



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Consultation Paper | CP20/20

Operational continuity in resolution: Updates to the policy

October 2020



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Consultation Paper | CP20/20

Operational continuity in resolution: Updates to the policy

October 2020

By responding to this consultation, you provide personal data to the Bank of England. This may include your name, contact details (including, if provided, details of the organisation you work for), and opinions or details offered in the response itself.

The response will be assessed to inform our work as a regulator and central bank, both in the public interest and in the exercise of our official authority. We may use your details to contact you to clarify any aspects of your response.

The consultation paper will explain if responses will be shared with other organisations (for example, the Financial Conduct Authority). If this is the case, the other organisation will also review the responses and may also contact you to clarify aspects of your response. We will retain all responses for the period that is relevant to supporting ongoing regulatory policy developments and reviews. However, all personal data will be redacted from the responses within five years of receipt. To find out more about how we deal with your personal data, your rights or to get in touch please visit bankofengland.co.uk/legal/privacy.

Information provided in response to this consultation, including personal information, may be subject to publication or disclosure to other parties in accordance with access to information regimes including under the Freedom of Information Act 2000 or data protection legislation, or as otherwise required by law or in discharge of the Bank's functions.

Please indicate if you regard all, or some of, the information you provide as confidential. If the Bank of England receives a request for disclosure of this information, we will take your indication(s) into account, but cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system on emails will not, of itself, be regarded as binding on the Bank of England.

Responses are requested by Sunday 31 January 2021.

In light of current measures to help prevent the spread of COVID-19, please address any comments or enquiries by email to: RAF_OCIR_consultations_2020@bankofengland.co.uk.

Alternatively, please address any comments or enquiries to:

The Recovery and Compensation Team
Prudential Regulation Authority
20 Moorgate
London
EC2R 6DA

Contents

1	Overview	1
2	Continuity of critical functions and core business lines	6
3	Contractual arrangements	10
4	Financial Arrangements	13
5	Proposals to support post-resolution restructuring	15
6	Management and governance arrangements	17
7	Other proposals	18
8	The PRA's statutory obligations	20

1 Overview

1.1 In this Consultation Paper (CP), the Prudential Regulation Authority (PRA) sets out its proposals to revise its operational continuity in resolution (OCIR) policy. The purpose of the proposals is to improve firms' resolvability and support the Bank of England's (the Bank) approach to resolution as set out in the Statement of Policy (SoP) 'The Bank of England's approach to assessing resolvability'.¹ The proposals would make amendments to the Operational Continuity Part of the PRA Rulebook (the Rules) (Appendix 1) and PRA OCIR expectations, and would result in a new Supervisory Statement (SS) on OCIR (Appendix 2). The new SS would supersede SS9/16 'Ensuring operational continuity in resolution'.²

1.2 The Bank and the PRA jointly published the Resolvability Assessment Framework (RAF) in July 2019.³ The RAF sets out how the Bank, as resolution authority, will assess resolvability. It also requires, through the Resolution Assessment Part of the PRA Rulebook, that the largest UK firms formally assess their preparations for resolution, submit a report of that assessment, and publish a summary of their most recent report.

1.3 The PRA committed in CP31/18 'Resolution assessment and public disclosure by firms' to reviewing its OCIR policy in light of the Bank's thinking on bail-in. The PRA is also proposing amendments to take account of firms' experience of implementing the PRA's existing OCIR policy.

1.4 This CP is relevant to PRA-authorised UK banks, building societies, PRA-designated UK investment firms currently in scope of, or likely to come into scope of, the Rules (firms). For a firm to be in scope of the Rules, it must receive critical services,⁴ and must meet one of the three thresholds set out in Operational Continuity 1.1. This is designed so that the Rules apply to all firms that pose risks to financial stability, particularly those for which the Bank has set bail-in or partial-transfer as their preferred resolution strategies. The proposals in this CP are also likely to be of interest to policymakers and practitioners involved in firms' resolution.

1.5 The proposals support the PRA's objective to promote firm safety and soundness, advanced primarily by minimising the adverse effect failure could have on financial stability. The proposals build on Fundamental Rule 8, where a firm must prepare for resolution so, if the need arises, it can be resolved in an orderly manner with minimum disruption to critical services.

1.6 The PRA considers that although an objective of the proposals is to reduce the burden of implementing OCIR policy, overall, some firms may incur some incremental costs as a direct result of the proposals, compared to costs incurred under existing policy. Further information on the PRA's judgement of incremental costs are set out in Chapter 8 of this CP.

Readers of this CP should also refer to the Bank of England's consultation 'Updates to the Bank of England's approach to assessing resolvability'.⁵

¹ July 2019: <https://www.bankofengland.co.uk/paper/2019/the-boes-approach-to-assessing-resolvability>.

² July 2016: <https://www.bankofengland.co.uk/prudential-regulation/publication/2016/ensuring-operational-continuity-in-resolution-ss>.

³ <https://www.bankofengland.co.uk/financial-stability/resolution/resolvability-assessment-framework>.

⁴ The Glossary Part of the PRA Rulebook defines critical services as 'activities, functions or services performed for one or more business units of the firm or for the firm and another member of its group, whether by the firm itself, any other group member or a person outside the firm's group, the failure of which would lead to the collapse of or present a serious impediment to the performance of the firm's critical function'.

⁵ October 2020: <https://www.bankofengland.co.uk/paper/2020/updates-to-the-boes-approach-to-assessing-resolvability>.

Background

1.7 The ability to 'continue to do business through resolution and restructuring' is one of the three outcomes that the Bank considers necessary to support resolution as set out in the SoP 'The Bank of England's approach to assessing resolvability'. Firms must achieve this 'RAF continuity outcome' to be considered resolvable. The OCIR policy supports the RAF continuity outcome by ensuring that a firm's operational arrangements facilitate orderly resolution and post-resolution restructuring, as well as recovery actions.

1.8 The SoP 'The Bank of England's approach to assessing resolvability' states that 'the surest way to deliver continuity in resolution is for most or all functions to continue through the 'resolution weekend'⁶ and the bail-in period, and for there to be continuity to allow post-resolution restructuring. In addition to critical functions, other business lines may need to continue to support the franchise and future viability'.

1.9 The existing OCIR policy was published in 2016 and is currently focused on the continuity of critical functions and the critical services that support them. The proposals in this CP are made in light of the Bank's judgement that other business lines may need to continue to support the franchise and the future viability of the firm, both through the immediate post-resolution stabilisation phase (three to six months) and through any subsequent restructuring phase.

1.10 Keeping most business lines going through the stabilisation phase should allow the firm to continue providing the key activities it performs for the UK economy while plans to reorganise the firm are being developed. Throughout resolution, and related restructuring, a firm needs to be able to carry out its core business in order to generate revenue so that it is not disrupted through, for example, customer attrition, or ultimately loss of confidence.

Summary of Proposals

1.11 Firms have already implemented the PRA's existing OCIR requirements, and the proposals in this CP seek to build on the work firms have already undertaken. The PRA proposes to update that policy in four main ways:

- The proposals in this CP would require firms to consider the operational arrangements that support the viability of the firm, and its key drivers of revenue and profit in addition to those supporting its critical functions. This acknowledges that the process of resolution could take 3 to 6 months to execute and that implementation of a post-resolution restructuring plan is likely to extend beyond the point at which the firm has exited from resolution.⁷ The firm needs to be able to continue to operate throughout this process.
- The PRA is proposing changes to its policy regarding the way firms' financial arrangements facilitate operational continuity. In the existing OCIR policy, the expectation for firms to hold resources is calibrated to ensure that firms remain financially resilient despite the failure or resolution of other group entities. This proposal acknowledges that, since much of the firm will continue during resolution, firms would only need to cover situations in which financial resources would be available within the group, but might not be accessible in a timely manner. Firms would need to know how much financial resources they would need, and when and

⁶ The 'resolution weekend' as described in page 60 of the SoP 'The Bank of England's approach to assessing resolvability' begins at the point that the authorities determine that the firm has met the conditions for resolution and that the relevant resolution entity will be placed into resolution. The phase ends the next business day when relevant markets open.

