Resolvability Assessment Framework

BSA response to Bank / PRA consultations

April 2019

Introduction

The BSA is pleased to respond briefly to these two related consultations published in December 2018. They apply only to a small number of our large member societies at present, though over time other fast growing societies may come within scope.

General comments

The BSA supports the principle of a transparent **resolvability assessment framework (RAF)**– resolvability should not be assessed on the basis of a secretive “black box”. The Bank is to be commended on what it has published so far in the field of resolution, especially the ground-breaking “Purple Book” which did an excellent job of explaining resolution clearly and simply.

But we hope that the implementation of this framework will be as **efficient** as possible, **keeping to a minimum any duplication of effort**. Central to this, and mentioned in passing in the Bank CP, is the proper acknowledgment of the systems, processes and capabilities already in place at firms in response to existing PRA or Bank rules or policy. The Bank CP would have been more useful and effective if it had adopted more firmly the “substantive gap” approach – identifying and focusing on what firms are not yet able to do, rather than mainly re-cataloguing, with minor variation, matters already substantively covered elsewhere through previous initiatives.

And we remain to be convinced that **disclosure** as proposed by the Bank and PRA is desirable, nor is there sufficient certainty that it will achieve the stated objectives.

In the sections that follow, we respond first to the chapters of the main Bank CP, and bring in comments on the PRA CP where relevant.

Specific responses to consultation questions

Chapter 2 – Scope

We are broadly content with the proposed scope, with the following qualification. It is possible that there will be some relatively small banks or building societies that are assigned to the partial transfer resolution strategy purely because they have more than the indicative range (40,000 to 80,000) of current accounts. We question whether application of the full RAF to this category is necessary or proportionate – a less burdensome, cut-down and simplified version may be called for – as, perhaps, contemplated by paragraphs 3.5 and 3.16 of the Bank CP.

Chapter 3 – Application to in-scope firms

Again, we are broadly content with the proposed application to firms assigned to the Bank-led bail-in or partial transfer strategy, with the promise of proportionality in paragraph 3.5 and of further tailoring in paragraph 3.16. Our members do not have MPE, nor is any a hosted firm.

Chapter - A stylised resolution timeline

Chapter 4 is a helpful explanation of the processes and expected timeline – Figure 1 is particularly useful as a visual representation of the phasing of various resolution activities.

Chapter 5 - Achieving resolvability

The eight generic "barriers" to resolvability, tabulated in Box 1 of the CP, are in our view adequately comprehensive, at least for domestic UK firms. On a point of nomenclature, each item in Box 1 is stated not as a **barrier**, but as a positive state of affairs that clearly is a **condition** of resolvability. To be a barrier rather than a condition, these items would have to be stated as negatives. So, for instance, on **Funding in resolution** :

Funding in resolution: In order to ensure they continue to meet their obligations as they fall due, firms are [not] able to estimate, anticipate and monitor their potential liquidity resources and needs and [cannot] mobilise liquidity resources in the approach to and throughout resolution.

With the added words in square brackets, this is a barrier. Without them, it is a positive condition, or possibly a hurdle. And in the sentence of the headpiece to Box 1 :

Box 1 sets out a brief description of each barrier grouped by the outcome for resolvability that they will contribute to achieving.

Clearly a "barrier" cannot achieve any outcome. If described as "barriers" in the negative, they might prevent or frustrate an outcome, or if stated as positive conditions, they can indeed contribute to achieving an outcome. The use of "barrier" language needs to be looked at again, as it is currently confusing.

For the generality of firms (other than purely domestic UK firms like our members) we would suggest that there is in fact a **ninth barrier** to resolvability, along the following lines:

Firms' group exposure to activities in non-UK jurisdictions, via branches or subsidiaries, impedes resolution of the UK entities due to conflicts of law or jurisdiction, or absence of practical co-operation.

Turning to the second question, we support the useful points made in paragraphs 5.5 to 5.9 : just as some of the proposed policy is not new, but derives from extant FSB materials, so firms should be able to leverage existing capabilities. Indeed, we urge the Bank to seek the maximum efficiency, and division of labour, in this process, so that duplication of effort is avoided. Where existing documents cover the necessary content, re-writing and re-presentation should not be necessary. **One way in which the Bank could minimise unnecessary burdens is to take a "substantive gap" approach** – that is, ***before*** a firm is required to do any more work under the RAF, the Bank should review all materials, explanations and processes already supplied by that firm or in place, and identify the material gaps. Only then should firms be required to expend effort, and then only on the gaps.

Chapter 6 – Financial resources

The principles and measures proposed are reasonable, and should not prove difficult for our MREL-holding members, as building society MREL arrangements are much simpler - MREL issued directly by the society, with no complex group structures. **We continue to challenge the current calibration of MREL**, where the effective minimum (for our typical MREL-holding member) of twice the leverage ratio is both illogical and excessive, and we will return to this issue ahead of the final calibration exercise, especially if in the meantime the BRRD-based obligation falls away.

