



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Consultation Paper | CP38/15

Ensuring operational continuity in resolution

October 2015

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This consultation paper sets out the PRA's proposed framework to facilitate continuity of firms' critical shared services in resolution.

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1 Overview

1.1 In this consultation paper (CP) the Prudential Regulation Authority (PRA) proposes the creation of a new framework requiring firms to ensure the continuity of critical shared services to facilitate recovery action, orderly resolution and post-resolution restructuring.

1.2 It follows the discussion paper DP1/14 'Ensuring operational continuity in resolution' published in October 2014.¹ It develops the principles set out in DP1/14 and proposes draft rules and a supervisory statement.

1.3 It is one of two papers published by the PRA on 15 October 2015, which forms part of the post-crisis reforms to enhance the resilience and resolvability of firms. The proposals support the resilience and resolvability of banks, building societies and PRA-authorized investment firms by seeking to ensure critical shared services are arranged in a way that facilitates continuity in the event of a failure. Restructuring efforts, through ring-fencing of core activities, set out in CP37/15, will support bank resolvability and increase the resilience of ring-fenced bodies (RFBs) to risks originating in other parts of its group or the global financial system and facilitate restructuring of banking groups before and after resolution.²

Scope of application

1.4 This consultation is relevant to banks, building societies and PRA-authorized investment firms.³ The proposals are also likely to be of interest to policymakers and practitioners involved in the resolution of failed firms.

1.5 The PRA intends the scope of the rules to be limited to those firms that receive critical shared services supporting functions that are critical to the economy. This CP does not define a precise boundary for firms to be in scope, instead it provides clarity on the proposed policy to enable firms, particularly RFBs, to start planning their approach.

1.6 Firms that perform functions critical to the economy are intended to be within scope, including but not limited to RFBs and global systemically important banks (G-SIBs). Size of the firm is not the only determinant, but many smaller firms are likely to be excluded.

1.7 The PRA will issue an addendum to the consultation defining the scope of application alongside a planned Bank of England consultation on the calibration of the minimum requirement for own funds and eligible liabilities (MREL). Both consultations require an understanding of which firms should ensure continuity of critical economic functions; the PRA and the Bank of England are considering the issues together.

Responses and next steps

1.8 The PRA invites feedback on the proposals set out in this consultation, but respondents may wish to wait for the publication of the addendum, which will set a closing date for the consultation period at the same time as publishing the addendum. The PRA intends any eventual rules to apply from 1 January 2019.

1.9 Please address any comments or enquiries to CP38_15@bankofengland.co.uk.

1 PRA Discussion Paper DP1/14, 'Ensuring operational continuity in resolution', October 2014: www.bankofengland.co.uk/pr/Pages/publications/cp/2014/dp114.aspx.

2 PRA Consultation Paper CP37/15, 'The implementation of ring-fencing: consultation on prudential requirements, intragroup arrangements and market infrastructure', October 2015: www.bankofengland.co.uk/pr/Pages/publications/cp/2015/cp3715.aspx.

3 Credit unions are not captured by the proposals.

2 Arrangements for critical shared services

2.1 This chapter sets out the PRA's proposed framework to help ensure firms' operational arrangements facilitate continuity of critical shared services in resolution.

2.2 The continuity of critical shared services is considered a necessary condition to ensure that firms can be resolved in an orderly fashion by removing operational barriers to resolution, thereby supporting financial stability in the United Kingdom. Critical shared services are those services that need to be available to one or more business unit of a firm or entity of a group in order to provide functions critical to the economy. The aim of continuity of critical shared services is to avoid disruption to one business unit of a firm spreading to another business unit or entity within a group. In addition, the PRA requires banking groups to facilitate their restructuring following resolution.

2.3 As set out in the PRA's Fundamental Rule 8, the PRA expects "A firm to prepare for resolution so, if the need arises, it can be resolved in an orderly manner with a minimum disruption of critical services".¹ Although the existing PRA regulatory framework fulfils, to a certain extent, the objective of ensuring that firms have appropriate operational arrangements in place, the PRA considers it necessary to place additional requirements on firms. These requirements are aimed at ensuring that firms make appropriate changes so that services necessary for continuity of functions critical to the economy operate effectively following the failure of a firm.

