



BANK OF ENGLAND

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Introduction to the Resolvability Assessment Framework

Bank of England | Prudential Regulation Authority

Foreword

It is ten years since the financial crisis. Like many countries at that time, the United Kingdom did not have a regime to enable banks to fail safely with investors taking the losses, without huge disruption to the vital services they provide to households and businesses. This left two choices when banks got into trouble: let them fail or bail them out. Governments felt they had no choice but to bail the banks out. Resolution aims to change this. It ensures banks can be allowed to fail, and their investors bailed in, in an orderly way.

Since the financial crisis we, along with our international partners, have put in place reforms to ensure that major banks are no longer too big to fail. Disorderly bank failures can imperil financial stability, including by interrupting the most important services banks provide to their customers. The Bank of England has been working to build an effective resolution regime which will ensure that banks are able to fail in an orderly manner with losses borne by their investors. That means minimising the impact to depositors, to the financial system, and to public finances. This also incentivises banks to operate more prudently. The Bank has committed to Parliament that major UK banks will be resolvable by 2022.

The Resolvability Assessment Framework (the Framework) proposed in these consultation papers, is the final major piece in the UK's resolution regime for banks. The Framework places the responsibility on banks to demonstrate both to the Bank, and publically, their preparedness for resolution and that they have identified the risks to successful resolution. Banks would publish the key aspects of their assessment and the Bank of England would make a public statement on their resolvability.

This represents a major step forward in implementing credible resolution and builds on the significant progress the UK has made since the financial crisis. The UK now has a comprehensive statutory resolution regime with clear resolution objectives. The Bank is the resolution authority with the legal powers to conduct a resolution. The PRA has a complementary objective to promote the resolvability of banks. We work closely with authorities in other countries to support cross-border resolution, for example through Crisis Management Groups and resolution colleges.

If a bank were to fail today, resolution would be a great improvement on the bail-outs and failures we saw in the crisis. This does not mean that resolution would be easy or painless. But the UK resolution regime, including the new proposals set out in the Framework, will leave banks and authorities much better equipped to manage financial failures so that investors in banks are bailed in and vital services to the economy are not disrupted. As the UK resolution regime moves into this next phase, the Bank and the PRA will have a wide range of options for managing the outcome of a resolution to return a successor bank to viability.

The Bank, as resolution authority, and the PRA as the supervisor, will work together to leverage our skills and responsibilities to improve the resolvability of banks. With these proposals, the final major piece of the resolution regime is now in place.



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Introduction

Why we need a resolution framework

1.1 To ensure an efficient, competitive banking system that supports growth, banks should be allowed to fail. And, if they do, the authorities need to be able to let them fail in an orderly way, reducing risks to depositors, the financial system and public finances – a process known as resolution.

1.2 Managing failing banks¹ effectively is a key element in delivering the Bank of England's mission to maintain financial stability. The financial crisis demonstrated the importance of an effective resolution regime, as disorderly bank failure is disruptive and costly.

1.3 Resolution imposes losses on the investors of failed firms, not taxpayers. It ensures larger banks' services can continue to operate for a sufficient period, allowing authorities or new management to restructure them or wind them down.

1.4 While shareholders and creditors are rewarded in the good times, effective resolution means they also bear the risks in bad times. By bearing responsibility for losses when the firm gets into trouble, investors are incentivised to demand that firms are not taking excessive risks. By ensuring losses will fall on a failed bank's investors, resolution can both reduce the risk of bank failures, by encouraging more responsible risk-taking, and limit their impact when they do occur, by placing the cost of failure on shareholders and investors, not public finances.

1.5 The Bank is responsible for resolving firms, and firms need to be able to carry out their responsibilities to make this happen. For the authorities to be able to take charge, recapitalise and restructure a bank, regardless of the cause of failure, firms need to have adequate financial resources that can be used in resolution, and the ability to continue functioning operationally when the authorities take control. This includes the ability to maintain trading and operational relationships so that any restructuring can be achieved.

