afme/
Finance for Europe

05 April 2019

The Bank of England
Threadneedle Street,
London
EC2R 8AH

The Prudential Regulation Authority
20 Moorgate
London
EC2R 6DA

Submitted via email to - RAF_consultation_2018@bankofengland.co.uk

AFME response to the Bank of England's approach to assessing resolvability, and the PRA's Consultation Paper 31/18 - 'Resolution assessment and public disclosure by firms'

Dear Sir / Madam,

Please find enclosed the Association for Financial Markets in Europe's response to the Bank of England and PRA consultation papers regarding the proposed approach to assessing resolvability and public disclosures.

We would welcome the opportunity to discuss this response with you should this be helpful to you in your consideration of the points raised.

Please do not hesitate to contact us if you have any questions or wish to discuss these issues further.

Yours faithfully

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The Bank of England's approach to assessing resolvability

AFME Response

5 April 2019

The Association for Financial Markets in Europe (AFME)[1] welcomes the opportunity to respond to the Bank of England's (the 'Bank') consultation paper on the approach to assessing resolvability (the 'CP'). In our response, we provide our general comments as well as answers to the specific questions raised in the CP. We would welcome the opportunity to discuss our response as the Bank proceeds to finalise its policy.

GENERAL COMMENTS

We continue to support the overarching aims of resolution and generally agree that a comprehensive, but flexible, resolvability assessment framework merits introduction. We also recognise the need for an appropriate division of responsibilities among firms and the Bank, reflecting the roles they play in advance of and in resolution. As such, we welcome the principles-based approach the Bank is proposing in the CP.

Proportionality

We welcome the Bank's intention to be proportionate in the way it assesses resolvability.

One aspect of proportionality is that the requirements for assessing resolvability for smaller and less complex firms should be lighter touch than for larger, more complex firms. We also note that firms are starting from different positions: this emphasises the need for proportionality as part of a tailored approach to resolvability.

We ask in particular that the proportionate application of measures in the CP takes account of where policy is very recent, where further guidance is still required or where firms are still developing compliance solutions in discussion with the Bank. This is particularly relevant to the level of assurance it will be possible to obtain for certain impediments where policy is more recent and/or work remains to be done to remove the impediment ahead of the 2022 compliance deadline.

Consistency of assessment with group resolution strategy

Much work has gone into the development and implementation of group-wide resolution strategies for major banks. The Resolvability Assessment Framework (the 'RAF') should support these strategies. This means that the outcomes and barriers should be assessed against the resolution strategy for the relevant firm. For firms that are within a group which has developed a group-wide strategy:

[1] AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society. AFME is listed on the EU Transparency Register, registration number 65110063986-76.

- the Bank's assessment should be made against the implementation of the group-wide strategy and not against a standalone resolution of legal entities; and
- the firms' assessments of barriers and mitigants should be against the barriers to the group wide strategy and not to a standalone entity-by-entity resolution.

This enables firms to make assumptions about the nature of the barriers they face – e.g. a firm within a single point of entry ('SPE') group should be entitled to assume that it will not be 'degrouped' when assessing operational continuity in resolution.

Regulatory cooperation and convergence

We would encourage the Bank to continue to enhance cooperation and convergence with other resolution authorities when developing and applying the RAF. Cooperation among regulators is key to the success of resolution of international firms: clarity will be needed on how the RAF will fit in with the assessment frameworks of other resolution authorities. Convergence of requirements is also important – by which we mean the creation of consistent substantive requirements around resolvability, and also the flexing of the resolvability assessment process to reflect the allocation of roles and responsibilities between home and host authorities.

Disclosure obligations

The interaction between the RAF and the UKLA disclosure regime needs further consideration. It may not be possible for the Bank and firms to manage disclosure consistent with the expectations currently proposed in the RAF. In particular, a resolvability assessment or communication between the PRA or Bank of England and a firm relating to its resolvability assessment could trigger the requirement promptly to disclose inside information. A safe harbour from UK inside information disclosure requirements may be one way to address this.

We question the added value in requiring firms to make a public summary of their resolvability assessment, especially in the proposed first round of public disclosures. Even if a public summary is considered desirable, it seems disproportionate, and potentially market-sensitive, to require firms to make the first such disclosure at a point when many requirements relating to resolvability have not begun to apply. In our view, the first public statement regarding resolvability assessments should come only from the Bank and in generalised, anonymised form. This is to ensure that the public statements in relation to firms are consistent and objective and that no firms are unfairly disadvantaged. Adopting this approach would enable the Bank to better control the message to the market, reduce the risk of disruption and incrementally enhance public understanding of progress on resolvability.

Phase-in

Carrying out a resolvability assessment will be a significant undertaking, and it is inevitable that compliance with the more recent components of the resolution framework will take time. The RAF and requirements on firms should take into account that firms are already working towards compliance with existing policies such as the Bank's statement of policy on valuation capabilities to support resolvability.

Given the investment needed to meet the Bank's expectations on resolvability (particularly in the new areas of policy) and risks associated with the public disclosure process, it would seem appropriate to defer public disclosure of resolvability until both firms and the Bank and the PRA are satisfied that disclosure is appropriate in light of the market and regulatory implications.