2.4 To achieve this, the PRA is proposing rules to ensure continuity of critical shared services in the following areas.

- Firms need to be structured to facilitate continuity of critical shared services by ensuring their operational arrangements support recovery and resolution plans. Structures that support business separability and restructuring can improve the ability of firms to continue critical functions without significant interruption in stress or resolution. If firms cannot demonstrate that their operational structure supports separability and restructuring, the PRA expects firms to make changes to achieve this.
- Critical shared services arrangements need to be capable of being continued or replaced and there should be agreements in place documenting these appropriately. An inability to provide timely and accurate information relating to critical shared services, as well as poorly designed or inadequate agreements may present an obstacle to continuity of critical shared services in resolution, particularly if agreements can be terminated on entry into stress or resolution of the firm or other group entities.
- Critical shared services providers from within the group need to have clearly defined reporting lines and should be capable of continuing in resolution without relying on senior staff that may no longer be part of the group. Ensuring there is sufficient governance oversight to supervise the carrying out of the critical shared services will help to ensure the operations can continue in resolution.
- Critical shared services provided from within the group need to be structured so that upon failure or resolution, no group entities receive preferential access to critical shared

¹ For the policy statement outlining the Fundamental Rules, see www.bankofengland.co.uk/pr/Pages/publications/ps/2014/ps514.aspx

services over other entities, as this could result in disruption to service provision to the entity being resolved or other group entities.

2.5 The proposed rules articulate the outcomes the PRA requires firms to achieve, but do not prescribe the way that firms achieve these outcomes or how firms structure their operational arrangements. Firms are expected to comply with the proposed rules regardless of their exact organisational arrangements. Draft rules can be found in the Operational Continuity Part in Appendix 2.

2.6 The proposed supervisory statement in Appendix 1 sets out the PRA's expectations in relation to the arrangements that firms make where they receive critical shared services in respect of the provision of critical shared services from third parties (either a group provider or a non-group provider) and from within a regulated firm. It also sets out the PRA's expectations as to how firms can meet the requirements in the existing Outsourcing Part and General Organisational Requirements Part of the PRA Rulebook as well as Fundamental Rule 8.

2.7 While the current rules set requirements in respect of ensuring continuity of firms' operational arrangements, the PRA considers it important to clarify its expectations in respect of arrangements supporting the continuity of critical shared services in resolution. In particular, the proposed supervisory statement sets out the PRA's expectations in the following areas.

- Critical shared services providers need to be financially and operationally resilient. If a critical shared services provider has sufficient financial resources and operational capability this will help facilitate continuation of operations in resolution and aid in ensuring they are capable of being restructured. Following the discussion set out in DP1/14, the proposed supervisory statement sets out the PRA's expectation that a critical shared services provider within the group should be supported, as a minimum, by capital resources (or positive net assets, as appropriate) equivalent to 25% of annual fixed overheads and liquidity resources equivalent to 50% of annual fixed overheads.¹
- Important functions that require senior management judgement or decision making that could affect the prudential soundness of a regulated firm should remain within the regulated firm. If the critical shared services provider undertook these activities it would make it unnecessarily large and complex. This may make it harder to restructure the service provider, if necessary, and could impede the continuity of critical shared services.

2.8 For firms subject to ring-fencing, the proposals in this chapter should be read in conjunction with the proposals set out in PS10/15 'The implementation of ring-fencing: legal structure, governance and the continuity of services and facilities'² and CP37/15 'The implementation of ring-fencing: consultation on prudential requirements, intragroup arrangements and market infrastructure'.³

¹ *PRA Discussion Paper DP1/14*, 'Ensuring operational continuity in resolution', October 2014: www.bankofengland.co.uk/pr/Pages/publications/cp/2014/dp114.aspx.

² *PRA Policy Statement PS10/15*, 'The implementation of ring-fencing: legal structure, governance and the continuity of services and facilities', May 2015: www.bankofengland.co.uk/pr/Pages/publications/ps/2015/ps1015.aspx.

³ *PRA Consultation Paper CP37/15*, 'The implementation of ring-fencing: consultation on prudential requirements, intragroup arrangements and market infrastructure', October 2015: www.bankofengland.co.uk/pr/Pages/publications/cp/2015/cp3715.aspx.

3 Approach to supervision

3.1 The PRA expects to use a combination of continuous supervisory assessment, resolution tools and targeted reviews to monitor firms and ensure compliance. For example, the PRA expects to utilise information gathered as part of its recovery and resolution planning work to undertake some of this assessment work.¹ Capital adequacy and liquidity assessments of firms will incorporate reviews of financial resilience expectations of critical shared services providers. Assessments of management and governance, and risk management and controls will also involve consideration of critical shared services arrangements.