1.6 The importance of an effective resolution regime is reflected in the Financial Policy's Committee's (FPC) judgement on the optimum level of system wide capital for the UK banking system. In its 2015 'Framework of capital requirements for UK banks'² the FPC judged that effective arrangements for resolving banks that fail will materially reduce both the probability and costs of financial crises. In the 2015 Bank of England analysis,³ these arrangements were assessed to reduce the appropriate equity requirement for the banking system.

¹ This consultation also applies to building societies and investment firms but for the sake of simplicity these are hereafter referred to as 'banks' or 'firms'.

² Bank of England (2015) 'The Framework of capital requirements for UK Banks' Supplement to the December 2015 Financial Stability Report available at: <https://www.bankofengland.co.uk/-/media/boe/files/financial-stability-report/2015/supplement-december-2015.pdf>.

³ Brooke et al. (2015) 'Measuring the macroeconomic costs and benefits of higher UK bank capital requirements', available at: http://www.bankofengland.co.uk/financialstability/Pages/fpc/fspapers/fs_paper35.aspx.

Who does this set of proposals relate to?

1.7 The package of proposals in both the Bank Consultation Paper (CP) ‘The Bank of England’s approach to assessing resolvability’,⁴ and the Prudential Regulation Authority (PRA) CP31/18 ‘Resolution assessment and public disclosure by firms’⁵ is relevant for banks whose failure would have a significant impact on the UK financial system. These firms would be resolved by the Bank using its stabilisation powers, that is, a bail-in or partial-transfer resolution strategy. For bail-in, the resolution strategy is typically to recapitalise the whole banking group – known as a single point of entry resolution – though in some specific cases, the strategy will be to intervene at different points within the wider group. This is known as ‘Multiple Point of Entry’ (MPE) resolution.

1.8 The package of proposals is also relevant for certain overseas firms where the Bank would support a home resolution authority in carrying out a cross-border resolution. It is not relevant for smaller firms for whom the Bank has designated their resolution strategy to be bank insolvency procedure.⁶

The Resolvability Assessment Framework (RAF) – the responsibility of firms

1.9 This package of consultations builds on the work done since the financial crisis and sets out the next step in implementing the resolution regime: ensuring that firms are, and are able to demonstrate that they are, resolvable. This will require firms to have the capabilities necessary to support their resolution. To this end, it sets out how the Bank and PRA propose to increase transparency and accountability and clarify the responsibilities on firms concerning resolution.

1.10 The proposals for the RAF have three main components:

- (i) how the Bank, as resolution authority, intends to **assess** resolvability, building on work that both firms and the Bank have already done. In the Bank’s CP, it outlines the **outcomes** it considers necessary to support resolution. These outcomes are supported by existing policies as well as the new policies proposed in the consultation **to remove barriers to resolvability**. This will also involve thinking more broadly about what firms can do with reference to a **stylised timeline** for a bail-in resolution to ensure the Bank’s execution of a firm’s resolution strategy is successful;
- (ii) a PRA proposal for new PRA Rules that would require firms to **perform an assessment** of their preparations for resolution, in which firms should identify any risks to successful resolution and the plans in place to address them, **submit a report** of that assessment, and **publish a summary** of their most recent report (‘public disclosure’). The PRA proposals emphasise the importance of senior management **accountability** within firms; and
- (iii) a proposal for the Bank to make a **public statement** concerning the resolvability of each firm in scope of the draft PRA Rules. In so doing, the Bank would identify any shortcomings where it believes there is more work to do.

1.11 Together, these components are designed to make resolution more transparent, better understood, and more successful. By holding firms accountable to regulators, the public and their investors, they help to ensure that firms would be able to fail in an orderly fashion without causing excessive disruption to the UK financial system.

⁴ December 2018: <https://www.bankofengland.co.uk/paper/2018/the-boes-approach-to-assessing-resolvability>.

⁵ December 2018: <https://www.bankofengland.co.uk/prudential-regulation/publication/2018/resolution-assessment-and-public-disclosure-by-firms>.

⁶ Or another form of modified insolvency procedure, such as the Building Society Insolvency Procedure.

1.12 The package of proposals is proportionate. We propose that firms with a bail-in or partial-transfer resolution strategy, determined by the Bank as the relevant home authority, should be able to achieve the **outcomes** needed for resolvability (set out below). Firms should do this in a proportionate manner reflecting their preferred resolution strategy and any specific business characteristics.