⁷ Described in paragraph 1.19 of the SoP 'The Bank of England's Approach to Assessing Resolvability'.

where those financial resources would be needed during resolution. They would also be expected to consider what might prevent such resources from being available in resolution.

- Firms should be capable of ensuring continuity while being restructured following resolution. The PRA has proposed a number of changes to provide greater clarity compared with the existing policy, as well as amendments to the policy requirements that facilitate continuity throughout post-resolution restructuring. This includes amendments to the change capabilities needed to support transitional service arrangements and the need for predictable and transparent charging structures.
- As the proportion of operational arrangements for which operational continuity must be ensured is likely to increase, the PRA has considered how it may be possible to reduce the burden on firms of implementing OCIR policy without compromising a firm's safety and soundness, or its ability to be resolved in an orderly manner. The PRA's proposals take account of the differences between arrangements that occur within individual legal entities, within a banking group, or with third parties, based on the risks that each poses to operational continuity in resolution. In this way, the PRA's proposals are consistent with a proportionate approach, because there are reduced requirements for arrangements that pose less risks. For example, where appropriate, the requirements are reduced for some arrangements that occur within legal entities and within a banking group.

Structure of the CP

1.12 The structure of the CP is as follows:

- Chapter 2 sets out proposals regarding the way firms should organise their operational arrangements to facilitate continuity of their critical functions and core business lines during resolution and restructuring. It also explains how the proposed terminology in this CP interacts with the concept of important business services proposed in CP29/19 'Operational resilience: Impact tolerances for important business services'.⁸
- Chapter 3 sets out proposals to amend existing requirements and expectations regarding firms' contractual arrangements supporting continuity during the stabilisation phase and the restructuring phase of resolution. It covers proposals regarding resolution-resilient contracts and prevention of preferential treatment.
- Chapter 4 sets out proposals relating to firms' financial arrangements and how they would support firms' critical and essential service providers in resolution and during restructuring.
- Chapter 5 sets out proposals relating to firms' ability to continue during the period of post-resolution restructuring, including proposals on arrangements to support continuity in restructuring, and predictable and transparent charging structures.
- Chapter 6 sets out proposals relating to management and governance.
- Chapter 7 sets out proposals for waivers and/or modifications for firms newly coming into scope of OCIR due to significant corporate restructuring, as well as other clarifications and amendments.

⁸ December 2019: <https://www.bankofengland.co.uk/prudential-regulation/publication/2018/building-the-uk-financial-sectors-operational-resilience-discussion-paper>.

- Chapter 8 sets out how the PRA is meeting its statutory obligations in respect of policy making.

Implementation

1.13 The PRA proposes that the changes resulting from this CP would take effect from Saturday 1 January 2022.

1.14 The PRA intends to publish its final policy relating to OCIR in H1 2021. Many firms' existing OCIR arrangements may already be consistent with some of these proposals. The PRA would therefore expect that firms would be able to leverage their existing OCIR arrangements when considering the extent to which further work may be necessary ahead of Saturday 1 January 2022.

1.15 Firms in scope of the Resolution Assessment Part of the PRA Rulebook should also refer to CP19/20 'Resolution assessments: Amendments to reporting and disclosure dates' for further information on the interaction between the proposals in this CP and resolution assessments as required under Resolution Assessment 2.1.⁹

Responses and next steps

1.16 This consultation closes on Sunday 31 January 2021. The PRA invites feedback on the proposals set out in this consultation. Responses to this CP, CP19/20 and the Bank's CP 'Updates to the Bank of England's approach to assessing resolvability' may be included in a single response to RAF_OCIR_consultations_2020@bankofengland.co.uk.

1.17 Further changes may be needed to the PRA's OCIR policy as a result of future policy development. In particular:

- The proposals in this CP and draft SS take into account the proposals in CP29/19 and CP30/19 'Outsourcing and third party risk management'.¹⁰ However, these proposals have not been finalised at the time of publication of this CP and could undergo changes due to consultation feedback. The PRA will consider feedback received regarding CP29/19 and CP30/19, and will consider whether any further changes to the proposals in this CP are required and whether they should be subject to further consultation.
- The draft amended Rules (Appendix 2) and draft SS (Appendix 1) reference the term 'resolution group', which has been defined in line with the text of the draft statutory instrument (SI) 'The Bank Recovery and Resolution (Amendment) (EU Exit) Regulations 2020'.¹¹ At the time of publication of this CP, the draft SI has been laid before Parliament and is subject to parliamentary approval. To the extent the term 'resolution group' will, in the future, be enshrined in UK legislation, the PRA may consider whether it is appropriate for the term to be employed elsewhere in resolution-related PRA policies, including elsewhere in OCIR policy.
- The PRA is committed to reviewing its ring-fencing rules by 1 January 2024.¹² As set out in 'The Bank of England's approach to setting a minimum requirement for own funds and eligible

⁹ October 2020: <https://www.bankofengland.co.uk/prudential-regulation/publication/2020/resolution-assessments-reporting-and-disclosure-dates>.

¹⁰ December 2019: <https://www.bankofengland.co.uk/prudential-regulation/publication/2019/outsourcing-and-third-party-risk-management>.

¹¹ Available at <https://www.legislation.gov.uk/ukdsi/2020/9780348213676/introduction>. The draft SI would amend section 3(1) of the BA 2009 to add this definition (among others).

¹² Section 142J of the Financial Services (Banking Reform) Act.

liabilities (MREL)',¹³ the Bank will also review the calibration of the MREL, and the final compliance date, prior to setting end-state MREs. The PRA will consult on further changes to OCIR policy relating to these reviews, if required.

- The PRA is also intending to consult on updates to PRA109 'Operational continuity',¹⁴ the template used to collect data in connection with the existing OCIR financial resilience policy. Any proposals relating to changes to PRA109 would reflect the finalised proposals in this CP.

1.18 This consultation closes after the end of the transition period set out in the EU (Withdrawal Agreement) Act 2020. The proposals set out in this CP have therefore been designed for the context that the UK is no longer bound by EU 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 after the end of the transition period, including those arising once any new arrangements with the European Union take effect.

1.19 At the end of the transition period, EU Regulations, EU Binding Technical Standards (EU BTS) and UK regulations and regulator rules implementing EU Directives will become 'retained EU Law' through the action of the EU (Withdrawal) Act 2018. They will be acted upon by the EU Exit Instruments made by HMG and the UK Financial Services Regulators in order for the 'retained EU law' to be operational in a UK only context. Unless stated otherwise, all references to regulations, technical standards and rules should be read as to the UK versions.

1.20 The draft SS attached to this CP should be read in conjunction with SS1/19 'Non-binding PRA materials: The PRA's approach after the UK's withdrawal from the EU'.¹⁵

¹³ June 2018: <https://www.bankofengland.co.uk/paper/2018/boes-approach-to-setting-mrel-2018>.

¹⁴ Available at: <https://www.bankofengland.co.uk/prudential-regulation/regulatory-reporting/regulatory-reporting-banking-sector/banks-building-societies-and-investment-firms>.

¹⁵ April 2019: <https://www.bankofengland.co.uk/prudential-regulation/publication/2019/non-binding-pra-materials-the-pras-approach-after-the-uks-withdrawal-from-the-eu-ss>.

2 Continuity of critical functions and core business lines

2.1 This chapter sets out the PRA's proposals on firms' organisation of their operational arrangements to facilitate continuity of critical functions and core business lines during recovery, resolution, and restructuring. A 'core business line' is a business line and its associated services which represent material sources of revenue, profit, or franchise value for an institution or for a group of which an institution forms part.¹⁶ The concept of a 'core business line' has been introduced in both SS9/17 'Recovery planning'¹⁷ and SS19/13 'Resolution planning',¹⁸ in line with the definition contained in the Bank Recovery and Resolution Directive (BRRD).¹⁹ Leveraging on an existing concept should reduce complexity for firms, as the PRA expects that firms should have identified their core business lines for the purposes of both recovery planning and resolution planning.