Regarding **valuations**, we agree that the existing material (Valuation SoP etc) referenced in chapter 6 already covers the necessary ground, and no additional guidance is needed.

Funding in resolution must remain an area of uncertainty, especially for our large members who are all retail-funded, and therefore exposed to more unpredictable behaviours and contagion effects. Here too duplication should be avoided. Liquidity is already a highly – regulated topic – so it would be sensible (in particular for all business-as-usual issues) for the Bank first to use whatever rules, or outputs, are already in place for the PRA's extensive liquidity regime, including stress testing, rather than calling for anything broadly similar that duplicates effort. The substantive gap approach is called for here. Indeed, this seems to be what paragraph 6.66 envisages, but the concept should be given much greater prominence.

Subject to that, we find the principles etc on liquidity to be reasonable. Regarding the existence of gaps, we consider that large societies' liquidity management, being already extremely prudent and highly developed, is unlikely to leave major gaps of substance, though some matters may need to be reviewed and reformulated in a resolution context.

The main additional risk is, as indicated above, the behavioural uncertainty attaching to retail savings in a highly-charged environment, as was experienced in 2007 during the run on Northern Rock Bank, and later during the collapses of the Icelandic banks, Bradford & Bingley Bank, and others, and the part public ownership rescues of Lloyds HBOS and Royal Bank of Scotland. What is needed here, in addition to the resolvability preparedness of the banks themselves, is effective and considered steps by **the authorities** designed to re-establish depositor confidence. This responsibility, as we learned during the crisis, cannot be outsourced to banks themselves.

Chapter 7 – Continuity

The principles on **financial contract continuity** look broadly appropriate. We note the Bank's observation that many of the required capabilities should be in place already.

Regarding **operational continuity**, we note (in line with the imperative for efficiency and non-duplication) and welcome the important recognition (Box 4, page 38) that the starting point should be the existing PRA OCIR rules :

In the RAF cycle in 2020, firms will be assessed, and should assess themselves against, how their compliance with current PRA OCIR Policy is helping them towards ensuring continuity in resolution.

Equally important, the review of PRA OCIR and the development of further Bank policy must be totally consistent, and their implementation synchronised, to maximise efficiency.

On **continuity of access to FMI**, we note and welcome the observation (paragraph 7.24) that :

While these principles have not been consulted on previously by the Bank, the Bank expects that firms' existing capabilities will deliver much of what is required.

and again commend the "substantive gap" concept. But we do not agree that firms should have backup providers for every single critical FMI service as a matter of course, as in some instances they will not provide credible alternatives. Even where the FMI is substitutable, it cannot be assumed that when the primary FMI provider has withdrawn service in the course of a resolution, the back-up provider will in fact, on the day, step up and cover , rather than declining service for similar reasons to the primary provider.

Finally, on **restructuring**, we strongly endorse the basing of restructuring work on what is already required by the PRA under recovery planning. The only context where firms might go beyond the PRA's SS is, as suggested by the CP, to include one or more options that may be difficult to realise in a recovery situation but might work well in a resolution and restructuring.

Chapter 8 - Coordination and Communication

Both these are very important, not only in resolution, but even under business as usual. So it is especially important not to invent new systems with a view to resolution, but instead to use those systems, processes and capabilities that already exist, including as contemplated by existing PRA requirements. We support the reference in paragraph 8.11 :

Firms are encouraged to draw upon the arrangements they have in place for other purposes, including the PRA Rules mentioned above.

but would argue that this should be emphasised more strongly. Almost all the measures needed under chapter 8 can, and should, be based on a modification or development of existing capabilities, and that must be the efficient way to proceed. Chapter 8 would in fact have been more useful if it had itself identified the likely gaps against firms' existing capabilities.

On a point of detail, and also in response to Question 4 on page 18, any obligation to maintain a list of critical job roles for the sole separate purpose of resolution would be unduly burdensome and unnecessary : existing business-as-usual lists should suffice as the starting point.

Chapter 9 – Assurance (taken together with CP 31/18 : resolution assessment)

The approach to assessment and assurance is reasonable in principle, but we would expect a greater commitment to efficiency, non-duplication, and division of labour. Fortunately, the Bank already proposes (paragraph 9.11) that :

Where firms have already provided relevant information as part of resolution packs and the EBA Implementing Technical Standard (ITS) on the provision of information for the purpose of resolution plans, the Bank will consider this prior to requesting additional materials.

By division of labour, we mean that the Bank should seek to avoid the re-performance of essentially the same work or assessments by both the firm and the Bank. Again, the Bank indicates (paragraph 9.3) that :

In many cases, the Bank will have already engaged with firms on their work to support resolvability as part of its annual resolvability assessment. This engagement will provide a natural starting point for the Bank's assurance.