1.13 The PRA intends to apply its proposals for firms to submit reports and disclose summaries of the assessments of firms' preparations for resolution to the largest UK firms first:⁷ their failure would have the largest impact on UK financial stability and would pose the greatest risk to the Bank's and PRA's objectives.

1.14 The PRA, in consultation with the Bank, may consider whether and how to apply some or all of its proposals, to other firms with a bail-in or partial-transfer resolution strategy at a later date.

The Bank's assessment of resolvability

Our approach to resolution

1.15 We have designed our resolution regime to equip us to manage financial failures of firms regardless of the underlying problems. In this way we help protect the system from unexpected shocks – what caused losses in the last crisis may not be the same for future failures.

1.16 As we may not be able to predict where in a firm the causes of a failure will arise, or the wider circumstances in which a failure will occur, the authorities first need to stabilise the firm before it can be restructured to address the causes of failure and restore its long-term viability. We need to be able to ensure that most or all of the functions of the firm can be continued while the authorities take charge of the firm to recapitalise and begin to restructure it. This buys time, as the implementation of restructuring will likely take longer than the immediate resolution period.

1.17 This does not mean that all parts of a firm will necessarily be continued after a resolution. Restructuring is likely to involve reshaping the firm over time by deciding which businesses to continue, which to dispose of, and which to wind down. The options will be supported by the capabilities firms have developed for their recovery plans and affected by any actions already taken in the recovery period.

Outcomes needed for resolvability

1.18 The authorities have to be confident that, if needed, it would be feasible from a practical point of view and credible given the wider circumstances to use their powers to resolve a firm, while protecting public funds, avoiding significant adverse effects on the financial system, and ensuring continuity of banking services or critical functions. In turn, firms need to have the capabilities to carry out their resolution strategy, as set for them by the authorities.

1.19 The Bank CP sets out how the Bank will assess resolvability. It builds on the Bank's publication in October 2017 of its overall 'Approach to Resolution' (the Purple Book).⁸

⁷ Those firms incorporated in the UK with at least £50bn in retail deposits on an individual or consolidated basis.

⁸ Bank of England (2017) 'The Bank of England's approach to resolution' available at: <https://www.bankofengland.co.uk/paper/2017/the-bank-of-england-approach-to-resolution>.

1.20 To be considered resolvable, a firm must, as a minimum, be able to achieve these outcomes:

(i) Have adequate financial resources in the context of resolution:⁹

Ensure that it has the resolution-ready financial resources available to absorb losses and recapitalise without exposing public funds to loss. This includes resources to meet its financial obligations in resolution. This is necessary to allow the authorities to keep the firm operating as described below. This means that firms must:

- meet the ‘minimum requirements for eligible liabilities’ (MREL) appropriately distributed across its business;
- be able to support a timely assessment of its capital position and recapitalisation needs; and
- be able to analyse and mobilise liquidity in resolution.

(ii) Be able to continue to do business through resolution and restructuring:

Ensure that the firm’s activities can continue while the authorities take charge and begin to restructure the firm in such a way that the business can be reshaped, including any parts of it being sold or wound down (as appropriate). This includes ensuring that the resolution does not result in the firm’s financial and operational contracts being materially disrupted or terminated, and that direct or indirect access to services delivered by financial market intermediaries is maintained. This is essential to having a continuing business that can be returned to long-term viability through restructuring. It also means building on recovery planning work so that the operational and support services needed for a viable business can be identified, separated, and reorganised to support restructuring options.

(iii) Be able to co-ordinate and communicate effectively within the firm and with the authorities and markets so that resolution and subsequent restructuring are orderly

Accountability

1.21 Firms should have ownership of their progress towards being resolvable by 2022. Figure 1 explains how firms should think about the core capabilities needed to achieve these outcomes. In building their capabilities, firms will need to consider the individual attributes of their own operations and whether there are additional measures they need to take. Firms will need to consider the capabilities they will need to build up in the normal course of business, and what would be needed on the approach to and during a resolution.