2.2 The PRA proposes to update its OCIR policy to provide for the continuity of most of a firm's business lines during the stabilisation phase of resolution, and during post-resolution restructuring. Ensuring the continuity of a firm's core business lines would support the franchise value of the firm and its viability during resolution, as well as contribute to post-resolution restructuring to return the firm to long-term viability.

2.3 To ensure the continuity of a firm's core business lines, the PRA proposes to apply the existing OCIR concepts that apply to a firm's critical services, as amended through the proposals set out in the draft SS, to those services that are necessary to ensure the continuity of core business lines during a resolution. Those services would be defined as a firm's 'essential services'. This CP sets out the PRA's proposed amendments to the Rules and the draft SS to incorporate the concepts of core business lines and essential services into the OCIR policy.

2.4 The remainder of this chapter sets out the PRA's proposals relating to the way firms organise their service provision models and identify their critical and essential services to ensure continuity of their critical functions and core business lines.

Essential services

2.5 The PRA proposes that firms would apply the requirements in the draft Rules and the proposed expectations in the draft SS to the essential services supporting their core business lines, in addition to critical services supporting firms' critical functions. The PRA proposes to define the term 'essential services' as those services which, if they were to fail, would lead to the collapse of, or present a serious impediment to, the performance of the firm's core business lines. The PRA considers that this approach is more proportionate than a firm applying OCIR requirements across all of their services.

2.6 Box A below explains how the proposed terminology in this CP interacts with the concept of important business services proposed in CP29/19 'Operational resilience: Impact tolerances for important business services'.

¹⁶ Commission Delegated Regulation 2016/778; Article 7(1): <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016R0778&from=EN>.

¹⁷ July 2020: <https://www.bankofengland.co.uk/prudential-regulation/publication/2017/recovery-planning-ss>.

¹⁸ June 2018: <https://www.bankofengland.co.uk/prudential-regulation/publication/2013/resolution-planning-ss>.

¹⁹ Article 1(36) of the BRRD: <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32014L0059&from=EN#d1e1165-190-1>.

Box A - Interaction between critical functions, core business lines, and important business services

To permit effective supervision and governance, firms should be able to clearly articulate the functions they perform that may make them systemic (critical functions), the key drivers of their business (core business lines), and the services they provide that would have a significant impact should they experience operational disruption (important business services).

Critical functions

Critical functions and core business lines are terms that are defined in legislation.²⁰ They aim to capture the legal entities and business units (and the activities, services, or operations within them) that need to continue during stress and resolution. Recovery and resolution policies require them to be identified so that contracts will be honoured, staff employed, legal entities maintained, and so that critical parts of the business will maintain access to operational assets. The PRA therefore focuses its OCIR policy on the continuity of critical functions and core business lines.

Firms should identify critical functions with reference to the economic functions listed in SS19/13, Phase 1, Part B. They should consider whether their contribution to the function within the UK economy, due to size or market share, makes their activity a critical function. They should have particular regard to the substitutability of their activities within the function concerned and their interconnectedness. A lack of substitutability makes it more likely that the firm is performing a critical function. Interconnectedness indicates levels of contagion risk.

Firms should identify core business lines in a way that makes sense for their business model and corporate structure. The identification of core businesses lines should follow the internal organisation of a firm and may consider some quantitative indicators.²¹ While profitability may be a key consideration, it does not need to be – maintaining franchise value may also be a determinant of a core business line.

Figure 1: Critical functions

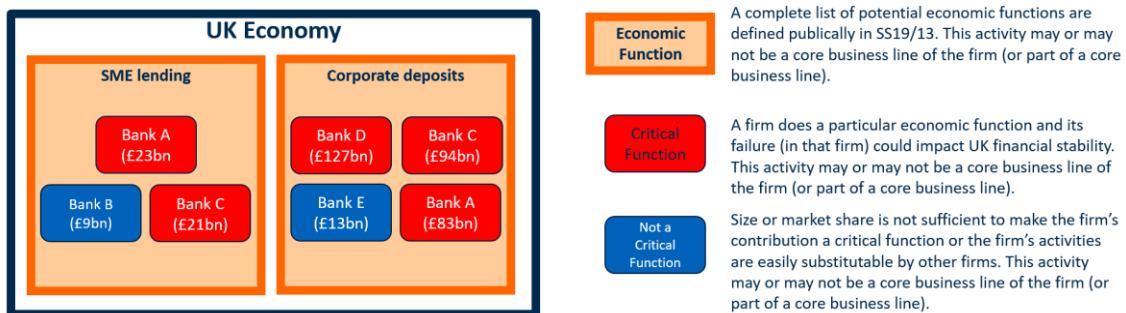


Figure 1 shows banks contributing to the delivery of two economic functions, SME lending and corporate deposits. Within this illustrative example, banks may be identified as providing a critical function, such as Bank A and Bank C providing SME lending. Bank B in this example does not contribute a significant market share (£9 billion), and so is not identified as providing a critical function. Bank A, B, or C may or may not identify this as their core business line (or part of a wider core business line). These figures are for illustrative purposes only, to demonstrate how market share might determine critical functions. Additional factors other than market share are relevant to determining critical functions.

²⁰ Critical functions has the meaning of section 3(1) and (2) of the Banking Act 2009. Core business lines is defined in Article 2(1)(35) of the BRRD: <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32014L0059&from=EN#d1e1165-190-1>.

²¹ EBA Technical advice on the delegated acts on critical functions and core business lines, EBA/Op/2015/05, 6 March 2015.

Important Business Services

The PRA's proposed operational resilience policy is designed to ensure firms focus on the consequences of operational disruption.²² It therefore requires identification of the specific important business services that are delivered to another person. Such an approach requires a granular understanding of the operational resources that deliver the service. A business service is 'important' if its disruption could pose a risk to the firm's safety and soundness or financial stability (for Capital Requirements Regulation firms, rather than Solvency II firms).

Figure 2: Important business services



As set out in paragraph 2.2 of CP29/19, a 'business service' is a service that a firm provides to an external end user. Business services deliver a specific outcome or service to an identifiable user and should be distinguished from business lines, such as mortgages, which are a collection of services and activities. Examples may include a bank's payments services, an investment bank's ability to provide currency hedging services, or a building society's disbursement of mortgages. They will vary from firm to firm.

The PRA has proposed in CP29/19 that firms would analyse the chain of activities which make up the important business service, from taking on an obligation to delivery of the service, and determine which part of the chain is important to delivery. This would vary by business service. Sometimes the chain will be long, and certain early stages, for example when an obligation is accepted, may not be important to the final delivery of a service. In other cases, the process of delivering a service may be more integrated, and origination may be a key part of this. Those parts which are identified as important are where firms should focus their operational resilience efforts, by investing in back-up systems for example.

It is likely that a firm's important business services will be a part of a firm's critical functions or core business lines. The PRA therefore would expect firms to have a coherent narrative between what is 'critical' or 'core' for OCIR and what is 'important' for important business services. Work done to map and understand the interconnectivity of functions, business lines, and services should be leveraged to meet the requirements of both OCIR and operational resilience policies.

Hosted firms

2.7 A 'hosted firm' is a firm for which the Bank is not the home resolution authority, or a firm that belongs to a group for which the Bank is not the resolution authority. The Rules apply equally to PRA-authorized UK banks, building societies, and PRA-designated UK investment firms that meet one of the three quantitative thresholds in Operational Continuity 1.1, and are in receipt of critical services. This is regardless of whether the Bank is a firm's home resolution authority (home firms) or is a firm's host resolution authority.

