

Policy Statement | PS29/17
Recovery planning

December 2017



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY





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1 Overview

1.1 This Prudential Regulation Authority (PRA) Policy Statement (PS) provides feedback on responses to Consultation Paper (CP) 9/17 'Recovery planning'¹ and sets out the PRA's final expectations on the content of recovery plans and on the approach to recovery planning for groups containing a ring-fenced body (RFB).

1.2 This PS is relevant to UK banks, building societies, PRA-designated investment firms and qualifying parent undertakings ('firms') to which the Recovery Planning Part of the PRA Rulebook applies.

1.3 In CP9/17, the PRA consulted on a new supervisory statement (SS) on recovery planning that would supersede SS18/13 'Recovery planning'.² The PRA also consulted on minor amendments to SS8/16 'Ring-fenced bodies (RFBs)'.

1.4 The appendices to this PS set out the final SS for recovery planning (Appendix 1) and the updated SS8/16 (Appendix 2). The PRA has made minor amendments to the draft SS published in CP9/17, mainly to add further clarity, after considering the responses to the CP. Chapter 2 of this PS summarises the issues raised by respondents and notes the main areas of the final SS where the PRA has made amendments to the proposals contained in CP9/17.

1.5 The PRA does not consider that the changes will have a significant impact on firms. In the PRA's opinion, the impact on mutuals of the policies set out in the final SS is not significantly different from the impact on other firms.

1.6 The policies contained in the SS have been developed in the context of the current UK and EU regulatory framework. The PRA will keep the policies under review to assess whether any changes would be required due to changes in the UK regulatory framework, including changes arising once any new arrangements with the European Union take effect.

2 Feedback to responses

2.1 The PRA received eight responses to CP9/17. Respondents were broadly supportive of the proposals but did raise a number of specific issues and questions on the details of the proposed SS. These are discussed below by topic.

Implementation date

2.2 Respondents asked that the PRA allow firms a reasonable period of time to meet the expectations set out in the new SS.

2.3 The PRA recognises that some aspects of recovery planning are less developed across the industry than others and that it will take firms more time to meet the PRA's expectations in these areas. Firms should therefore meet the following expectations in SS9/17 by Sunday 30 June 2019:

- full separability analysis for disposal options (paragraph 2.30(i) of the SS);
- modelling of capital and liquidity profiles in each scenario (paragraph 2.66 of the SS);

¹ June 2017: www.bankofengland.co.uk/pru/Pages/publications/cp/2017/cp917.aspx.

² January 2015: www.bankofengland.co.uk/prudential-regulation/publication/2013/supervisory-tools-recovery-and-resolution-plans.

- full analysis of funding needs by currency in each scenario (paragraph 2.68 of the SS); and
- integration of liquidity contingency plans (contingency funding plans) (paragraph 2.93 of the SS).

2.4 The PRA expects firms to meet all other expectations set out in SS9/17 by Saturday 30 June 2018, or by the firm's first annual update of their recovery plan following publication of this policy statement, whichever is later.

Proportionality

2.5 In the draft SS, the PRA stated that the expectations should be met by all firms, but that the degree of detail and analysis in the recovery plan should reflect the complexity and the size of the firm.

2.6 Respondents requested that the PRA provide clear criteria to identify small firms and specify a sub-set of the expectations that would not apply to them. The PRA was also asked whether small firms need to conduct fire drills and produce playbooks and whether 'simplified obligations'¹ would be applied to smaller firms.

2.7 The PRA considers recovery planning to be important for all firms as it increases their resilience to stress. But the PRA anticipates that the burden of recovery planning will naturally reflect the size and complexity of the firm in question and should not be disproportionate. For example, smaller and simpler firms are likely to have fewer recovery options to consider and will not need to consider the interdependencies between group and local entities, as would be the case for multinational banking groups.

2.8 The PRA has applied the principle of proportionality to the SS; it has not applied simplified obligations in respect of recovery planning. The draft SS was already clear that firms with shorter and less complex recovery plans did not need to produce a separate playbook or complete the information template. In response to feedback, the PRA has amended the SS (paragraph 2.72) to clarify that it expects at least one fire drill exercise to be conducted prior to the submission of the recovery plan to the PRA, subject to a minimum of one fire drill taking place every three years (rather than every two years as proposed in the draft SS). The PRA determines the frequency with which firms should submit their recovery plan on a firm-by-firm basis, with larger firms tending to submit their plans on an annual cycle.

2.9 Firms may contact their supervisor to discuss the application of the different components of recovery planning specified in the SS, to ensure they are tailored to the firm in question and proportionate. To fulfil their responsibilities under the Senior Managers Regime,² firms should satisfy themselves as to the sufficiency of their recovery planning and that this is consistent with their size and complexity.