1.22 Resolvability should be a key focus for firms’ senior management and governance bodies. The Bank and PRA co-operate to monitor firms’ resolvability. If firms do not make satisfactory progress, then the Bank can, amongst other things, use its power to direct institutions to address substantive impediments to resolvability¹⁰ and the PRA may also take action to advance the resolvability of firms.¹¹

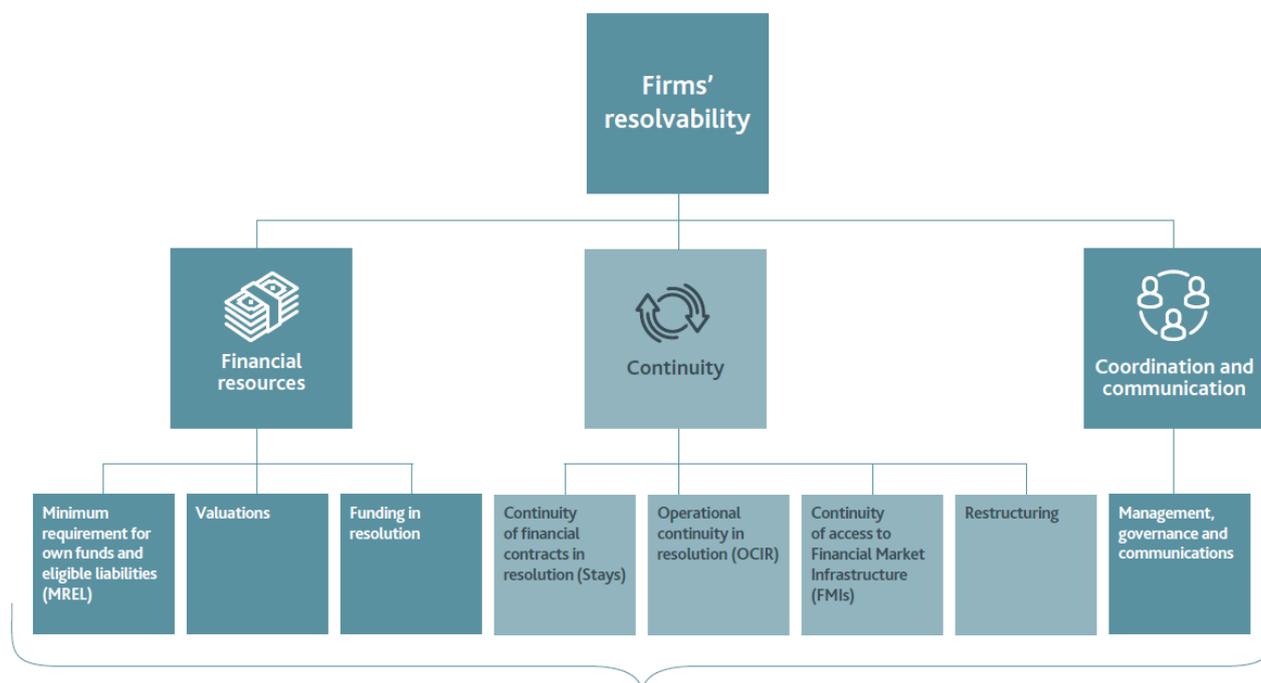
⁹ Appropriate minimum levels will be determined by the relevant authorities.

¹⁰ Under Section 3A of the Banking Act. Also see Bank of England (2015) ‘The Bank of England’s power to direct institutions to address impediments to resolvability’ available at: <https://www.bankofengland.co.uk/paper/2015/the-boes-power-to-direct-institutions-to-address-impediments-to-resolvability-sop>.

¹¹ Where appropriate, and in support of its general objective to promote safety and soundness the PRA may take action to advance the resolvability of firms. The PRA’s Fundamental Rule 8 states that ‘a firm must prepare for resolution so, if the need arises, it can be resolved in an orderly manner with a minimum disruption of critical services’. The PRA has also made a number of specific rules in relation to resolvability as set out on p. 60, Figure 2 of the Bank CP.

Figure 1: The Resolvability outcomes and how to achieve them

A firm needs to meet the resolvability outcomes, so that it can be resolved



Beyond this, firms will need to consider their business model and any additional barriers that are relevant for resolvability.