A better approach might be to have the Bank and each firm agree what process of overall assurance can give both parties the assurance they need, with the minimum total effort, and expense. The sequential approach implied in paragraph 9.5 may not achieve this.

Otherwise, the new requirement to prepare resolvability assessments every two years is not unreasonable – though it could be made clearer for whose benefit these are called for - the firm's Board / senior managers or primarily the Bank / PRA ?

Chapter 10 -The Bank's public statement (taken together with CP 31/18 : public disclosure)

As stated at the beginning, we do not consider that the Bank/ PRA has made the case for its proposed disclosures or disclosure requirements. We do, nevertheless, agree with the Bank's reasons for not making a single pass/fail judgment (paragraph 10.4) – as the CP indicates, a pass could suggest successful resolution is certain, while a fail would be (obviously) counterproductive. We think much the same reasoning argues against the vaguer disclosures actually proposed, nor is it clear for which stakeholders these disclosures will prove useful.

Taking first the PRA's proposals, the reasons advanced are set out in paragraph 2.14 of the PRA CP. They are not conclusive by any means. Rather they remain aspirational - disclosure "*should* support public confidence in the stability of the financial system" ; and the increased incentives "*may* contribute to greater financial stability".

Our first question is whether there is any actual evidence from any banking system elsewhere in the world that this kind of specific resolvability disclosure does in fact support public confidence, or contribute to financial stability. If so, it would have been helpful for the Bank /PRA to have cited it. If not, it may still be reasonable to try out this new policy, but it should be recognised as a **high-risk experiment**. If, contrary to the Bank / PRA's expectation, the actual disclosures reduce public confidence, and impair financial stability, they may prove a regrettable but irreversible mistake.

We fully appreciate the attraction to the Bank/PRA of using, in effect, “market discipline” as a further incentive to firms to ensure their resolvability is satisfactory – it is the Pillar 3 approach. But the stakes are massively higher. And the proposals beg the question of which stakeholders are supposed to benefit. While wholesale counterparties or institutional investors in bank securities (and rating agencies) may have the resources and expertise to understand the assessment summary report, collectively the most important stakeholders for a large building society are its members – for whom these disclosures are unlikely to be useful or comprehensible. There is a widespread view that existing Pillar 3 disclosures have become counterproductive, so piling more on top does not look sensible.

Turning to the Bank’s own proposal for disclosure, similar arguments apply. No evidence base is cited to support the expectation that the incremental step of this kind of disclosure will foster greater understanding of the Bank’s resolution regime.

This, we find, is the core issue. There is already extensive and commendable transparency around the resolution regime (as acknowledged at the start of our response), and considerable disclosures of, for instance, MREL. The Bank/ PRA have however failed to establish that the ***incremental*** benefit from the additional steps now required are worth the very real risks if this all goes wrong.

There is one further point specific to mutuals. Under current UK law, the resolution pathway for a large building society, if bail-in were required, is likely to involve a demutualisation executed by the Bank using statutory powers. While an exceedingly remote contingency, we consider that drawing attention to this in the context of resolution disclosures will cause misunderstanding among the principal stakeholder category, that is, the society’s ordinary savers, and to no benefit. We support the counter-proposal that Bank publish a single industry-level resolution disclosure, which gives assurance on the status of banks’ resolution planning, following a similar structure to the Bank’s approach to the disclosure of firms’ Concurrent Stress Testing results. Firms could then make supporting statements as part of their Annual Report and Accounts disclosures.

Chapter 11- Preliminary Impact Assessment

We agree with the Bank that the costs and benefits are difficult to quantify, and the Bank’s qualitative explanation that the benefits of a credible resolution regime comfortably exceed the costs of implementation of the RAF itself. But we note two important points. First, the 2015 estimates cited for the gross benefits of a resolution regime – 0.3% to 0.9% of GDP annually – relate to the totality of the UK’s resolution regime, made up of legislation (the SRR), bail-in resources (MREL), ring-fencing; and other organisational changes including but not limited to the implementation of the RAF. So the implicit baseline is not simply no RAF, but no resolution regime at all. What these figures cannot indicate is the incremental gross benefit of implementing the RAF (the subject of this consultation) where the baseline is all the non-RAF resolution regime measures already in place or in train (which are not the subject of this consultation). Second, in concluding that the implementation costs are relatively low, the Bank places reliance (paragraph 11.7) on the very point we make repeatedly above – **non duplication and use of existing capabilities** :

The Bank does not expect that firms should start again: it expects firms to use existing capabilities as much as possible.

Finally, we note that the impact assessment takes no account of the real possibility that the new disclosure requirements prove counterproductive. This strengthens our case that the disclosure requirements are a high-risk experiment, based neither on evidence from prior use elsewhere, nor on impact analysis.

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