Level of detail

2.10 Respondents raised concerns that the increase in the level of detail in the draft SS would result in an increase in the content of the recovery plan, which might diminish its usability.

2.11 The level of detail in the new SS has increased relative to SS18/13. Informal feedback from firms pre-consultation suggested that they would welcome this. The PRA considers that the level of detail in the SS now strikes the right balance between providing detail of the PRA's

¹ Article 4 of Directive 2014/59/EU.

² See Allocation of Responsibilities 4.1(10).

expectations of firms and not being overly prescriptive, allowing firms to take a pragmatic approach to recovery planning.

2.12 Firms should note that the examples provided in the SS relating to the content of playbooks and design of fire drill exercises are intended to be illustrative, not prescriptive; the approach should be highly tailored to the firm in question. The PRA encourages firms to focus, in general, on the quality rather than the quantity of information provided in their recovery plans.

2.13 The PRA recognises, however, that some content produced by firms for recovery planning is more relevant to the production of the recovery plan, and for the PRA in assessing its credibility, than for practical application in a recovery situation. In response to feedback, the PRA has amended the SS (paragraph 2.78) to clarify that firms may include such content in annexes to the plan.

2.14 The PRA was asked to hold events for regulated firms to help firms understand where they are deficient in recovery planning relative to the PRA's expectations. The PRA has considered this and, in addition to the feedback the PRA provides to firms on their recovery plan submissions, will hold workshops for firms in 2018 H1 on the content of the SS. Further information will be provided to firms via their usual supervisory contact in early 2018.

Recovery capacity

2.15 In response to a request for clarification of the methodology for calculating 'recovery capacity', further detail has been added to the SS (paragraph 2.39).

Indicators

2.16 The PRA was asked to clarify whether it expects firms to define a risk appetite for indicator metrics that do not currently have an associated risk appetite.

2.17 The PRA has clarified in the SS (paragraph 2.51) that firms are not expected to define additional risk appetite metrics, but should make use of existing metrics as one of the inputs when calibrating relevant indicators. The SS also now notes (paragraph 2.46) that the PRA expects firms to have a coherent process for monitoring risk appetite metrics and indicators, within the management information framework.

Scenario testing

2.18 In the CP, the PRA proposed that scenario testing should be used to improve the consistency of the different parts of the recovery plan and demonstrate that the plan is credible as a whole.

2.19 Respondents asked how granular the modelling of the scenarios should be and whether all shortcomings identified in scenario testing needed to be addressed prior to the submission of the recovery plan to the PRA.

2.20 The PRA expects firms to take responsibility for their scenario testing and satisfy themselves that they have conducted appropriate modelling and analysis to understand whether they would be able to recover from different types of stress. The level of detail included in the analysis should be proportionate to the size and complexity of the firm. The PRA expects deficiencies identified through scenario testing to be remediated before the recovery plan is submitted to the PRA in the relevant year. In response to feedback, the PRA has clarified in the SS (paragraph 2.61) that in exceptional cases, when this is not possible,

firms should report the findings in their recovery plan and specify when these issues will be rectified.

2.21 In response to feedback, the PRA has also clarified the wording in the SS (paragraph 2.86) relating to communications plans. The PRA expects firms to explain in the scenario testing how the communications strategy would mitigate risks associated with the implementation of recovery options. The PRA does not expect firms to quantify the impact of the communications strategy on the firm's recovery.

Recovery plan information template

2.22 Feedback to the CP noted that the proposed information template could distort complex aspects of firms' recovery plans by forcing the data into a standardised template. Other responses recognised the usefulness of the template to the PRA for assessing and comparing plans and said it was a useful addition to the recovery planning framework. The PRA has clarified in the SS (paragraph 2.70) that the template will aid, but not replace, the assessment, comparison and benchmarking of recovery plans by the PRA.

Interaction between group and subsidiary plans

2.23 In the CP, the PRA proposed that expectations relating to the interaction between group recovery plans and subsidiary recovery plans would be consistent with the outcome of the EBA's consultation 'Recommendations on the coverage of entities in a group recovery plan'.¹

2.24 Respondents asked for further clarity on the interaction between the proposed SS and the EBA's consultation, including the approach that firms should take in respect of indicator frameworks and scenario testing relating to local entities.

2.25 The EBA published 'Recommendation on the coverage of entities in a group recovery plan' on 1 November 2017.² The PRA has updated the SS (paragraphs 1.3 and 2.90) to reference the EBA's Recommendation, and clarified that firms should follow the Recommendation. For the avoidance of doubt, the PRA has removed content from the SS to avoid duplication with the EBA's Recommendation.

