



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Consultation Paper | CP10/20

Simplified Obligations for recovery planning

July 2020



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Responses are requested by Friday 23 October 2020.

In light of current measures to help prevent the spread of COVID-19, please address any comments or enquiries by email to: CP10_20@bankofengland.co.uk.

Alternatively, please address any comments or enquiries to:

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1 Overview

1.1 In this consultation paper (CP), the Prudential Regulation Authority (PRA) sets out a proposal to allow certain firms to benefit from Simplified Obligations for recovery planning ('Simplified Obligations'), in light of the discretion the PRA has under Article 4(1)¹ of the Bank Recovery and Resolution Directive 2014/59/EU (BRRD) as to whether to apply Simplified Obligations.

1.2 This CP proposes changes to PRA Supervisory Statement (SS) 9/17 'Recovery planning'² ("SS 9/17") (Appendix 1) that would reduce expectations for certain firms' recovery planning. The firms concerned would be notified by the PRA that they are eligible for Simplified Obligations.

1.3 This CP is relevant to PRA-authorized UK banks, building societies, PRA-designated UK investment firms and their qualifying parent undertakings ('firms') to which the Recovery Plans Part of the PRA Rulebook applies. The proposals are likely to be of particular interest to smaller and non-systemic firms that do not perform critical functions.

1.4 The proposals support the PRA's approach to enhanced proportionality for smaller and non-systemic firms consistent with the principles set out in Deputy Governor for Prudential Regulation and Chief Executive Officer of the PRA Sam Woods' 'Stylish regulation' speech;³ in particular, the principles of 'proportionality and sensitivity to business models, and promoting competition'.

1.5 The PRA considers that its proposals introduce a more proportionate approach for recovery planning that would not cause firms to incur additional costs as a direct result of the proposals.

Background

1.6 Under Article 4 of the BRRD, the PRA has discretion to apply Simplified Obligations for firms where their failure is not expected to have a 'significant negative effect on financial markets, on other institutions, on funding conditions, or on the wider economy', taking account of the other criteria set out in Article 4(1). Simplified Obligations enables the PRA (as UK competent authority) and the Bank of England ('the Bank') (as the UK resolution authority) to decide on the level of detail of firms' recovery and resolution planning respectively.

1.7 In 2017, the PRA published Policy Statement (PS) 29/17 'Recovery planning',⁴ confirming that it had been asked about whether Simplified Obligations would be applied to smaller firms. It noted that while it had not formally applied Simplified Obligations, it had applied the principle of proportionality to SS9/17, which sets the PRA's expectations in order to enhance the quality of recovery plans and increase the likelihood that these plans are credible and useable in stress. The PRA also noted that it expected that the burden of recovery planning would naturally reflect the size and complexity of the firm in question and should not be disproportionate.

1.8 The PRA has reviewed its recovery planning policy expectations as set out in SS9/17 in light of its supervisory approach in practice and its assessment of firms' recovery plans. On this basis, the PRA proposes to introduce Simplified Obligations.

1.9 The PRA has identified two instances where Simplified Obligations could be applied to those firms that are deemed eligible. For those firms, these proposals seek to reduce the minimum number of scenarios considered in recovery planning to two, and clarify that firms that are eligible

¹ Article 4 of BRRD was transposed into UK law by Article 7 of the Bank Recovery and Resolution (No. 2) Order 2014 No. 3348.

² December 2017: <https://www.bankofengland.co.uk/prudential-regulation/publication/2017/recovery-planning-ss>.

³ May 2019: <https://www.bankofengland.co.uk/speech/2019/sam-woods-ubs-20th-annual-financial-institutions-conference-lausanne>.

⁴ December 2017: <https://www.bankofengland.co.uk/prudential-regulation/publication/2017/recovery-planning>.

for Simplified Obligations are not expected to submit the information template referred to in SS9/17.

Summary of proposals

1.10 The proposals relate to:

- (i) how the PRA would perform the eligibility assessment process to determine which firms are eligible for Simplified Obligations in respect of recovery planning; and
- (ii) recovery planning expectations for firms deemed eligible for Simplified Obligations.

Implementation

1.11 The PRA intends to publish a final PS and to notify firms that are eligible for Simplified Obligations in the second half of 2020-21. Pending consideration of the responses to this CP, the amendments to SS9/17 would apply with immediate effect once the final policy statement is published.