2.8 The PRA proposes that hosted firms should identify their essential services in relation to the core business lines of the firm's wider group only. This is because these are the services that need to

²² December 2019: <https://www.bankofengland.co.uk/prudential-regulation/publication/2018/building-the-uk-financial-sectors-operational-resilience-discussion-paper>.

be available to support the execution of its group resolution strategy. The PRA also proposes that a hosted firm may be able to meet some of the detailed expectations in the draft SS by relying on its group-wide capabilities. As set out in the SoP 'The Bank of England's approach to assessing resolvability', the Bank's assessment of firms' resolvability will also take into account the capabilities of the entire resolution group where relevant.

2.9 Chapter 2 in the draft SS sets out the PRA's proposed expectations for hosted firms.

Service provision models for critical and essential services

2.10 Chapter 2 in SS9/16 describes the different ways a firm can organise the critical services it receives. The chapter provides context for the expectations set out in SS9/16, which in some cases vary by type of service provision model.

2.11 The PRA proposes to provide more detail regarding the different service provision models to distinguish further between services received from another entity within a firm's own group (intra-group) and services provided from business units within the firm itself to another (intra-entity). The proposed descriptions are set out in paragraph 2.9 of the draft SS. This proposal would acknowledge that arrangements that occur between legal entities within the same banking group, and between business units within the same individual legal entity, can pose different risks to operational continuity in resolution. The revised descriptions are used throughout the draft SS, and would enable the PRA to tailor its expectations based on the risks presented by intra-group, intra-entity, and non-group provider service provision models.

Demonstrating effective operational arrangements to facilitate recovery and resolution

2.12 Paragraph 3.1 of SS9/16 sets out that the Rules require a firm to ensure its operational structure facilitates effective recovery and resolution planning, and to be able to demonstrate how its operational arrangements supporting critical services facilitate recovery and resolution.

2.13 As well as extending the requirement to cover essential services, the PRA proposes to clarify the existing expectation of reasonable time by referring to the stylised resolution timeline as published in the SoP 'The Bank of England's approach to assessing resolvability', in order to align the draft SS with the Bank's intended process for resolution.

Identifying and documenting critical and essential services

2.14 Chapter 3 paragraph 3.4 of SS9/16 sets out the PRA's expectation that firms would undertake comprehensive mapping, from providers to recipient, of critical services and critical functions to provide greater clarity of what critical services need to be maintained in resolution. Firms are expected to include information such as services descriptions and identification of legal entities that provide and/or receive them, jurisdiction of each party, the service delivery model used, the ownership of assets, the infrastructure used, pricing, and contractual arrangements. These expectations are referred to as a firm's OCIR map.

2.15 The PRA proposes to introduce a new rule in the Operational Continuity Part that would require a firm to identify and document its critical and essential services. This acknowledges the importance of mapping in supporting a firm's understanding of the services it requires to deliver both its critical functions and core business lines, and the interdependencies between them.

2.16 The PRA proposes to introduce a new chapter in the draft SS that would set out the PRA's expectations regarding the identification and documentation of a firm's critical and essential

services, and would replace paragraph 3.4 of SS9/16. Cumulatively, the proposals relating to a firm's identification and documentation are designed to support a firm's continuity through both the stabilisation phase and the restructuring phase of resolution.

2.17 The PRA considers that firms would be able to consider how any mapping tools and capabilities they may develop as a result of these proposals, and the proposals in CP29/19 and CP30/19, as well as mapping already undertaken to support compliance with existing OCIR policy, could be used to meet both the proposed OCIR identification and documentation requirements as well as other PRA policies.

3 Contractual arrangements

3.1 This chapter sets out the PRA's proposals regarding a firm's contractual arrangements supporting recovery, resolution, and restructuring. If contractual arrangements can be terminated on the basis of entry into stress or resolution of the firm or other group entities, it could jeopardise the continuity of service provision in resolution. The PRA considers that the design of a firm's contractual arrangements will be important in ensuring that a service can be provided even as it is being changed during any restructuring related to resolution.

Resolution-resilient contracts

3.2 Operational Continuity 3.2 requires firms to ensure that agreements governing the provision of services contain clauses that allow for the continued use of services in stress and resolution. These clauses prevent disorderly termination of contracts with the firm upon entry into resolution, provided the firm continues to honour its payment obligations.

3.3 In undertaking the review of its OCIR policy, the PRA considered proportionality and where it would be possible to reduce the burden on firms without compromising a firm's safety and soundness, or its ability to be resolved in an orderly manner. In particular, the PRA has considered whether section 48Z of the Banking Act 2009 could be relied on to achieve continued use of services in stress or resolution for specific types of contractual agreements.

3.4 To effect this, the PRA proposes to introduce the concept of 'excluded agreement'. Firms would not be required to apply the proposed requirements to excluded agreements. This is because section 48Z of the Banking Act 2009, which transposes Article 68 of the BRRD, provides that a resolution action (or pre-resolution action) by the Bank, the PRA, or the Financial Conduct Authority cannot give rise to a counterparty's right to terminate a contract with a UK credit institution or investment firm, or to exercise rights over collateral (the general stay).

3.5 The PRA's proposed definition for excluded agreement has been informed by its consideration of the circumstances where the Bank, as resolution authority, would have the most certainty that section 48Z could appropriately be relied on when executing a resolution, namely where contracts are governed by the laws of any part of the UK, where the parties are also incorporated in the UK and are part of the same resolution group.

3.6 The proposed requirements would therefore apply to contracts that are not excluded agreements to ensure the continued use of services in stress or resolution. In a resolution scenario, the actions of the relevant counterparties in respect of the proposed definition of excluded agreement are likely to be within scope of the powers of the resolution authority. As such, there is a diminished likelihood of the firm and/or the resolution authority being required to enforce their rights under section 48Z to ensure continuity of critical services to support a resolution action.

3.7 In other resolution scenarios involving counterparties out of the scope of its proposed definition, the PRA considers that there is a risk that such action might be required, with commensurate potential disruption to a firm's critical and essential services. With this in mind, the PRA considers that it would be appropriate to limit the proposed definition of excluded agreements.

3.8 The PRA also proposes to introduce a new, separate definition of 'excluded persons' in order to exclude the contracts firms enter into with certain financial market infrastructures (FMI) from the proposed requirements in Operational Continuity 3.2. The intent of the proposed definition is that firms would not be required to apply the requirements to contracts with FMIs (whether these are

accessed directly or indirectly) that are also in scope of the Bank's SoP on 'Continuity of Access to Financial Market Infrastructures' (CoA to FMIs SoP).²³ The PRA considers that this exemption is compatible with FMI membership criteria.

3.9 The PRA proposes that firms would also be expected to consider whether there are any aspects of their arrangements for service provision that would prevent continued use of services (paragraph 6.2 of the draft SS). Firms would be expected to be prepared to take further steps as necessary to ensure their contractual arrangements remain robust during resolution and post-resolution restructuring.

Prevention of preferential treatment

3.10 Operational Continuity 3.1 and 4.3 require that, upon financial deterioration of a group member, the group provider continues to provide critical services in accordance with agreements governing critical services. Chapter 12 of SS9/16 elaborates further on how a firm is expected to meet the requirements set out in these rules.

3.11 The PRA proposes that most of the preferential treatment expectations in the draft SS would also apply to a firm's essential services, in addition to its critical services (with the exception of paragraph 12.2 of SS9/16, which sets out the PRA's expectation that firms ensure that organisational structures and agreements do not require the group provider to prioritise its resources to support certain group entities over the firm). This would ensure that a firm would continue to receive the group critical and essential services necessary for continuing its business during resolution and restructuring. Because much of the firm is expected to carry on in resolution, group providers would be expected to continue to treat a firm in resolution in accordance with existing agreements and documentations. The PRA therefore proposes to delete paragraph 12.2 of SS9/16.

²³ Available at 'The Bank of England's Approach to Assessing Resolvability. July 2019: <https://www.bankofengland.co.uk/paper/2019/the-boes-approach-to-assessing-resolvability>.

4 Financial Arrangements

4.1 The proposals in this CP acknowledge that much of a firm will continue during resolution. This contrasts with the existing OCIR policy, which anticipates critical service providers remaining financially resilient despite the failure or resolution of other group entities.