3.2 In assessing compliance, the PRA will take a proportionate approach, focusing on critical shared services arrangements of those firms where operational continuity is judged to be an area of particular significance for a firm.

3.3 For firms subject to ring-fencing, the PRA is planning a further consultation by mid-2016 setting out proposals in relation to the data the PRA intends to collect to support its supervision of firms' compliance with the Financial Services (Banking Reform) Act 2013 and the PRA's ring-fencing rules. The PRA will consider whether to include proposals for additional reporting on operational continuity.

4 The PRA's statutory obligations

4.1 The PRA must ensure the proposals are compatible with the PRA's statutory objectives under the Financial Service and Markets Act 2000 (FSMA) to promote the safety and soundness of PRA-authorized firms.² These proposals advance the PRA's general objective by reducing the adverse effect that the failure of firms could be expected to have on the stability of the UK financial system.

4.2 The PRA must also assess the costs and benefits of proposals and have regard to the regulatory principles as set out in FSMA, including proportionality. In addition, when consulting on draft rules, the PRA is required to consider the impact on mutuals. The PRA has a duty to facilitate competition as a secondary objective subordinate to its general safety and soundness objective. Finally, the PRA must consider the equality and diversity impact of its proposals. The PRA's assessment of these obligations is set out below.

Cost benefit analysis

4.3 FSMA requires the PRA to perform an economic assessment of the impact of its proposals. In particular, FSMA requires the PRA to publish estimates of the costs and the benefits, unless these cannot reasonably be estimated or it is not reasonably practicable to do so.

Scope of assessment

4.4 The analysis set out below covers the costs and benefits arising from the operational continuity proposals in this CP. The proposals will affect banks, building societies and PRA-authorized investment firms that receive critical shared services supporting functions that are critical to the economy.

1 *PRA Supervisory Statement SS18/13, 'Recovery Planning', January 2015:*
www.bankofengland.co.uk/pr/Pages/publications/ss/2015/ss1813update.aspx.

PRA Supervisory Statement SS19/13, 'Resolution Planning', January 2015:
www.bankofengland.co.uk/pr/Pages/publications/ps/2015/recoveryresolutionupdate.aspx.

2 See s.2B(1) and s.2B(2) FSMA.

Incremental benefit

4.5 The proposals in the CP will contribute to financial stability by helping to ensure continuity of critical economic functions. The proposals will allow firms to be more easily restructured in recovery or post-resolution without imposing substantial costs to the UK financial system. If firms can be resolved in an orderly manner, this should reduce implicit taxpayer subsidies, which should in turn reduce incentives for excessive risk taking by firms.

Direct costs to firms

4.6 Direct costs to firms of meeting the proposals in this CP are two-fold: initial implementation costs and the ongoing costs associated with compliance.

4.7 Firms can comply with the proposed rules in a number of ways. The cost is expected to vary depending on the operational structure followed. Firms that fulfil the criteria predominantly through establishing operational subsidiaries may face higher implementation costs, due to the need to transfer assets and services into a different legal entity. Conversely, firms that seek to comply with the rules by keeping services predominantly within existing regulated entities may have lower implementation costs. Allowing firms to establish their preferred operational arrangements will help to reduce the costs of compliance.

4.8 To estimate the costs for large firms, the PRA has used the estimates from the cost of compliance exercise undertaken for banks expected to be subject to ring-fencing, which estimated combined costs associated with operational continuity and structural reform.¹

4.9 The initial implementation costs, defined as the cost of setting up group functions, IT infrastructure and back office operations are expected to be in the order of 5% of the current annual costs of providing operational services, on average. That is to say, a large banking group, which might typically have annual operating costs of £4 billion, might face an initial implementation cost of £200 million as a result of the proposed rules.

4.10 The ongoing costs associated with compliance, defined as the cost of running group functions, IT infrastructure and back office operations plus the cost of funding (capital and liquidity) are expected to be in the order of 3% of the current annual costs of providing operational services, on average. That is to say, a large banking group, which might typically have annual operating costs of £4 billion, might face ongoing compliance costs of £120 million per annum as a result of the proposed rules.