Responses and next steps

1.12 This consultation closes on Friday 23 October 2020. The PRA invites feedback on the proposals set out in this CP. Please address any comments or enquiries to CP10_20@bankofengland.co.uk.

1.13 The proposals set out in this CP have been designed in the context of the UK's withdrawal from the European Union and entry into the transition period, during which time the UK remains subject to European law. The PRA will keep the policy under review to assess whether any changes would be required due to changes in the UK regulatory framework at the end of the transition period, including those arising once any new arrangements with the European Union take effect.

1.14 The PRA has assessed that the proposals would not need to be amended under the EU (Withdrawal) Act 2018 (EUWA). Please see PS5/19 'The Bank of England's amendments to financial services legislation under the European Union (Withdrawal) Act 2018'⁵ for further details.

⁵ April 2019: <https://www.bankofengland.co.uk/paper/2019/the-boes-amendments-to-financial-services-legislation-under-the-eu-withdrawal-act-2018>.

2 Simplified Obligations proposals

2.1 This chapter sets out the PRA's proposals for applying Simplified Obligations, in light of the discretion the PRA has under Article 4 of the BRRD, including the proposed eligibility assessment for Simplified Obligations and the updated recovery planning expectations for eligible firms.

Eligibility assessment process

2.2 In considering whether a firm is eligible for Simplified Obligations, the PRA as competent authority will take into account the criteria set out in Article 4(1) of the BRRD, which aim to assess the firm's systemic importance. In December 2018, Commission Delegated Regulation (EU) 2019/348 was published with regard to regulatory technical standards (RTS) specifying the quantitative and qualitative criteria for granting Simplified Obligations under the BRRD. The RTS became effective on Sunday 24 March 2019 and replaced the European Banking Authority (EBA) guidelines on the application of Simplified Obligations (EBA/GL/2015/16).

G-SIIs and O-SIIs

2.3 In order to determine eligibility for Simplified Obligations, for firms within the scope of Simplified Obligations, the PRA must independently assess whether a firm meets the criteria set out in the RTS at least every two years.⁶ The RTS mandates separate assessments for credit institutions⁷ and investment firms, based on two consecutive stages: a quantitative assessment and a qualitative assessment. Further details of these assessments are set out in paragraphs 2.5–2.13.

2.4 In terms of the quantitative assessment of credit institutions and investment firms, the PRA has discretion not to carry out a quantitative assessment:

- where a credit institution has been identified as a global systemically important institution (G-SII) or other systemically important institution (O-SII) on the basis set out in Article 1(7); and
- where an investment firm has been identified as a G-SII or an O-SII on the basis set out in Article 3(5).⁸

In such cases the PRA proposes to use that discretion to determine that G-SIIs and O-SIIs are not eligible for Simplified Obligations, as it would be inappropriate for G-SIIs and O-SIIs to benefit from Simplified Obligations due to their systemic importance.

Credit institutions

2.5 In the quantitative assessment for credit institutions, in order to calculate the total quantitative score, the PRA is required to calculate and aggregate weighted scores of underlying indicators on the basis of regulatory returns. These indicators are comprised of quantitative measures of size, interconnectedness, scope and complexity of services, and nature of business. The RTS gives the competent and resolution authorities the ability to set the quantitative threshold for credit

⁶ Article 1(1), RTS.

⁷ A credit institution is an undertaking the business of which is to take deposits or other repayable funds from the public and to grant credits for its own account

⁸ In the case of credit institutions, the relevant quantitative process is set out in paragraphs 1 to 5 of Article 1 of the RTS, and in the case of investment firms, the relevant quantitative process is set out at paragraphs 1 to 4 of Article 3 of the RTS.

institutions between 0 to 105 basis points, above which firms would not be eligible for Simplified Obligations (instead of the default threshold of 25 basis points).⁹

2.6 After assessing UK credit institutions' indicative scores and their distribution,¹⁰ the PRA proposes to set the threshold at 60 basis points, which represents the point that differentiates between the scores of small UK credit institutions and the very large UK credit institutions.

2.7 As set out in the RTS, only credit institutions that are below the quantitative threshold should then be subject to a qualitative assessment. The RTS provides a non-exhaustive list of qualitative considerations that the PRA would be required to have regard to, including, most importantly, the extent to which the credit institution performs critical functions in one or more EU Member States.¹¹ The RTS gives the PRA discretion to take into account other relevant considerations as appropriate.