Benefits of transparency

1.23 The resolvability of a firm is not binary. Whether or not a firm meets the levels of resolvability the Bank expects is a judgement based on many contributing factors. For this reason, the Bank consultation sets out the proposed outcomes that firms would need to be able to demonstrate to be deemed resolvable.

1.24 Transparency concerning these judgements should help market participants make more informed investment decisions, based on more accurate pricing of the risks they bear in resolution; help ensure continuity of services in resolution for firm's contractual counterparties; and ultimately incentivise in scope firms to be resolvable by 2022.¹²

The RAF cycle

1.25 The assessment and disclosure framework proposed in this package of publications would operate on a two year cycle beginning in 2020. Firms' assessments, reports and the public disclosure would occur in each cycle. The timing of the first cycle in 2020 is intended to allow the first reports to reflect any changes to firms' structures that are required for EU withdrawal and ring-fencing.

- The first round of reports in 2020 would provide each firm's roadmap on their course to being resolvable by 2022.

¹² Bank of England (2017) 'The Bank of England's response to the Treasury Committee's enquiry into capital' available at: <http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/treasury-committee/capital-and-resolution/written/69208.html>.

- From 2022 onwards, firms would assess their steady-state resolvability and the steps they have taken to achieve it, as well as reflecting changes to their business model as it evolves over time.

1.26 The Bank will consider the firms' reports against the description of resolvability in the Bank CP, and the PRA will ask firms to set out their plans for future work. This will involve firms supplying evidence, upon request, to support the statements within their reports. The Bank and the PRA will engage with firms throughout the RAF cycle with regards to assurance and in particular to discuss firms' future plans.

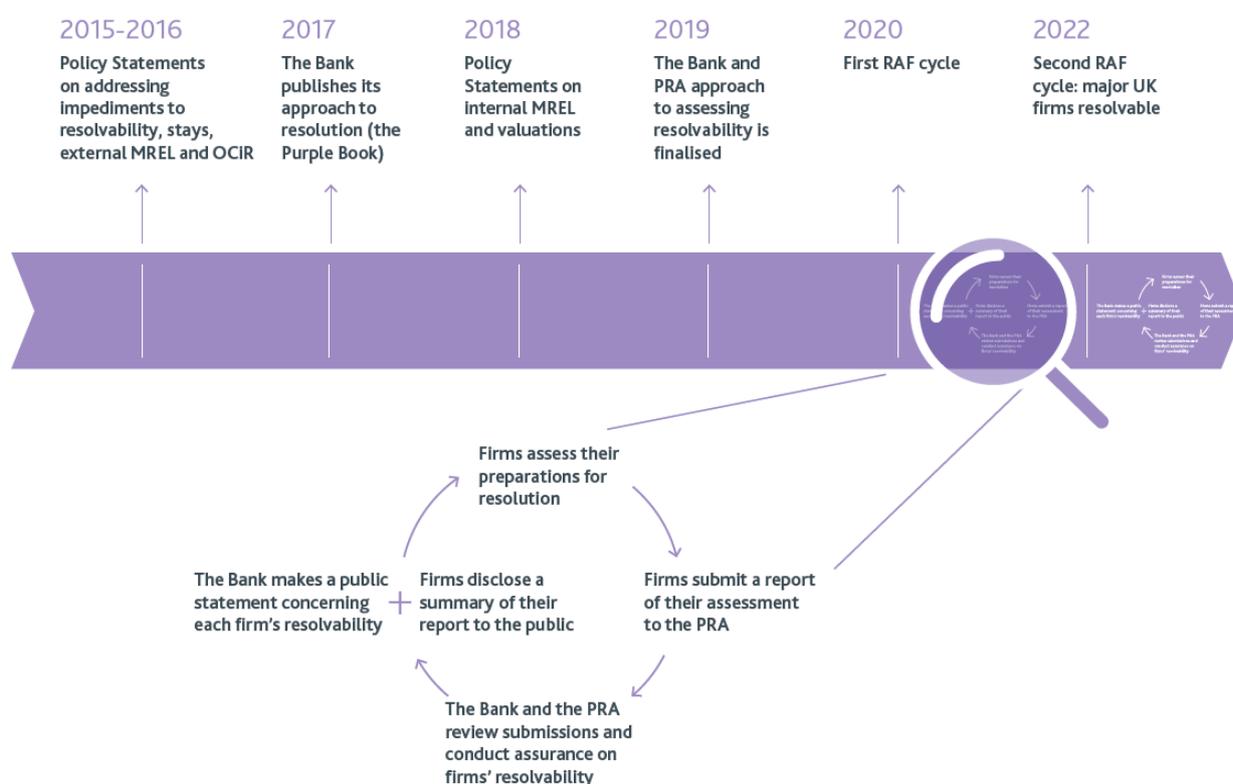
1.27 Wherever possible, the Bank will consider other information submitted as part of resolution planning to inform what it will request so as to reduce information burden upon firms.