4.11 The PRA expects both the initial implementation and ongoing compliance costs to be considerably lower for smaller firms in scope. Services are less likely to be shared across a number of entities performing critical economic functions. Smaller firms are therefore less likely to have to undertake significant restructuring to improve resolvability. Furthermore, concerns related to operational continuity in resolution are likely to have been addressed by operational changes to systems needed to facilitate Continuity of Access and Single Customer View. The costs associated with these were considered in CP20/14 'Depositor Protection'.²

4.12 The PRA expects the costs described above to represent an upper estimate to the cost of introducing the rules associated with operational continuity for firms of all sizes.

1 An analysis of the overall costs and benefits of the implementation of ring-fencing was published by the Government in 2013, available in HM Treasury 'Banking reform: draft secondary legislation', July 2013, www.gov.uk/government/uploads/system/uploads/attachment_data/file/223566/PU1488_Banking_reform_consultation_-_online-1.pdf

2 *PRA Consultation Paper CP20/14, 'Depositor Protection', October 2014:* www.bankofengland.co.uk/pr/Pages/publications/cp/2014/cp2014.aspx

4.13 International groups that have UK subsidiaries or branches may face additional costs to adapt their business models to meet the requirements, due to often having more complex corporate structures.

Direct costs to the PRA

4.14 Direct costs to the PRA are expected to relate to an increase in supervisory work to review firms' compliance with the rules. However, it is anticipated that these costs would be absorbed into the general operational costs of the PRA and therefore have a minimal impact.

Impact on mutuals

4.15 FSMA requires that the PRA assesses whether, in its opinion, the impact of the proposed rules on mutuals will be significantly different from the impact on other firms.¹ The proposals will affect some building societies, however the costs are not expected to be substantially different from the costs incurred by banks of similar size. The PRA considers that these proposals will not have a significantly different impact on mutuals than other firms subject to these rules.

Impact on competition

4.16 When discharging its general rule-making function, the PRA is legally required, as far as is reasonably possible, to facilitate effective competition in the markets for services provided by PRA-authorised persons in carrying on regulated activities.²

4.17 The operational continuity proposals support the PRA's wider resolution agenda aimed at ending too-big-to-fail. The proposals are likely to support orderly resolution of firms whose failure could damage the UK financial system. 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 favours larger institutions.

4.18 Implementation and compliance costs are likely to be proportionate to the size and complexity of the firm. The PRA does not expect the proposals in this CP to lead to a significant competitive disadvantage for new entrants and smaller firms compared to large firms in the relevant markets. International groups that plan to enter the UK market may face higher costs to adapt their business models to meet the requirements due to often having more complex corporate structures.

Regulatory principles

4.19 In developing the proposals in this CP, the PRA has had regard to the eight Regulatory Principles as set out in section 3B of FSMA.³ Of these, three principles are of particular relevance:

- *The principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction.* 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 judgements. 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.

1 Section 138K of FSMA.

2 See s.2H FSMA.

3 See s.2H and s.3B FSMA.

- *The principle that the PRA should exercise its functions as transparently as possible.* In this CP, the PRA sets out all the key information relevant to its proposals, and gives respondents the opportunity to comment.
- *The desirability in appropriate cases of the PRA exercising its functions in a way that recognises differences in the nature of, and objectives of, business carried on by different persons subject to requirements imposed by or under the Act.* The PRA recognises that there will be a range of business models and has taken this into consideration when developing its proposals, for example, in relation to the application of requirements which recognise that certain firms will structure themselves in different ways.

Equality and diversity

4.20 In making its rules and establishing its practices and procedures, the PRA may not act in an unlawfully discriminatory manner. It is required, under the Equalities Act 2010, to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out its policies, services and functions.¹ To meet this requirement, the PRA has performed an assessment of the policy proposals and does not consider that the proposals give rise to equality and diversity implications.

¹ Equalities Act 2010, section 149(1).

Appendices

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| 1 | Draft Supervisory Statement - Operational Continuity in Resolution |
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| 2 | Draft Operational Continuity Part |
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Appendix 1 - Draft Supervisory Statement - Operational Continuity in Resolution

1 Introduction

1.1 This supervisory statement is relevant to UK banks, building societies and PRA-authorised investment firms (hereinafter ‘firms’) to which the Operational Continuity Part of the PRA Rulebook applies.

1.2 The purpose of this supervisory statement is to set out the PRA’s expectations on firms to ensure operational continuity of critical shared services to facilitate recovery actions, orderly resolution and post-resolution restructuring.

1.3 Providing clarity on the PRA’s expectations in this area supports the PRA’s general objective of promoting the safety and soundness of firms by reducing the adverse effect that the disorderly failure of a firm can have on the UK financial system.