2.8 After assessing the quantitative and qualitative criteria, the PRA expects that credit institutions that do not provide critical functions would likely be eligible for Simplified Obligations.

Investment firms

2.9 For investment firms, the RTS requires the PRA to conduct a two-step analysis (quantitative and then qualitative) before deciding whether to apply Simplified Obligations. For the quantitative assessment, the RTS specifies the quantitative indicators the PRA would need to consider. These indicators focus only on the size of the firm. The RTS gives the PRA discretion to determine the weightings of the indicators used to calculate the quantitative score and the level of the quantitative threshold. Only investment firms that are below the agreed quantitative threshold should then be subject to a qualitative assessment by the PRA.

2.10 The RTS provides a minimum list of qualitative considerations that the PRA would be required to have regard to, including the type of the investment firm's clients and the extent to which it performs critical functions in one or more Member States.¹² Again, the PRA may use the discretion it has under the RTS to take into account other relevant considerations as appropriate.

2.11 At present, the majority of UK investment firms are regulated by the FCA. The PRA currently regulates eight UK designated investment firms,¹³ out of which only one is not classified as a G-SII or an O-SII.

2.12 The PRA does not propose to set out a threshold for the quantitative assessment of UK investment firms, given that the PRA would currently only need to assess one such firm. Accordingly, the PRA proposes that the assessment decision for the one UK investment firm that is not classified as a G-SII or an O-SII, regarding its eligibility for Simplified Obligations, would be taken in line with the qualitative assessment process for investment firms set out in the RTS, including the extent to which the investment firm performs critical functions in one or more Member States.

⁹ Article 1(3) of the RTS: 'Competent and resolution authorities may raise or lower the threshold referred to in paragraph 2 within the range of 0 to 105 basis points. Competent and resolution authorities shall keep the amended threshold under regular review'.

¹⁰ The assessment of the score is based on reports submitted to the PRA (as specified in RTS 2019/348 Annex 3) as of Monday 31 December 2018.

¹¹ RTS 2019/348 Article 2.

¹² RTS 2019/348 Article 4.

¹³ A PRA-designated investment is a firm that, broadly speaking, meets the following conditions:

- it has, or has applied for, permission to deal in investments as principal;
- it has (or would have if it was authorised) a minimum capital of €730,000, or is broadly analogous to a European Economic Area (EEA) passporting firm or non-EEA firm; and
- it qualifies under our criteria for designated investment firms. For more information, see: <https://www.bankofengland.co.uk/prudential-regulation/publication/2013/designation-of-investment-firms-for-prudential-supervision-by-the-pra>.

2.13 The PRA notes that if it becomes the regulator of additional firms that would be classified as PRA-regulated investment firms, then it would consider its approach in relation to their eligibility assessment process as necessary, consistent with the RTS.

Eligibility

2.14 Following its assessment, the PRA will notify firms that are eligible for Simplified Obligations.

2.15 In relation to firms that are part of groups, the PRA notes that, in line with the RTS, a group recovery plan should only be simplified if all parts of the group are eligible for Simplified Obligations according to the assessment taken in each Member State where the group has presence.

Recovery planning expectations for Simplified Obligations firms

Scenario testing

2.16 At present, the PRA expects G-SIIs and O-SIIs to include analysis of at least four scenarios in their recovery plan, whereas all other firms should include at least three scenarios. While the PRA continues to attach importance to scenario testing, it also recognises that some smaller firms are having difficulties in designing more than two scenarios that are plausible and severe enough to test their recovery plan.

2.17 The PRA therefore proposes to amend its recovery planning expectations in SS9/17, so that firms that are eligible for Simplified Obligations are expected to include in their plan at least two scenarios.

Template submission

2.18 As set out in SS9/17, the PRA expects firms with complex and lengthy recovery plans to consolidate a core set of recovery plan information and data into one consistent template. Firms with shorter and less complex recovery plans are expected to contact their supervisor to determine whether the PRA expects the template to be submitted with their plans.

2.19 The PRA proposes to use the above eligibility assessment process to clarify its expectations in relation to template submission for firms with shorter and less complex recovery plans, to reflect that firms that are eligible for Simplified Obligations are not expected to submit the template.