1.28 Following this, the PRA proposes that firms in scope would disclose a public summary of their assessment of the preparations they have made for resolution and any further work they have planned to improve their resolvability. In addition to this, the Bank would disclose a statement concerning its assessment of the resolvability of each of those firms.

1.29 The proposals in this package will not replace the Bank's annual resolvability assessment. Rather, the information received will help to inform this assessment.¹³

1.30 An illustrated example of the RAF cycle described above is set out in Figure 2.

Figure 2: Development of the UK resolution framework and the RAF cycle



¹³ Part 6 of the Bank Recovery and Resolution (No. 2) Order 2014 (the No. 2 Order)

Forthcoming proposals

1.31 The PRA intends to consult on changes to its Senior Manager and Certification Regime ('SM&CR') to incorporate the responsibility for carrying out assessments and related obligations into the existing prescribed responsibilities in the Allocation of Responsibilities Part of the PRA Rulebook in due course.

1.32 The Bank has set out in Chapter 7 of its CP that most or all functions may need to continue in order to facilitate the continuity of critical functions and other business lines may need to continue to enable post bail-in restructuring. The PRA is intending to review its policies regarding operational continuity in resolution (OCIR) in light of this, and in light of feedback resulting from firms' experiences in implementing the existing PRA policies.

1.33 In the meantime, the requirement for firms in scope of the Operational Continuity Part to comply with the PRA's existing OCIR rules from Tuesday 1 January 2019 remains unchanged because these existing requirements already support firms' continuity in resolution.

Using these documents

1.34 The first consultation sets out the Bank's proposed approach to assessing resolvability, against which the Bank will perform its assurance and publically disclose the result. The Bank consultation is relevant to firms where: (i) the Bank, as Resolution Authority, has notified them that their preferred resolution strategy is bail-in or partial-transfer, ie that the Bank would expect the strategy to involve the use of its stabilisation powers; or (ii) in its capacity as host Resolution Authority, the Bank has notified them that they are a 'material subsidiary' of an overseas-based banking group for the purposes of setting internal MREL in the UK.¹⁴

1.35 The second consultation (PRA CP31/18) sets out the PRA's proposed rules and expectations on how in-scope firms would implement the assessment and disclosure requirements. The PRA CP proposed scope is UK banks and building societies with retail deposits greater than or equal to £50 billion on an individual or consolidated basis as at the date of their most recent annual accounts.

1.36 We welcome responses to the questions asked throughout the two CPs, and the approach as a whole. Feedback is welcomed from all parts of the financial sector, as well as from consumers, market participants and other stakeholders, including other regulatory organisations. Comments may be included in a single response. All responses should be emailed to: RAF_consultation_2018@bankofengland.co.uk by Friday 5 April 2019.

1.37 The proposals in the Bank and PRA CPs have been designed in the context of the current UK and EU regulatory framework. They will be kept under review to assess whether any amendments would be required due to changes in the UK regulatory framework, including those arising once any new arrangements with the European Union take effect. In particular, the PRA CP contains a second draft instrument which would only take effect in the event that the UK leaves the EU on exit day without an Implementation Period agreed between the EU and the UK.

¹⁴ Bank of England (2018) 'The Bank of England's approach to setting a minimum requirement for own funds and eligible liabilities (MREL)' available at: <https://www.bankofengland.co.uk/paper/2018/boes-approach-to-setting-mrel-2018>.