1.4 Where necessary, the PRA may use its power under section 55M of Financial Services and Markets Act 2000 (FSMA) to require a firm to meet these expectations.

2 Operational arrangements for critical shared services

2.1 Critical shared services are those services that need to be available to one or more business unit of a firm or entity of a group in order to provide functions critical to the economy.

2.2 A firm can receive critical shared services in a number of ways:

- a firm can outsource critical shared services to another entity within its group (group provider) or to an external party (non-group provider);
- a firm can operate a business unit within the firm that provides critical shared services to one or more of its business units or firms of the group; or
- a firm can use a combination of the above.¹

2.3 This supervisory statement should be read alongside the PRA Rulebook, and does not replace the PRA’s rules. The firms to which this supervisory statement is relevant will continue to be required to comply with the existing PRA rules, including Fundamental Rule 8, the General Organisational Requirements Part, the Risk Control Part and the Outsourcing Part of the PRA Rulebook.

3 Facilitating recovery and resolution

3.1 Irrespective of operational structure, the PRA expects a firm to be able to demonstrate how its operational arrangements supporting critical shared services facilitate recovery and resolution as required by Chapter 2 of the Operational Continuity Part.

¹ These organisational arrangements are referred to in this supervisory statement as critical shared services providers.

3.2 This may include demonstrating how its operational arrangements support separability and restructuring. If a firm cannot demonstrate how its operational arrangements support separability or restructuring the PRA will expect the firm to make changes to achieve this.

3.3 Where a firm has identified the disposal of business units or legal entities as part of its recovery strategy, the PRA expects it to be able to demonstrate how its operational arrangements improve the execution of recovery options by shortening the disposal timeline.

3.4 The PRA also expects a firm to be able to demonstrate how its operational arrangements facilitate any post-resolution restructuring. For example, a firm should be able to evidence how the arrangements facilitate separability of group entities while ensuring operational continuity.

3.5 The PRA expects a firm subject to ring-fencing to demonstrate how its proposed arrangements support separability of the ring-fenced body (RFB) and its sub-group from the other entities in the wider group.

4 Financial resilience

4.1 The PRA expects a firm to ensure that the critical shared services provider has sufficient financial resources to ensure continuity of provision of critical shared services to receiving entities during stress or resolution, and after resolution, as part of the post bail-in restructuring of any group entities. Firms should also manage the risks associated with the liabilities of critical shared services providers. See Rule 2.6 of the Outsourcing Part and Rule 2.5 of the General Organisational Requirements Part of the PRA Rulebook.

4.2 The PRA considers that financial resources may be necessary to manage the risks that critical shared services providers are exposed to in a stressed scenario or resolution event, including:

- temporary loss of revenue due to suspension of payments from clients during the resolution period;
- expense-revenue mismatch during resolution, related to reduced demand for services from entities in resolution but constant fixed overheads for the service provider;
- employee costs, for example, retention and redundancy payments;
- restructuring and wind-down costs; and
- write down of intangible and relationship-specific assets.

4.3 The method by which a firm may seek to ensure the critical shared services provider is financially resilient may vary depending on whether the critical shared services provider is an unregulated group provider, a PRA-regulated provider or a non-group provider.

Critical shared services provided from within the group

4.4 The PRA expects firms to ensure there is sufficient capital and liquidity to cover all risks, including the critical shared services provider's financial resilience.

4.5 For a critical shared services provider located in a group, the PRA expects that, as a minimum, the critical shared services provider should be supported by capital resources (or

positive net assets, as appropriate) equivalent to 25% of annual fixed overheads and liquidity resources equivalent to 50% of annual fixed overheads. This is a minimum expectation only and the PRA expects a firm to analyse and establish the adequate level of capital and liquidity resources needed to ensure a critical shared services provider can manage the risks it is exposed to in stress or resolution event.

4.6 The PRA expects the critical shared services provider to calculate its annual fixed overheads, using figures resulting from the applicable accounting framework. The following may be excluded:¹

- a) fully discretionary staff bonuses;
- b) employees', directors' and partners' shares in profits, to the extent that they are fully discretionary;
- c) other appropriations of profits and other variable remuneration, to the extent they are fully discretionary;
- d) shared commission and fees payable which are directly related to the commission and fees receivable, which are included within the total revenue and where the payment of commission and fees payable is contingent upon the actual receipt of the commission and fees receivable;
- e) fees, brokerage and other charges paid to clearing houses, exchanges and intermediate brokers for the purposes of executing, registering or clearing transactions;
- f) fees to tied agents in the sense of point 25 of Article 4 of the Directive 2004/39/EC of the European Parliament and of the Council;
- g) interest paid to customers; and
- h) non-recurring expenses from non-ordinary activities.