3 The PRA's duty to consult

3.1 The PRA has a statutory duty to consult when introducing new rules and, when not making rules, has a public law duty to consult widely where it would be fair to do so. When doing so, the PRA provides the following in relation to the proposed policy:

- a cost benefit analysis;
- an explanation of the PRA's reasons for believing that making the proposed policy is compatible with the PRA's duty to act in a way that advances its general objective, insurance objective (if applicable), and secondary competition objective;
- an explanation of the PRA's reasons for believing that making the proposed policy is compatible with its duty to have regard to the regulatory principles; and
- analysis as to whether the impact of the proposed policy will be significantly different to mutuals than to other persons.

3.2 The Prudential Regulation Committee (PRC) should have regard to aspects of the Government's economic policy as recommended by HM Treasury.¹⁴

3.3 The PRA is also required by the Equality Act 2010¹⁵ to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out its policies, services, and functions.

Cost benefit analysis

3.4 The PRA considers that these proposals will generate economic benefits in the form of cost savings for the population of firms eligible for Simplified Obligations. In particular, the PRA expects the reduced number of scenarios and the removal of the expectation to submit a template to realise cost savings for affected firms.

Compatibility with the PRA's objectives

3.5 The PRA considers that the proposals are compatible with its statutory objective under the Financial Services and Markets Act 2000 (FSMA) to promote the safety and soundness of PRA-authorized firms.¹⁶ The proposals would allow the PRA to formalise current supervisory practice in relation to the template, to reflect that firms that are eligible for Simplified Obligations are not expected to submit the template, and to amend the PRA's scenarios expectation following its review of firms' recovery plans. The PRA considers that these proposals would not affect the quality and usability of firms' recovery plans, and consequently the proposals allow for enhanced proportionality while not adversely impacting the PRA's safety and soundness objective.

3.6 When discharging its general function in a way that advances its primary objectives, the PRA has, as a secondary objective, a duty to facilitate effective competition in the markets for services provided by PRA-authorized persons. The PRA expects that the proposals would modestly ease the compliance burden that is related to scenario designing and testing for eligible firms who are generally smaller. The reduction in the compliance burden will help their competitiveness in relation

¹⁴ Section 30B of the Bank of England Act 1998.

¹⁵ Section 149.

¹⁶ Section 2B(1) and Section 2B(2) FSMA.

to larger firms, although the direct, positive impact on competition is expected to be small. The PRA's ability to apply proportionate treatment for smaller firms would facilitate effective competition, as it reduces the regulatory burden on small firms, and compensates for the fact that systemic firms have lower funding costs.

Regulatory principles

3.7 In developing the proposals, the PRA has had regard to the regulatory principles. Of these, three principles are of particular relevance:

- The principle that a burden or restriction should be proportionate to the benefits. The proposals would promote proportionality for firms that are small and non-systemic in nature. In particular, the PRA's approach in relation to scenarios would allow eligible firms to use their resources in a more efficient and economical way while meeting the PRA's expectations.
- The principle of recognising diversity of different business models. In this CP, the PRA sets out its proposals to apply Simplified Obligations in line with the discretion granted under Article 4(1) of the BRRD. In general, Simplified Obligations provisions aim to ensure that the recovery planning requirements and expectations (as well as resolution planning), apply proportionally in a way that reflects the systemic importance of the firm in question. Furthermore, the criteria set out in Article 4(1) of the BRRD and the eligibility assessment process set out in RTS, which the PRA must follow in order to determine eligibility for Simplified Obligations, recognises the difference between firms and the nature of their business, including their size, interconnectedness, scope and complexity, and risk profile.
- The principle that the regulators should exercise their function as transparently as possible. The PRA considers that the proposals would bring greater transparency to how the PRA intends to apply Simplified Obligations and which firms are likely to be eligible for these obligations.

Impact on mutuals

3.8 The PRA considers that the impact of the proposed policy on mutuals is expected to be no different from the impact on other authorised firms. In the two-part eligibility assessment process set out in paragraphs 2.9–2.11, none of the considerations relate to mutuality.

HM Treasury recommendation letter

3.9 HM Treasury has made recommendations to the PRC about aspects of the Government's economic policy to which the PRC should have regard when considering how to advance the PRA's objectives and apply the regulatory principles.¹⁷ The aspects of the Government's economic policy most relevant to the proposals in this CP are:

- (i) competition;
- (ii) innovation;
- (iii) diversity of business models; and
- (iv) transparency.

¹⁷ Information about the PRC and the recommendations from HM Treasury are available on the Bank's website at <https://www.bankofengland.co.uk/about/people/prudential-regulation-committee>.

