' has the meaning given by Article 4 (1) (26) of Regulation 575/2013/EU.

⁴ Bank of England (2015) 'The Bank of England's power to direct institutions to address impediments to resolvability' available at: <https://www.bankofengland.co.uk/paper/2015/the-boes-power-to-direct-institutions-to-address-impediments-to-resolvability-sop>.

1.5 Not meeting these objectives and principles may constitute a barrier to resolvability and may result in the Bank directing firms to improve their capabilities to ensure resolvability.

1.6 In considering these objectives and principles, firms should have regard to their size, business model, and preferred resolution strategy.¹

2 Policy scope

2.1 This SoP applies to:

- (a) institutions notified by the Bank that their preferred resolution strategy is bail-in or partial-transfer, i.e. that the Bank would expect the strategy to involve the use of its stabilisation powers; or
- (b) institutions notified by the Bank that they are a 'material subsidiary' of an overseas-based banking group for the purposes of setting internal MREL in the UK, as determined in accordance with the criteria set out in the Bank of England's approach to setting a minimum requirement for own funds and eligible liabilities (MREL SoP).²

2.2 Hereafter, references to 'firms' should only be taken to include those institutions that meet the criteria set out in paragraphs 2.1(a) and (b). Further detail is set out below on the application of this SoP to firms, and to entities in firms' groups.³

2.3 Material subsidiaries should consider this SoP within the context of the Statement of Policy: *The Bank of England's Approach to Assessing Resolvability* (Approach to Assessing Resolvability SoP), in particular paragraphs 2.5-2.6.

3 Objective

3.1 In order to ensure they continue to meet their obligations as they fall due, firms are able to estimate, anticipate and monitor their potential liquidity resources and needs and mobilise liquidity resources, in the approach to and throughout resolution.

4 Principles

Principle 1: Overview of liquidity analysis

Firms should be able to perform liquidity analysis on a timely basis at the level of material entities and for material currencies.

4.1 Firms should identify the entities and currencies that they consider material on the grounds of liquidity, and consider and identify the potential locations of liquidity risk within these. Firms should define and justify the range of entities and currencies which they consider to be in and out of scope.

4.2 At a minimum, the scope of firms' material entities should include those already defined as material for the purposes of internal MREL. Firms should also identify additional entities that are material for liquidity purposes.

4.3 At a minimum, firms' assessment of material currencies should consider the denominated currency of assets, liabilities, and contingent liabilities held by each material entity. Material currencies should include, at a minimum, each currency (which may include the reporting currency) that represents 5% or

¹ The Bank will notify a firm of its preferred resolution strategy on at least an annual basis.

² Bank of England (2018) 'The Bank of England's approach to setting a minimum requirement for own funds and eligible liabilities (MREL)' available at: <https://www.bankofengland.co.uk/paper/2018/boes-approach-to-setting-mrel-2018>.

³ For the purposes of this SoP, a firm's group should be taken to include the firm and subsidiaries that are directly or indirectly owned by the firm. It does not include the parent entities of the firm or subsidiaries thereof in which the firm does not have an ownership stake.

more of the total liabilities of each material entity. Firms should also identify additional currencies which are material for the purposes of liquidity at each material entity, or the group as a whole, taking into particular consideration the currency of obligations that are likely to arise in resolution.

4.4 Firms should develop capabilities to perform liquidity analysis, at the level of material entities, for currencies which are deemed to be material for that material entity, and for currencies which are deemed to be material for the group. Firms should also develop capabilities to perform liquidity analysis at the level of the group for currencies which are deemed to be material to the group.

4.5 For entities and currencies that are not deemed to be material, firms may choose to conduct less granular analysis. At a minimum, firms should be able to use existing systems to confirm that the liquidity needs of each non-material entity, and the obligations arising in each non-material currency, do not represent a risk to the liquidity position of the firm in resolution.

4.6 Firms should be able to refresh the relevant liquidity analysis as necessary, at the level of material entities, and deliver this information in a timely manner. Firms should be able to make the liquidity analysis available on a T+1 basis, or more rapidly if both necessary and appropriate. The mechanism for collecting and compiling information should be robust and compliant with the relevant data quality processes within the firm. The liquidity analysis should be sufficiently adaptable that it can be readily adjusted to reflect the circumstances of a stress.

4.7 The range of liquidity analysis capabilities and the characteristics of these capabilities, described in the remainder of this section of the SoP, should be read as applying to the scope of the analysis described in paragraph 4.4.

Principle 2: Liquidity needs

Firms should be able to develop estimates of, and assess, liquidity needs in resolution.

4.8 Firms should have the capability to estimate their liquidity needs in resolution based on their current balance sheet, and based on future estimated balance sheets. As such, firms should be able to estimate their liquidity needs in resolution for at least 90 days from the point of entry, both if they were to enter resolution either immediately or following a period of prolonged stress.

4.9 These capabilities should be sufficiently flexible that firms' projections of liquidity needs can reflect the different circumstances that firms might face in resolution and the different ways counterparties to the firm might behave in these circumstances. Firms should be able to perform sensitivity analysis and identify the key drivers of liquidity needs at the level of material entities.

4.10 Firms should design and document methodologies to estimate their liquidity needs in resolution. Firms' methodologies should consider the types and potential severity of outflows in resolution, record the behavioural assumptions used to support cash flow forecasts, and identify key drivers of liquidity needs in resolution.

4.11 When estimating their liquidity needs in resolution, firms should be able to estimate and detail the liquid assets they will be required to hold for operational reasons, such as minimum amounts in central bank reserve accounts, payment systems, initial margin on market transactions, and legal tender held in physical form.