4.2 The PRA proposes that firms' financial arrangements facilitate operational continuity. The term 'financial arrangements' is different from the term 'financial resilience' because it covers payments to service providers in addition to the financial resilience of service providers. Firms would need to consider and mitigate two key financial risks that could undermine operational continuity:

- cases in which firms would be unable to meet payment obligations to service providers in the resolution and related restructuring; and
- cases in which financial resources, that are otherwise available within the group, would not be available in a timely manner for a group service provider, due to 'internal frictions', whereby financial resources that are available within the firm's group cannot be accessed by a critical or essential service provider in a sufficiently timely manner.

4.3 The proposals aim to achieve this outcome in three ways:

- a general requirement for firms to ensure their financial arrangements support continuity during resolution and restructuring;
- a specific expectation that firms monitor risks and maintain early warning indicators, as well as undertake scenario analysis, so they understand risks to the financial resilience of their critical and essential service providers; and
- a specific expectation that intra-group service providers maintain resources of a minimum of 1/6th of the annual fixed overheads of critical and essential services provision for use in resolution. This should enable these service providers to meet their liquidity needs during the maximum two-month period following resolution during which a firm would be expected to prepare a business reorganisation plan.

Financial arrangements to support continuity during resolution and restructuring

4.4 Chapter 5 of SS9/16 states a firm is expected to ensure that critical services providers have sufficient financial resources to allow continuity of provision of critical services to receiving entities during stress or resolution, and after resolution, as part of the post-resolution restructuring of any group entities.

4.5 The PRA proposes that a firm ensures its financial arrangements support the continuity of their critical and essential services during resolution and restructuring (draft Rule 2.3).

4.6 The draft SS sets out the PRA's proposed expectation that firms should ensure they can meet their payment obligations for their critical or essential services, and that intra-group critical or essential service providers would remain financially resilient during resolution and related restructuring.

4.7 The PRA proposes that firms should identify how the two key risks described above apply to their arrangements and, if needed, take remedial action to address the risks they have identified

(paragraph 11.1 of the draft SS). The PRA would expect that firms undertake scenario analysis to enable them to do this, and should be prepared to share the outputs of their scenario analysis with the PRA to demonstrate they are meeting the requirements in the draft Rule.

4.8 The PRA proposes that firms should monitor and maintain early warning indicators of risks related to the financial resilience of their critical and essential service providers in resolution. This should enable a firm to anticipate and act in a timely manner to address any financial risks that might prevent the continuity of its critical and essential services.

Financial resources for intra-group service providers

4.9 Firms are expected under the existing OCIR policy to ensure that a group critical services provider has liquidity resources equivalent to at least 50% of annual fixed overheads of the critical services provided by the critical service provider, to ensure those services continue regardless of the failure or resolution of any group entities.

4.10 The PRA proposes to recalibrate the financial resources expectation to cover a minimum of 1/6th of the annual fixed overheads of its intra-group critical and essential service providers for use in resolution. This should enable a firm's critical and essential services to continue during the maximum time of two months immediately following a resolution during which a firm would be expected to prepare a business reorganisation plan.

4.11 The draft SS sets out the PRA's proposal that firms should ensure that their group service providers maintain ownership of the financial resources related to the annual fixed overheads of their own critical and essential service provisions costs, for use in resolution. The financial resilience expectation in SS9/16 does not specify the ownership of a firm's financial resources, but emphasises their segregation from other group liquid assets. The PRA now considers that the best way to prevent instances where liquid assets may not be immediately available to group service providers in resolution is to ensure that the liquid assets are owned by, and readily accessible by, the entity that needs them in resolution.

4.12 In addition, the PRA proposes that the minimum financial resources expectation described in paragraph 4.10 above would not apply to services provided between business units within the same legal entities, because internal frictions are less likely to prevent resources being available to these types of service providers.

4.13 The PRA anticipates the outcome of these proposals to be that most group service providers would be expected to hold smaller amounts of OCIR financial resources compared to expectations under SS9/16.

4.14 The PRA additionally proposes to clarify how the proposed financial resilience expectation would apply to ring-fenced bodies (RFBs). Firms are currently expected to segregate their OCIR financial resources to ensure they are available to critical service providers in the event of the failure or resolution of another group entity, which may involve holding liquid assets outside the group in a third party. Rule 9.2 of the Ring-Fenced Bodies Part of the PRA Rulebook requires that services from other group entities and third parties that are needed by the RFB to carry out its core activities should not be capable of being disrupted by other group members. The PRA proposes that the OCIR financial resources maintained by an intra-group critical or essential service provider which is part of a group containing an RFB should not be held with any entity within the non-ring-fenced part of a group. This is because arrangements of this type would not be compatible with ring-fencing requirements.

5 Proposals to support continuity through changes to service provision

5.1 This chapter sets out the PRA's proposals to ensure that firms would be capable of maintaining continuity while being restructured either in recovery or following resolution.

5.2 The proposals, compared with the existing policy, are predominantly driven by the need for a firm's essential services to continue, in addition to its critical services, during the restructuring phase. In restructuring, the continuity of both the critical services and essential services that support both their critical functions and core business lines needs to be ensured. As such firms should be able to put in place transitional service arrangements (TSAs) for both their critical as well as essential services, if and when needed in restructuring.

5.3 The proposals also aim to more explicitly link firms' ability to ensure continuity during changes to its service provision and put in place TSAs, with the need for firms to be able to plan and execute restructuring effectively and on a timely basis. This is set out in 'The Bank of England's Statement of Policy on Restructuring Planning',²⁴ which was published after SS9/16. The Bank must be confident that resolution and restructuring would not cause significant operational disruption to a firm, and that there is a reasonable prospect of returning a firm to long-term viability, before it can use the bail-in tool.²⁵

Supporting continuity through changes to service provision

5.4 Operational Continuity 3.1 requires a firm to document details of the critical services received from one of its business units. Paragraph 8.4 of SS9/16 sets out that firms, irrespective of their service provision model, are expected to document the details of the critical services, and that this information should form the basis of TSAs to facilitate the services being easily identified and transferable to another provider in resolution without interruption.

5.5 The PRA proposes to modify the existing requirement under Operational Continuity 3.1 to include the transitional arrangements capability for all types of service provision models, rather than only the services a firm receives from one its business units. The capability would apply to intra-entity, intra-group, or third-party critical or essential services that do not meet the definition of 'outsourcing' in the PRA Rulebook (for example, a firm's hardware or software).

5.6 There is no expectation in SS9/16 that firms should have the capability to implement TSAs regardless of the specificities of a restructuring plan. The PRA proposes that firms would be expected to ensure continuity irrespective of the various scenarios they may encounter during restructuring. The draft SS includes a new Chapter 5, 'Ensuring continuity during changes to service provision', explaining that the successful implementation of a TSA should be supported at minimum by information about interdependencies among firms and service providers, objective service level agreements, charging structures, and management and governance arrangements.

5.7 The PRA considers that, for those contracts that involve critical or essential services provided via a direct relationship with an FMI that is also in scope of the Bank's CoA to FMIs SoP, firms may be able to leverage their contingency planning under the CoA to FMIs SoP to meet the expectation that a firm is able to develop and implement TSAs in resolution and related restructuring.

²⁴ Paragraph 3.1 of bank-of-england-restructuring-planning-sop.pdf, available at <https://www.bankofengland.co.uk/paper/2019/the-boes-approach-to-assessing-resolvability>.

²⁵ Paragraph 11(b) of Annex 1 of the policy statement, available at <https://www.bankofengland.co.uk/paper/2019/the-boes-approach-to-assessing-resolvability>.

Predictable and transparent charging structures

5.8 Operational Continuity 3.3 requires firms to ensure the charging structures for the critical services they receive are predictable, transparent, and set on arm's-length terms. Appropriate charging structures ensure that firms' critical services are capable of being continued or replaced during resolution and restructuring.