3.10 Recommendations (i) to (iv) have been considered in the 'compatibility with the PRA's objectives' and 'regulatory principles' sections above.

Equality and diversity

3.11 The PRA considers that the proposals do not give rise to equality and diversity implications.

Appendices

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1 Draft amendments to Supervisory Statement SS9/17 'Recovery planning'

This appendix outlines proposed amendments to SS9/17. Underlining indicates new text and striking through indicates deleted text.

1 Introduction

...

1.3 This SS complements and should be read in conjunction with:

- the Recovery Planning Part of the PRA Rulebook;
- Commission Delegated Regulation (EU) 2016/1075;
- the European Banking Authority (EBA) 'Guidelines on the range of scenarios to be used in recovery plans'¹;
- the EBA 'Guidelines on the minimum list of qualitative and quantitative recovery plan indicators'² and
- the EBA 'Recommendation on the coverage of entities in a group recovery plan'³ and
- Commission Delegated Regulation (EU) 2019/348

...

2 Key recovery plan components and considerations

...

~~2.3 the PRA expects all firms to meet these.~~ Having reflected on its approach to recovery planning, the PRA has decided to apply simplified obligations for recovery planning ('Simplified Obligations') to firms that have been notified by their supervisor that they meet the eligibility criteria for Simplified Obligations. For these firms, the reduced recovery planning obligations apply in respect of scenarios and the information template (paragraphs 2.54 and 2.70). Additional information in relation to the approach that smaller and less complex firms should take in respect of certain aspects of recovery planning is included where relevant in this SS. ~~the degree of detail and analysis in a recovery plan should reflect the complexity and size of the firms. Firms should follow this principle in relation to all aspects of this SS.~~

~~2.4 For firms with simple business models, the PRA recognises that recovery options may be limited in number, but nevertheless expects firms to give careful thought to identifying possible options,~~

¹ Available at: www.eba.europa.eu/documents/10180/760136/EBA-GL-2014-06+Guidelines+on+Recovery+Plan+Scenarios.pdf.

² Available at: www.eba.europa.eu/documents/10180/1064487/EBA-GL-2015-02+GL+on+recovery+plan+indicators.pdf.

³ Available at: www.eba.europa.eu/documents/10180/1770344/EBA-Rec-2017-02+%28Recommendation+on+coverage+of+entities+in+group+recovery+plans%29.pdf.

including a sale of the whole business. For small firms with very simple business models, whose key prudential metrics have not changed materially year on year, the firm's governing body may decide at its annual review that the information, plans, and triggers from the previous year continue to be appropriate. Additional information in relation to the approach that smaller and simpler firms should take in respect of certain aspects of recovery planning is included where relevant in this SS. For all firms, the degree of detail and analysis in a recovery plan should reflect the complexity and size of the firms. Firms should follow this principle in relation to all aspects of this SS.

...

(i) Recovery options

...

2.6A For firms with simple business models, the PRA recognises that recovery options may be limited in number, but nevertheless expects firms to give careful thought to identifying possible options, including a sale of the whole business.

...

(iv) Scenario testing

...

2.54 The PRA expects all global systemically important institutions (G-SIIs) and other systemically important institutions (O-SIIs) to include analysis of at least four scenarios in their recovery plans. The PRA recognises that some small firms may have difficulty designing more than two relevant scenarios that are sufficiently severe to test their recovery plan, and therefore permits firms that are eligible for Simplified Obligations to include at least two scenarios in their recovery plans, as appropriate. All other firms (which are neither G-SIIs, O-SIIs nor Simplified Obligations firms) should include at least three scenarios.

...

(v) Recovery plan information template

2.70 For complex and lengthy recovery plans, the PRA expects firms to consolidate a core set of recovery plan information and data into one consistent template. This will aid, but not replace, the assessment, comparison and benchmarking of recovery plans by the PRA. Firms should ensure this core information is appropriately considered and justified in their recovery plan. Firms that are eligible for Simplified Obligations are not expected to submit the template with their recovery plan, though they ~~Firms with shorter, less complex recovery plan may find the completion of the template useful for comparing their options, but should contact their supervisor to determine whether the PRA expects the template to be submitted with their recovery plan.~~

...

(viii) Governance

...

(b) Governance associated with the production, review and sign off of the recovery plan

...

2.84A For small firms with very simple business models, whose key prudential metrics have not changed materially year on year, the firm's governing body may decide at its annual review that the information, plans, and triggers from the previous year continue to be appropriate.

...