Unregulated provider

4.7 The PRA expects recipient firms to ensure that liquidity resources for the critical shared services provider are segregated from other group assets. The resources will need to be available to the critical shared services provider regardless of the failure or resolution of other group entities. This may involve holding liquid assets outside the group or making deposits with third parties. The PRA expects recipient firms to be able to explain how and where such assets are held.

PRA-regulated provider

4.8 Where critical shared services are located within a business unit of a PRA-regulated firm, the PRA expects the firm to ensure that it has sufficient liquid assets to support the provision of those critical shared services. The PRA expects a firm to ensure that liquidity resources to support critical shared services are segregated from other group assets. The resources will need to be available to the critical shared services provider regardless of the failure or resolution of other group entities. This may involve holding liquid assets outside the group or

¹ Based on the calculation of fixed overheads set out in Commission Delegated Regulation EU 2015/488 of 4 September 2014 amending Delegated Regulation (EU) No 241/2014 as regards own funds requirements for firms based on fixed overheads.

making deposits with third parties. The PRA expects the firm to be able to explain how and where such assets are held.

Critical shared services provided from outside the group

4.9 If the critical shared services a firm receives are provided by a non-group provider, the PRA expects a firm to comply with the requirements set out in the Outsourcing Part of the PRA Rulebook. Firms should consider the service provider's ability and capacity to perform the outsourced service reliably and professionally before the firm enters into the outsourcing contract.

5 Operational resilience

5.1 In ensuring that the critical shared services provider has sufficient operational capability, under Rule 2.6 of the Outsourcing Part and Rule 2.5 of the General Organisational Requirements Part of the PRA Rulebook, the PRA expects a firm to ensure the services will remain operational despite the failure of any group entities. The PRA views the following as examples of how a firm could achieve this:

- ensuring that the operating division of a firm or group 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 operational division of a firm or the group provider has sufficient staff and expertise dedicated to the critical shared services provision to carry out post-restructuring activity if necessary.

6 Contractual service provisions

6.1 In accordance with Rule 3.2 of the Operational Continuity Part of the PRA Rulebook, a critical shared services provider, whether a group provider or a non-group provider, should not be able to change the arrangements of provision as a result of a firm or a member of the group entering into a period of stress or resolution.

6.2 It is expected that steps to achieve this could include:

- clauses in contracts or agreements for critical shared services provided by group providers and non-group providers that allow for continued use of services, and that contracts or agreements remain valid after the firm or a group member has entered stress or resolution, provided there is no default on payment obligations (this does not apply if the contract ends due to an upcoming maturity date);
- clauses in contracts or agreements that allow for the continued use of such products or receipt of such services, by entities following their disposal by a group for a reasonable period of time in order to support group restructuring; and
- agreements with group providers and non-group providers that are enforceable pre and post-resolution.

7 Objective service level agreements

7.1 The PRA expects firms, irrespective of their business model, to demonstrate that they have identified and documented the critical shared services they receive. The PRA's expectations are different depending on what type of entity is providing the service.

7.2 The PRA expects that under Rule 2.7 of the Outsourcing Part, the General Organisational Requirements Part and Fundamental Rule 8, service level agreements from group providers or non-group providers are objective and on third party terms. Objective service level agreements help to identify operational interdependencies and may guide restructuring efforts.

7.3 The PRA expects agreements for critical shared services between legal entities to be well documented and include the following considerations as a minimum:

- clear parameters against which service provision can be measured;
- quantifiable and qualitative metrics and performance indicators;
- the provider and recipient(s) of the service;
- the nature of service and its pricing structure;
- any onward provision to other entities or sub-contracting to third party providers; and
- provisions that terms and pricing should not change as result of a party to the contract entering stress or resolution.

7.4 Under Rule 3.1 of the Operational Continuity Part of the PRA Rulebook, the PRA expects firms to document the details of the critical shared services provided from one business unit to another. The minimum information expected to be documented includes details of the business area receiving and providing the services as well as the transition arrangements in resolution. This information should form the basis of transitional service agreements to facilitate the services being easily identified and transferable to another provider in resolution without interruption, should this be the preferred resolution strategy.