5.9 The PRA proposes to amend the requirement for charging structures to be set on arm's-length terms for certain service provision models. Arm's-length charging structures contribute to continuity during restructuring because they facilitate the transfer of services to another party. In the case of intra-entity service provision, in line with paragraph 1.11 the PRA considers that it would be proportionate to remove the requirement for charging structures related to intra-entity services to be set on arm's-length terms. Contracts with another party would continue to need to be set on arm's-length terms.

5.10 The expectation that charging structures should be predictable and transparent would be maintained regardless of the type of service provision models.

6 Management and governance arrangements

6.1 As there may be a period of heightened uncertainty immediately following resolution, the PRA considers that effective management and governance arrangements are necessary so that a firm can continue to do business during resolution.

6.2 Firms are already expected under Chapter 11 of SS9/16 to ensure that the critical services providers within the group should have their own governance and management structure to ensure continuation of services. Providers should have in place senior management responsible for day-to-day running of the services, who can ensure services can continue in resolution, and who are mainly remunerated and employed by the service provider. The PRA proposes to extend this expectation to cover essential service providers.

6.3 The PRA proposes to incorporate the example regarding firms' change capabilities, previously found in Chapter 6 of SS9/16, with the proposed management and governance chapter in the draft SS as set out below. Paragraph 12.2 of the draft SS also acknowledges that firms may be able to leverage arrangements developed for the Bank's MGC SoP to ensure availability of key staff.

6.4 The PRA also proposes to clarify that the responsibility for implementing and maintaining OCIR within a firm should be clear and explicit. Paragraph 12.4 of the draft SS sets out examples of how a firm might meet this proposed expectation. For example, where it exists, the Chief Operations role Senior Management Function 24 could hold overall responsibility for implementing OCIR policy.

7 Other proposals

Approach to waivers and/or modifications

7.1 The existing OCIR policy does not provide an implementation period for firms coming into scope of the Rules. The Rules apply to PRA-authorized UK banks, building societies, and PRA-designated UK investment firms that receive critical services and fulfil one of three financial conditions set out in Operational Continuity 1.1 on 1 January of any given year.

7.2 The PRA recognises that there may be circumstances where a firm may seek to alter the date of application of the Rules. This could be due to circumstances that may otherwise bring a firm into scope of the Rules immediately. This could occur, for example, as a result of a merger or acquisition that brings a firm above quantitative thresholds, or when a function it performs is judged to be a critical function for the first time.

7.3 The PRA has discretionary power to waive or modify its rules under section 138A of FSMA, where the application of rules would be unduly burdensome or would not achieve the purpose for which they are made, as long the advancement of the PRA's objectives is not adversely affected. In such situations, as described in paragraph 13.3 of the draft SS, the PRA would consider whether to grant a waiver or modification on a case-by-case basis.

Other clarifications and amendments

7.4 Firms frequently ask about the interaction between OCIR and other policies. Chapter 1 of the draft SS sets out the PRA's proposed expectations for the relationship between OCIR and other relevant PRA requirements and expectations.

Operational Resilience and OCIR

7.5 SS9/16 contains a chapter titled 'Operational resilience'. This chapter sets out the PRA's expectation that firms should ensure services will remain operational despite the failure of any group entities. Examples of how a firm might achieve this expectation are also provided, namely by:

- ensuring that the critical services provider has change capabilities and operational contingency arrangements;
- demonstrating that operational resilience is not affected by the loss of key business clusters or entities post-resolution; and
- ensuring the critical services provider has sufficient staff and expertise dedicated to the critical services provision to carry out post-restructuring activity if necessary.

7.6 Since SS9/16 was published, the PRA has published CP29/19. In undertaking the review of existing OCIR policy, the PRA has considered how the operational resilience expectation contained in SS9/16 aligns with the proposed operational resilience policy in CP29/19.

7.7 In light of the new proposals in CP29/19, the PRA has not included a separate operational resilience chapter in the draft SS. This is because the PRA considers that the proposals contained in CP29/19, if implemented, would also support the operational continuity of a firm's critical and essential services during resolution and any post-resolution restructuring. The remaining examples have been incorporated into a new chapter on management and governance in the draft SS.

7.8 The proposals in this CP acknowledge that much of the firm will continue in resolution. The general expectation set out in paragraph 6.1 of SS9/16 has been removed from the draft SS, along with the example that firms could demonstrate that operational resilience is not affected by the loss of key business clusters or entities post-resolution.

7.9 The proposals in CP29/19 have not yet been fully consulted on or published as final policy. Where firms are already considering how to implement the proposals in this CP and in CP29/19, the PRA considers that firms should look for synergies between them. In particular, firms should be able to clearly articulate the financial drivers of their business, the functions they perform that may make them systemic, and the services they provide that would have a significant impact on financial stability or their safety and soundness should they experience operational disruption. The PRA intends for it to be possible for firms to leverage work done to identify, document, and understand the interconnectivity of functions and services to meet the proposed requirements of both draft policies.

Other clarifications and amendments

7.10 Chapter 4 of SS9/16 sets out the PRA's expectation that firms refer to the rules in the Outsourcing Part of the PRA Rulebook when considering their operational arrangements supporting critical services. Since SS9/16 was published, the Markets in Financial Instruments Directive 2014/65/EU (MIFID II) has come into force, and in December 2019 the PRA published CP30/19 'Outsourcing and third party risk management'. The PRA proposes to update references to requirements and expectations on outsourcing and third party risk management, and to consolidate Chapter 4 of SS9/16 'Scope of outsourcing' into Chapter 1 of the draft SS, which outlines policies that are relevant to OCIR.

7.11 The PRA also proposes a number of minor amendments to the Operational Continuity Part:

- Operational Continuity 1.1: This Rule sets out the criteria for a firm coming into scope of OCIR policy. The financial conditions are based on the average total assets, safe custody assets, and sight deposits reported in the previous 36 months on 1 January of any year. These figures are reported to the PRA quarterly. To include the final quarter of the previous year in this calculation, the PRA is proposing to amend Rule 1.1 to say 'for the previous 36 months' rather than 'in the previous 36 months', where applicable. This amendment would be for the practical purpose of accommodating the underlying Q4 data, which is not typically reported by firms until 15 to 30 January of any one year end. By clarifying that it is 'for' rather than 'in', it would afford firms certainty to work back 36 months from the 1 January of any one year, rather than basing the reporting on what data was available on 1 January.
- Operational Continuity 1.5: The PRA proposes to add a definition of group provider to this Rule. It would define 'group provider' as a member of a firm's group that provides critical services or essential services to it, or the firm itself for the purposes of Chapter 4 of the draft Rules. The PRA notes that 'group provider' is also defined in the Glossary Part of the PRA Rulebook, where the term is limited to 'critical services'. This is to ensure the reporting return PRA109 is maintained on its existing basis. The PRA is intending to consult on updates to PRA109 once the proposals in this CP are finalised.

8 The PRA's statutory obligations

8.1 In carrying out its policy making functions, the PRA is required to comply with several legal obligations. Before making any rules, the Financial Services and Markets Act 2000 (FSMA)²⁶ requires the PRA to publish a draft of the proposed rules accompanied by:

- a cost benefit analysis;
- an explanation of the PRA's reasons for believing that making the proposed rules is compatible with the PRA's duty to act in a way that advances its general objective,²⁷ insurance objective²⁸ (if applicable), and secondary competition objective;²⁹
- an explanation of the PRA's reasons for believing that making the proposed rules are compatible with its duty to have regard to the regulatory principles;³⁰ and
- a statement as to whether the impact of the proposed rules will be significantly different to mutuals than to other persons.³¹

8.2 The Prudential Regulation Committee (PRC) should have regard to aspects of the Government's economic policy as recommended by HM Treasury.³²

8.3 The PRA is also required by the Equality Act 2010³³ 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

Introduction

8.4 The PRA's OCIR policy has been in place since Tuesday 1 January 2019. Firms in scope of the Operational Continuity Part are already required to ensure their operational arrangements facilitate recovery, orderly resolution, and restructuring.