4.12 In particular, firms should be able to estimate their likely intra-day liquidity needs in resolution based on current and estimated future exposures and taking account of how their peak needs may evolve in resolution. Firms should engage relevant counterparties in business-as-usual to understand the likely implications of resolution on their intra-day liquidity needs.

4.13 Firms should be able to estimate how intra-group funding needs would impact on their liquidity needs in resolution. In particular, firms should consider how their preferred resolution strategy would influence the movement of liquidity throughout the group.

Principle 3: Liquidity sources

Firms should be able to monitor and mobilise liquidity sources in resolution.

4.14 Firms should have the ability to estimate the liquidity resources available to them in resolution, both if they were to enter resolution immediately, or at any point during a period of prolonged stress. When estimating the liquidity resources available to them, firms should take into account the impact of prevailing market conditions on the method and timing of asset monetisation.

4.15 Firms should be able to identify unencumbered collateral¹ on a spot basis and project collateral balances, including how they evolve in a stress. Firms should be able to identify important information relating to the availability of collateral, such as currency, asset class, eligibility for central bank facilities, and whether the collateral is pre-positioned or has become encumbered as a consequence of the stress. They should also identify any legal and operational features that impact the management of collateral, including the transfer of collateral across jurisdictions and across the ring-fence.²

4.16 Firms should account for the assumptions made regarding intra-group liquidity needs, and for firms in scope of ring-fencing, restrictions in transferring collateral across the ring-fence in considering the resources available to be moved around the group. The assumptions around transferability are expected to be consistent with firms' preferred resolution strategy, and should remain sufficiently flexible.

Principle 4: Third party facilities

Firms should be able to project their possible need to use third party facilities.

4.17 Firms should be able to project their possible need to use third party facilities, including central banks.

4.18 Firms should consider their need and ability to monetise a wide range of collateral with third parties, including any potential need or ability to request liquidity from central banks. This should include an assessment of the timing of, and collateral suitable for, borrowing, and the availability of information a third party would require to risk manage their exposures.

4.19 Firms should be able to demonstrate that, subject to the agreement of third parties, if they were to be unable to meet their liquidity needs utilising their own resources, there is a reasonable likelihood that third-party facilities could be used in resolution.

Principle 5: Governance

Firms should embed the outcome of their analysis into their internal governance framework.

4.20 Firms' internal governance frameworks should facilitate effective and timely decision-making throughout the periods illustrated in the stylised resolution timeline set out in Annex 1 and Annex 2 of the Approach to Assessing Resolvability SoP, and should also support firms' existing management of liquidity risk.

¹ As referred to in Article 7(2) of Commission Delegated Regulation (EU) 2015/61 of 10 October 2014 to supplement Regulation (EU) No 575/2013: *an asset shall be deemed to be unencumbered where the credit institution is not subject to any legal, contractual, regulatory or other restriction preventing it from liquidating, selling, transferring, assigning or, generally, disposing of such asset via active outright sale or repurchase agreement within the following 30 calendar days. The following assets shall be deemed to be unencumbered: (a) assets included in a pool which are available for immediate use as collateral to obtain additional funding under committed but not yet funded credit lines available to the credit institution. This shall include assets placed by a credit institution with the central institution in a cooperative network or institutional protection scheme. Credit institutions shall assume that assets in the pool are encumbered in order of increasing liquidity on the basis of the liquidity classification set out in Chapter 2, starting with assets ineligible for the liquidity buffer; (b) assets that the credit institution has received as collateral for credit risk mitigation purposes in reverse repo or securities financing transactions and that the credit institution may dispose of.*

² For firms in scope of ring-fencing, as set out in The Financial Services and Markets Act 2000 (Ring-fenced Bodies and Core Activities) Order 2014.

4.21 Firms should integrate their capabilities for managing liquidity risk in resolution into their existing comprehensive liquidity management framework, alongside any existing legal entity-specific liquidity requirements, and internal stress tests.

4.22 Firms should have internal governance arrangements in place for reporting liquidity risks in resolution to senior management, appropriate risk committees, and relevant authorities. Firms should consider quantitative and qualitative indicators for such reporting. These indicators should ensure senior management are informed of firms' liquidity risks in resolution on a sufficiently forward-looking basis. Firms' consideration of appropriate indicators should take into account the sensitivities and key drivers of risk identified through the analysis described earlier in this section.

4.23 Firms should consider the appropriate frequency with which they estimate and report their projected liquidity needs and resources to senior management. Specifically firms should be able, and have processes, to increase the frequency of reporting in a period of stress.

Principle 6: Testing

Firms should participate in, and provide information for, tests of the above capabilities.

4.24 Firms should test the capabilities and governance arrangements set out in this SoP on a regular basis. Firms should document the outcomes of these tests and review them, which may involve internal audit or third-party assurance providers. The tests should be conducted in a way that facilitates assurance by the Bank, the PRA, or a third party.

5 Timeframe for compliance

5.1 Firms should be compliant with this SoP by 1 January 2022.

5.2 The Bank may on a firm-specific basis set an earlier compliance date, for example where the Bank has concerns about the resolvability of a firm.

5.3 The Bank may also set a firm-specific compliance date where a firm that was not previously within scope becomes within scope of this SoP. This might occur if the preferred resolution strategy applicable to the firm changes, or if the firm becomes 'material' for the purposes of setting internal MREL. In these cases, the Bank will determine the appropriate compliance date on a firm-specific basis, and expects to allow firms at least 18 months for compliance.