8 Access to operational assets

8.1 The PRA expects, under Rule 3.4 of the Operational Continuity Part of the PRA Rulebook, that firms should articulate clearly how access to operational assets supporting critical shared services will be guaranteed at the point of stress or resolution of a firm, another group entity or the critical shared services provider itself. Types of operational assets the PRA considers should meet this expectation include but are not limited to: data, intellectual property, premises, licences and leases.

8.2 This is particularly important for subsidiaries, where a subsidiary's parent company negotiates contractual arrangements at a group level.

8.3 In some cases, the PRA may expect operational assets essential to performing critical shared services to be owned or leased by the same firm that receives the critical shared services.

9 Charging structures

9.1 In meeting Rule 3.3 of the Operational Continuity Part of the PRA Rulebook, the PRA expects charges for critical shared services to be predictable, transparent and set on an arm's length basis, irrespective of a firm's operating model. If critical shared services are located in a group provider, arm's length terms can help to ensure that the contract can more easily be transferred to another service provider if needed.

9.2 If the critical shared services are located within a business unit of a firm, similar internal charging structures are necessary to ensure that corresponding documentation could form the basis of an external contract if the critical shared services provider is restructured following resolution. The PRA expects that critical shared services are on terms which could be readily substituted with another service provider, such that critical shared services could be provided on an uninterrupted basis.

10 Prevention of preferential treatment

10.1 Under Rule 4.3 of the Operational Continuity Part of the PRA Rulebook, the PRA expects all firms to be able to demonstrate that they have taken the necessary steps to ensure a group critical shared services provider treats all group members according to existing arrangements.

10.2 Firms should ensure that organisational structures and agreements do not require the critical shared services provider to prioritise its resources to support certain group entities over others.

11 Governance arrangements

11.1 The PRA expects firms to ensure a critical shared services provider located within the group, either a business unit of a firm or a group provider, has its own governance structure in place for the provision of critical shared services to the firm as set out in Rule 4.2 of the Operational Continuity Part of the PRA Rulebook. A firm should be able to articulate to the PRA the governance and oversight arrangements the critical shared services provider has in place.

11.2 The PRA expects the critical shared services provider within the group not to rely excessively on management remunerated externally to it. The PRA expects firms to demonstrate that the provider has sufficient governance oversight in place to ensure that critical shared services can be provided without relying on senior staff that may be dismissed or that may no longer form part of the same group after resolution.

11.3 Where there are multiple reporting lines within the group, the PRA expects firms to ensure that there is clarity on reporting lines in the event of resolution, prioritising operational continuity for critical shared services.

11.4 If critical shared services are received from external non-group providers, the PRA expects that the provider will have suitable governance and oversight arrangements as set out in the Outsourcing Part of the PRA Rulebook. This includes properly supervising and adequately managing the risk associated with the outsourced critical shared services.

12 Outsourcing

12.1 The PRA expects firms to refer to the rules in the Outsourcing Part of the PRA Rulebook when considering their operational arrangements supporting critical shared services. The Outsourcing Part of the PRA Rulebook (Rules 2.1 to 2.4) permit the outsourcing of critical or important operational functions only if the outsourcing of such activities does not result in:

- a transfer of responsibility from the PRA-authorized firm to the outsource provider;
- an increase in operational risk;
- an impairment of the quality of the firm's internal control; or
- an alteration to the conditions with which the firm must comply in order to be authorised.

12.2 The PRA expects that a consequence of the outsourcing rules will be that a firm that outsources critical shared services will continue to remain responsible for functions that require senior management judgement or decision-making that could affect the prudential soundness or risk appetite of the regulated firm. For this reason, the PRA expects these functions to be retained within the regulated firm. This reflects the principles set out in Outsourcing Part of the PRA Rulebook.

Appendix 2 - Operational Continuity Part

PRA RULEBOOK: CRR FIRMS: OPERATIONAL CONTINUITY INSTRUMENT [DATE]

Powers exercised

- A. The Prudential Regulation Authority (“PRA”) makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 137G (The PRA’s general rules);
 - (2) section 137T (General supplementary powers);
- B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

Pre-conditions to making

- C. In accordance with section 138J of the Act (Consultation by the PRA), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

PRA Rulebook: CRR firms: Operational Continuity Instrument 2016

- D. The PRA makes the rules in Annexes A, B, and C to this instrument.