8.5 The proposals in this CP are aimed at ensuring that firms' operational arrangements facilitate the continuity of critical functions and core business lines. Chapter 1 of this CP sets out that the PRA has reviewed OCIR in light of the approach set out in the SoP 'The Bank of England's approach to assessing resolvability', which states that continuity of 'most or all functions' of a firm is the surest way to deliver continuity.

8.6 The PRA considers that the main driver of any incremental costs to firms would arise from the proposal in this CP to apply OCIR to firms' essential services supporting core business lines, in addition to critical services supporting critical functions. The PRA has considered the costs of this proposal compared to the benefits to firms and the wider economy. Specifically, the PRA has considered the potential costs associated with:

²⁶ Section 138J of FSMA.

²⁷ Section 2B of FSMA.

²⁸ Section 2C of FSMA.

²⁹ Section 2H(1) of FSMA.

³⁰ Sections 2H(2) and 3B of FSMA.

³¹ Section 138K of FSMA.

³² Section 30B of the Bank of England Act 1998.

³³ Section 149.

- Identification and documentation of services;
- resolution-resilient contracts (contractual remediation); and
- costs of holding OCIR-specific resources.

8.7 This cost benefit analysis focuses on the incremental costs and benefits of the proposals made by the PRA in this CP. OCIR policy is designed to avoid significant costs to firms and to the wider economy that would otherwise result from discontinuity and disruption of services during recovery and resolution. The PRA considers that the total costs for firms in scope of the Operational Continuity Part are proportionate to the estimated benefits.

Benefits

8.8 The PRA considers that the proposals in this CP are necessary for ensuring that firms are prepared for resolution so, if the need arises, they can be resolved in an orderly manner with a minimum disruption of critical services. Resolution reduces the risks to depositors, the financial system, and public finances that could arise due to the failure of a bank. By ensuring losses will fall on a failed bank's investors, resolution can both reduce the risk of bank failures and limit their impact when they do occur.³⁴

8.9 Past experiences of operational disruption in going concern highlight how expensive operational discontinuity can be for firms themselves, and how disruptive it could be to financial stability. As set out in paragraph 6.6 in CP29/19, examples of operational disruptions include events of the magnitude of the TSB migration failure in 2018 (a loss of £330.2 million, including post migration cost, fraud, and foregone income),³⁵ or the RBS IT failure in 2012 (10% of the UK population affected).³⁶

8.10 The PRA judges that when firms are in recovery and/or resolution the likelihood of disruptions occurring can be heightened, as firms are operating under stressed circumstances. The costs of disruption are likely to also be higher in recovery and resolution, as firms are subject to more financial and reputational risk, which may create a disorderly failure and threaten financial stability. The PRA's OCIR policy is designed to mitigate these outcomes.

8.11 In addition to benefits coming from mitigating these risks, the PRA considers that firms may also leverage their OCIR capabilities to advance their own shareholders' objectives. Firms would benefit as follows:

- orderly resolution is likely to preserve more value for firms being resolved, compared to disorderly resolution;
- counterparties may prefer to trade with firms that have robust operational continuity arrangements in place, as a firm would be expected to continue to carry out its core business during resolution in order to generate revenue; and
- their OCIR capabilities may be applicable for facilitating business as usual restructuring.

³⁴ October 2017: <https://www.bankofengland.co.uk/-/media/boe/files/news/2017/october/the-bank-of-england-approach-to-resolution>.

³⁵ <https://www.tsb.co.uk/news-releases/tsb-announces-2018-full-year-results/>.

³⁶ Paragraph 2.8, <https://www.fca.org.uk/publication/final-notices/rbs-natwest-ulster-final-notice.pdf>.

Methodology for cost estimates

8.12 In Q1 2020, the PRA surveyed firms currently in scope of OCIR rules for information on how they implemented the current policy and the associated costs (OCIR voluntary survey). Fifteen firms (nine groups) responded, including building societies and international groups.

8.13 Firms in scope of OCIR rules have to report information about operational continuity under PRA109.³⁷ Estimates in Table 2, on the cost of holding OCIR financial resources, are based on PRA109 reporting figures.³⁸ In that period, 35 firms (25 groups) reported information, out of 45 firms (31 groups) in scope of OCIR.

8.14 For the purpose of this cost benefit analysis, the PRA categorised these firms into 'large OCIR firms' or 'small OCIR firms' based on their total assets.³⁹

8.15 The calculations for this analysis have been made as follows: if a firm that is part of a wider group reported figures at firm-level, those figures were used. Where firms reported only group figures, the PRA calculated an average of the group figure for each OCIR firm within the group. For firms that do not belong to a wider group, or for firms that are the only entity in scope of OCIR within their wider group, calculations were made on a firm basis and not on a group basis.

8.16 As a result, sample sizes vary for different calculations based on different parts of the OCIR voluntary survey or reporting under PRA109.

Costs

8.17 For firms subject to the current OCIR policy, the PRA expects that the majority of incremental costs will result from the proposal to apply the OCIR requirements and expectations to firms' services supporting their core business lines, in addition to critical services supporting firms' critical functions.

8.18 In the OCIR voluntary survey, firms were asked to provide an estimate of total services received. 'Total services' is not defined in PRA OCIR policy, and firms were asked to interpret this as critical services (as defined in the Glossary Part) plus other services received by the firm not identified as critical. Applying OCIR policy to essential services, as proposed in this CP, would bring more non-critical services into scope of the policy. The PRA does not expect that all non-critical services, or total services received, would be identified as essential services by firms. Likewise, PRA109 requests firms to report total operational costs.⁴⁰ The PRA does not expect that the costs of essential and critical services would equate to total operational costs. Both the OCIR voluntary survey responses, as well as information provided under PRA109, provide an upper bound estimate for the marginal impact of the proposal to apply OCIR policy to firms' essential services.

8.19 Based on results from the OCIR voluntary survey, small firms have a higher lower bound for the proportion of services that are currently identified as non-critical (range of 61% to 71%) compared to large firms (range of 32% to 80%).⁴¹ These ranges suggest that, for small firms, the impact of applying OCIR policy to essential services, as proposed in this CP, could be potentially higher, as there are more services that are currently identified as non-critical that could be identified as essential services. This suggests a potential for the proposals in this CP to impose higher costs for

³⁷ <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/regulatory-reporting/banking/pra109-instructions.pdf>

³⁸ Using latest figures as of publication.

³⁹ Firms have been categorised as large if they are part of a group with total assets greater than £50 billion.

⁴⁰ Field c150 in Part 1 of PRA 109.

⁴¹ Ranges provided by survey respondents. This includes measures reported at group and firm level.

these firms relative to their implementation of current OCIR policy. However, countering this potential for increased cost, proposals in the CP have been designed to exclude intra-entity arrangements from the scope of application of some policy elements, such as OCIR financial resources.⁴² These proposals aim to reduce the burden for firms with less complex business structures. Evidence from firm structures show that those are most likely to be the smaller firms.

Table 1: One-off and ongoing costs of implementation of current OCIR policy (firm-level figures)⁴³

	Large firms		Small firms	
	One-off costs			
	<i>Aggregate industry impact £000's</i>	<i>% of operating costs per firm</i>	<i>Aggregate industry impact £000's</i>	<i>% of operating costs per firm</i>
Identification and documentation of services	95,000	~0.00%–0.18%	1,000	0.01%–0.06%
Contractual remediation	18,000	~0.00%–0.07%	600	0.01%–0.04%
Arrangements for OCIR-specific financial resources	3,050	0.00 %–~0.00%	250	0.00%–0.05%
Total	116,050	~0.00%–0.25%	1,850	0.02%–0.15%
	Ongoing costs			
	<i>Aggregate industry impact £000's</i>	<i>% of operating costs per firm</i>	<i>Aggregate industry impact £000's</i>	<i>% of operating costs per firm</i>
Identification and documentation of services	23,500	~0.00%–0.04%	150	0.00%–0.01%
Contractual remediation	2,450	~0.00%–~0.00%	50	~0.00%–0.01%
Arrangements for OCIR-specific financial resources	63,800	0.00%–0.52%	1,350	0.00%–0.10%
Total	89,750	~0.00% - 0.56%	1,550	~0.00%–0.12%

8.20 Table 1 sets out that the cost of setting arrangements for OCIR financial resources varies significantly but does not, in total, go above 1.00% of firms' annual operating costs. Two survey respondents suggested that the cost of meeting these requirements are absorbed into business as usual costs. One firm has reported the cost of arrangements for OCIR financial resources costing up to 1.4% of their current OCIR financial resources.