Interaction with other relevant regimes and requirements

2.26 In the draft SS, the PRA stated that it strongly encouraged firms to integrate their liquidity contingency plan (contingency funding plan) into their recovery plan.

2.27 Respondents argued that this may not always be possible, for example when local regulations require separate documents. The PRA has recognised in the SS (paragraph 2.93) that there may be circumstances where it is necessary to maintain separate documents. But this should be the exception rather than the rule. Where firms maintain separate documents, they should explain in the recovery plan the rationale for doing so, and ensure the two documents are consistent with each other.

2.28 The PRA was asked to clarify what it meant by a 'single process' for addressing a liquidity stress. The PRA has clarified in the SS (paragraph 2.93) that it expects firms to have a coherent process for responding to a liquidity stress. The PRA wants to reduce the risk posed by inconsistencies in approach within the risk management framework.

1 March 2017: www.eba.europa.eu/documents/10180/1770344/Consultation+Paper+on+recommendation+on+coverage+of+entities+in+group+recovery+plans.pdf.

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

2.29 The PRA was asked to clarify whether it has changed its expectation regarding the choice of the accountable director responsible for the firm's recovery plan. The PRA has amended the wording in the SS (paragraph 2.97) to clarify that the PRA has generally observed (rather than expects) that the accountable director is the CEO, CFO or CRO. The PRA recognises that some firms may take a different approach, but expects a suitably senior individual to be accountable for recovery planning.

Approach to recovery planning for groups containing a ring-fenced body (RFB)

2.30 The PRA was asked to clarify whether an RFB sub-group can execute recovery options to generate surplus capital or liquidity for the benefit of group entities outside the RFB sub-group. It would not be appropriate to include this level of detail in the SS on recovery planning but in response to this feedback the PRA has included a brief explanation of the relevant ring-fencing policy below.

2.31 For groups containing an RFB, any proposed recovery action should comply with the PRA's ring-fencing rules and guidance.¹ In particular, an RFB must, in carrying on its business, ensure that it is able to take decisions independently of other members of its group.² An RFB is also required to take all reasonable steps to identify and manage any conflict between its interest and those of one or more members of its group.³ The board of an RFB would therefore need to agree to any proposed recovery options involving the RFB or its ring-fenced affiliates, including those that may benefit group entities which are not ring-fenced affiliates. This is particularly important during a stress, where an RFB may be under pressure from other members of the group to take actions to support the other members of the group but which are detrimental to the interests of the RFB.

2.32 An RFB must also not make a distribution to any entity in its group that is not a ring-fenced affiliate unless it has given reasonable notice to the PRA of its intention to make the payment.⁴ If the PRA was notified of such a transaction, it might ask the firm to demonstrate how the proposed transaction is compliant with the ring-fencing obligations.

2.33 In addition, any recovery option that involves a transaction or arrangement between the RFB sub-group and group entities which are not ring-fenced affiliates would be subject to the PRA's rules on intragroup arrangements. These include the requirement that an RFB must ensure as far as reasonably practicable that it applies the same standard to the management of its transactions with any member of its group that is not a ring-fenced affiliate as it would to the management of its transactions with any person that is not a member of its group.⁵ Also, an RFB must enter into a transaction with a member of its group which is not a ring-fenced affiliate only on arm's length terms.⁶ These rules are likely to restrict the RFB sub-group from making payments to group entities which are not ring-fenced affiliates during a stress. Ring-fencing requirements are therefore likely to act as a constraint on the recovery options available to the group. This will depend on the facts of each case.

2.34 The PRA will consider the ring-fencing rules when assessing the credibility of the recovery options proposed in a firm's recovery plan.

1 The PRA has a dedicated webpage on ring-fencing and structural reform, which includes background, key changes, a table summarising policy development and updates on implementation, see www.bankofengland.co.uk/pr/Pages/supervision/structuralreform/default.aspx.

2 See Ring-fenced Bodies 3.1.

3 See Ring-fenced Bodies 3.3.

4 See Ring-fenced Bodies 11.

5 See Ring-fenced Bodies 3.5.

6 See Ring-fenced Bodies 12.

Amendments to SS8/16, 'Ring-fenced bodies (RFBs)'

2.35 No responses were received on the proposal to update SS8/16. In addition to the amendment proposed in CP9/17, the PRA has made a further update to SS8/16 to correct a numbering error; the paragraph previously numbered as '4.23 4.22A' has been renumbered as 4.22A.

Appendices

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- 1 Supervisory Statement SS9/17 'Recovery planning', available at www.bankofengland.co.uk/prudential-regulation/publication/2017/recovery-planning-ss
 - 2 Supervisory Statement SS8/16 'Ring-fenced bodies (RFBs)', available at www.bankofengland.co.uk/prudential-regulation/publication/2016/ring-fenced-bodies-ss