Commencement

- E. This instrument comes into force on [DATE].

Citation

- F. This instrument may be cited as the PRA Rulebook: CRR firms: Operational Continuity Instrument 2016.

By order of the Board of the Prudential Regulation Authority

[DATE]

Annex A

In this Annex, the text is all new and is not underlined.

Part

OPERATIONAL CONTINUITY

Chapter content

- 1. APPLICATION AND DEFINITIONS**
- 2. FACILITATION OF EFFECTIVE RECOVERY AND RESOLUTION PLANNING**
- 3. DETAILS OF OPERATIONAL CONTINUITY ARRANGEMENTS**
- 4. GROUP ARRANGEMENTS FOR OPERATIONAL CONTINUITY**

Links

1 APPLICATION AND DEFINITIONS

1.1¹

1.2 In this Part, the following definitions shall apply:

critical functions

has the meaning in Article 2(1) of the *BRRD*.

critical shared services

means 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 functions*.

group provider

in relation to a *firm*, means a member of its *group* that provides *critical shared services* to it.

2 FACILITATION OF EFFECTIVE RECOVERY AND RESOLUTION PLANNING

2.1 A *firm* must ensure the operational arrangements for the *critical shared services* it receives facilitate the effective execution of:

- (1) its *recovery plan*; and
- (2) the *group recovery plan* of its *group*.

2.2 A *firm* must ensure the operational arrangements for the *critical shared services* it receives facilitate the effective planning for and effective taking of actions in the event of:

- (1) circumstances in which all or part of its business is likely to fail; or
- (2) the failure of all or part of its business.

2.3 A *firm's* operational arrangements must ensure the continuity of the *critical shared services* it receives in the event of:

- (1) circumstances in which all or part of the business of any other member of its *group* is likely to fail; or
- (2) the failure of all or part of the business of any other member of its *group*.

¹ The PRA intends to apply the following rules to banks, building societies and PRA-authorised investment firms that receive critical shared services supporting functions that are critical to the economy.

3 DETAILS OF OPERATIONAL CONTINUITY ARRANGEMENTS

- 3.1 If a *firm* receives *critical shared services* from one of its business units, it must document:
- (1) the details of the *critical shared services*; and
 - (2) the transition arrangements for these *critical shared services* in the event of the *firm* being restructured or resolved.
- 3.2 If a *firm* receives *critical shared services* from another party, it must ensure the agreement governing the provision of these services:
- (1) does not permit the other party to terminate, suspend or materially alter the services or facilities or the agreement as a result of the deterioration in the financial circumstances or the resolution of the *firm* or any of its *group* members; and
 - (2) entitles the *firm* to continue to receive those services during the *firm's* resolution or restructuring as long as the *firm* fulfils its obligations under the agreement.
- 3.3 A *firm* must ensure the charging structure for the *critical shared services* it receives is predictable, transparent and set on arm's length terms.
- 3.4 A *firm* must ensure access by the *firm*, the service provider and the *PRA* to the operational assets supporting *critical shared services* is not disrupted in the event of a *group* member being restructured or resolved.

4 GROUP ARRANGEMENTS FOR OPERATIONAL CONTINUITY

- 4.1 This chapter applies to a *firm* that receives *critical shared services* from a *group provider*.
- 4.2 A *firm* must ensure the *group provider* has a governance structure in place for the provision of *critical shared services* to the *firm* that does not depend on senior staff of the *firm* or other members of its *group* that might not be available if a *group* member is restructured or resolved.
- 4.3 A *firm* must ensure the *group provider* does not deal with a *group* member or business unit in the *group* in any other way than set out in its agreement with that *group* member or business unit as a result of the deterioration of the financial circumstances of another *group* member.

Annex B

In this Annex, new text is underlined and deleted text is struck through.

Part

RECOVERY PLANS

...

1.2 In this Part, the following definitions shall apply:

...

Group recovery plan

~~Means a group recovery plan drawn up by a BRRD undertaking in accordance with Chapter 3.~~

...

Recovery plan

~~Means a recovery plan drawn up by a firm in accordance with 2.~~

Annex C

In the Glossary Part of the Rulebook, insert the following definitions.

Group recovery plan

Means a group recovery plan drawn up by a *BRRD undertaking* in accordance with Recovery Plans 3.

Recovery plan

Means a recovery plan drawn up by a *firm* in accordance with Recovery Plans 2.