8.21 Table 1 also shows that, both in absolute and relative terms, the one-off and annual ongoing costs of current OCIR policy implementation are smaller for small OCIR firms compared to larger ones.

8.22 The PRA considers that the proposals related to financial arrangements, including the proposed calibration of OCIR financial resources, would counter much of the incremental costs from the proposals related to the proposal to apply OCIR to firms' essential services. Feedback from firms has shown that the holding of those OCIR financial resources is associated with opportunity cost. PRA

⁴² Proposals for financial arrangements are set out in Chapter 4 of this CP.

⁴³ Results are based on OCIR voluntary survey responses. 'Industry' is defined as the set of all firms in scope of Operational Continuity rules as per 1 January 2020. Aggregate industry impact in £000's is calculated based on the average of the aggregate of responses in each sample (large firms sample and small firms sample), which are assumed to be representative, and multiplied by the number of firms in each population (large firms population and small firms population). Percentages of operating costs per group is a range including the lowest reported value in each sample and the highest reported value in each sample, for each category of costs.

calculations suggest that the minimum⁴⁴ OCIR financial resources holdings for intra-group critical or essential services, as proposed in the CP, would most likely result in firms holding equal or less than current holdings for firms currently in scope. The average estimated change for resource holdings is set out in Table 2 below. Calculations in Table 2 below set out the proposed resource holdings as a percentage of current actual and required resources holdings, based on different sets of data for firms in scope of paragraph 11.15 of the draft SS.

8.23 The sample of firms used for the calculations in Table 2 excludes firms that do not have intra-group service provision arrangements, as the PRA proposes that those firms would not be expected to maintain OCIR financial resources under the proposals in this CP. Evidence from firms' reporting under PRA109 and the OCIR voluntary survey suggests that those firms are most likely to be smaller firms.

Table 2: Proposed resource holdings as % of current resource holdings⁴⁵

	Weighted average for OCIR firm
Estimated proposed expectations as % of current actual holdings ⁴⁶	28%
Estimated proposed expectations as % of current required holdings ⁴⁷	38%
Estimated proposed expectations as % of current holdings using operating expenditure as alternative measure ⁴⁸	94%

Summary

8.24 The PRA considers that in a resolution scenario, firms and financial stability will materially benefit from the proposals outlined in this CP. When comparing these benefits against the likely costs of the proposals, the PRA considers that the benefits outweigh the costs.

Compatibility with the PRA's objectives

8.25 The PRA considers that the proposals are compatible with its statutory objective under FSMA to promote the safety and soundness of PRA authorised firms.⁴⁹ The proposals in this CP will promote the continuity of services supporting core business lines in addition to critical functions in the event of resolution. This change to OCIR policy will reflect the Bank's position that most or all functions may need to continue in order to facilitate the continuity of critical functions and other

⁴⁴ Paragraph 11.5 in the draft SS sets out the proposed minimum OCIR financial resources expectation. Paragraph 11.6 sets out circumstances where the PRA would require firms to hold additional resources.

⁴⁵ Calculated using an average weighted for small and large firms based on the population of small and large OCIR firms in scope of the expectations set out in Paragraph 11.5 of the draft SS. This has been assessed based on PRA109 returns and the PRA's understanding of firm's service provision models. Aggregates based on firm-level data.

⁴⁶ Figures are based on firms' reporting under PRA109. Calculation based on total services (Part 1, c150) as a proxy for critical and essential services as a ratio of amount already held by firms under current policy (Part 3, c030). SPE hosted firms and firms with intra-entity service provision models only are excluded as per proposed policy.

⁴⁷ Figures are based on firms' reporting under PRA109. Calculation based on total services (Part 1, c150) as a proxy for critical and essential services as a ratio of amount already held by firms under current policy (Part 1, c170). SPE hosted firms and firms with intra-entity service provision models only are excluded as per proposed policy.

⁴⁸ This is an estimate based on total operating expenditure from annual reports, and is therefore an upper bound estimate. This will include services beyond the expenditure for intra-group services.

⁴⁹ Section 2B(1) and Section 2B(2) FSMA.

business lines that may need to continue to enable post-bail in restructuring. Improved resolvability reduces implicit taxpayer subsidies, which in turn reduces incentives for excessive risk taking by firms.

8.26 In reviewing the policy, the PRA has assessed whether the current policy and the proposals in this CP facilitate effective competition. The design of the proposals draws on the PRA's understanding of the experiences that smaller firms had when implementing the OCIR rules and expectations set out in SS9/16. The proposals facilitate effective competition by lowering barriers to exit and, by reducing burdens on smaller firms, reducing barriers to entry and growth.

Regulatory principles

8.27 In developing the proposals in this CP, the PRA has had regard to the regulatory principles. Three of the principles are of particular relevance:

- The principle that the PRA should exercise its functions in a way that recognises differences in the nature of businesses carried on by different persons. This includes specific proposals designed to accommodate hosted firms and solutions to accommodate inorganic growth in the policy.
- The principle to use resources in the most efficient and economical way. The proposed policy would support the PRA in supervising firms in an efficient and economical way, with clear standards and outcomes-based requirements where applicable.
- The principle that a burden or restriction which is imposed on a person should be proportionate to the benefits which are expected to result from the imposition of that burden. The PRA has followed this principle when developing the proposals outlined in this CP, and has indicated in the CP the key areas of its considerations. This includes areas where the PRA considers that existing capabilities can be leveraged to minimise duplication and realise synergies. The PRA's approach of articulating the outcomes to be achieved in relation to operational continuity in resolution, and only being prescriptive where necessary, is consistent with taking a proportionate approach.

Impact on mutuals

8.28 The PRA considers that the impact of the proposed rule changes on mutuals is expected to be no different from the impact on other firms.

HM Treasury recommendation letter

8.29 HM Treasury has made recommendations to the Prudential Regulation Committee (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.⁵⁰

8.30 The aspects of the Government's economic policy most relevant to the proposals in this CP are:

- i. Competition: The policy proposals support the PRA's wider resolution agenda aimed at ending 'too big to fail'. The PRA expects these proposals to have a positive effect on competition, as they help to mitigate distortions to competition related to implicit government support that

⁵⁰ 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>.

favours larger institutions. The PRA does not expect that the proposals would lead to a significant competitive disadvantage for new entrants or smaller firms compared to larger firms in scope of the proposals.

- ii. Diversity of business: Different business models will result in different risks to continuity in resolution. The PRA has taken these differences into consideration, and the proposals mitigate the risks where necessary.

8.31 Aspects (i) and (ii) have been considered in the 'compatibility with the PRA's objectives' and 'regulatory principles' sections above.

Innovation

8.32 The PRA considers that the outcomes-based approach to the proposals would facilitate innovation where applicable. The proposals in this CP have been designed to take account of the differences between arrangements that occur within individual legal entities, within a banking group, or with third parties, based on the risks that each poses to operational continuity in resolution.

Equality and diversity

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

Appendices

- 1 Draft Supervisory Statement: 'Ensuring operational continuity in resolution', available at: <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/consultation-paper/2020/cp2020app1.pdf>
 - 2 Draft Operational Continuity rule instrument, available at: <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/consultation-paper/2020/cp2020app2.pdf>
-