RESPONSES TO SPECIFIC QUESTIONS

Scope

1. Do you agree with the proposed scope of the Bank's Policy Statement on the Resolvability Assessment Framework, as set out in paragraphs 2.1-2.5?

In the CP, branches and material subsidiaries are currently subsumed under the term "hosted firms" (see paragraph 2.5 of the CP). The treatment of branches and subsidiaries must, however, be considered separately as they are generally subject to different regulatory requirements.

UK branches of third country banks

We understand from the Q&A session in the RAF webinar on 14 January 2019 that the Bank's approach to UK branches of third country banks is to focus on the engagement with their home authorities. We strongly support this approach as comfort for the resolvability of these branches can be drawn from the relevant fora such as the Crisis Management Group ('CMG') and Resolution Colleges (see paragraph 3.7 of the CP). If there are any capabilities that would need to be assessed locally to support a resolution led by the relevant home authority (see paragraph 3.8 of the CP), this should be subject to discussion in the CMG. Any such local assessment carried out by the Bank should:

- solely serve the purpose of home authority led resolution proceedings and the UK exercise of resolution powers to support those proceedings;
- be based on the home authority's resolution strategy including timelines;
- be integrated with the home authority's resolvability assessment; and
- reflect the legal framework for resolution in the home authority jurisdiction.

In light of this we would welcome clarification from the Bank that there is no direct application of the RAF to UK branches of third country banks and that the Bank does not expect such branches to carry out the resolvability assessment described by the RAF.

UK subsidiaries of third country banks

The majority of UK subsidiaries of third country banks are within groups which have developed SPE strategies which do not contemplate UK resolution proceedings. As such, the home resolution authority requirements may not align to that of the RAF. We support the Bank's intention to assess resolvability for hosted firms through its engagements with international counterparts in CMGs and Resolution Colleges. To this end, we would welcome stronger engagement between the Bank and the home resolution authorities (e.g. the SRB).

We note nevertheless that the Bank proposes to use the CP when assessing hosted firms' resolvability. The Bank should therefore identify the specific parts of the RAF policies that it intends to apply to UK subsidiaries of third country banks.

Approach to different types of firm in scope

2. Do you agree with the proposal for how the Bank's Policy Statement on the Resolvability Assessment Framework will apply to different types of firm?

Our comments in relation to UK branches and subsidiaries of third country banks in Question 1 are also applicable here.

Paragraph 3.16 of the CP refers to a differentiated application of the measures in the CP to firms with a partial transfer resolution strategy. We would welcome more details on what these differences might be.

Achieving resolvability

3. Do you consider there to be any additional generic barriers that will need to be removed in order for firms to be considered resolvable?

No. We consider the generic barriers to be adequate and cover the key impediments to resolvability. We agree that idiosyncratic barriers might arise but these should be dealt with on an individual basis.

4. The Bank will apply the measures within the CP in a proportionate way. Are there any specific areas of new policy that would be unduly burdensome or unnecessary for certain firms to implement?

We agree that a proportionate application is appropriate. However, firms will need a degree of certainty around what that means. We have made specific comments regarding necessity and proportionality throughout our response. In particular we note our comments in:

- Question 16 on the requirement for bilateral engagement with critical FMI;
- Question 32 on the need for and timing of the disclosures by firms following the first RAF cycle; and
- Subject to clarification by the Bank on the requirements, Question 7 on liquidity modelling capabilities.

Please also see our comment on proportionality in the general comments section above.

The minimum requirements for own funds and eligible liabilities (MREL)

5. Do you agree that the measures proposed in the CP are appropriate to enable firms to show that they have adequate loss-absorbing resources to support resolvability?

AFME members are creating runways to 2022 consistent with the regulatory expectations of the Bank and the PRA. However, the responsibility for setting MREL lies with the Bank and therefore it is ultimately for the Bank to apply its rules to determine whether a firm's loss-absorbing resources support resolvability.

Many firms have also implemented processes for MREL monitoring, forecasting, compliance, etc which are integrated into current capital management arrangements. We would therefore be grateful for clarification from the Bank that no MREL-specific enhancements are expected to these arrangements.

We would like further guidance from the Bank on its expectations (as set out in paragraph 6.16 of the CP) as to what actions firms are expected to take in relation to:

- non-CET1 instruments that cannot be converted;
- non-CET1 instruments issued from non-resolution entities; and

- the absence of contractual features in non-CET1 instruments.

For example, given the permitted inclusion of non-resolution entity issued non-CET1 instruments in MREL until 2022 it is not clear what the Bank expects of firms with such instruments.

We would also like further clarity on:

- the Bank's expectations around:
    - documentation in paragraph 6.21 of the CP – in particular, that firms have received independent legal advice supporting an impracticability assessment under Art 55. The Supervisory Statement on impracticability with respect to the contractual recognition of bail-in (SS7/16) does not say that firms need to obtain such independent legal advice. Neither does this requirement appear in BRRD II: we consider that such advice will not be necessary in most, if not all, cases; and
    - the internal policies referred to in paragraph 6.22 of the CP; and
- any responsibility that a UK firm would have for the MREL compliance of its overseas subsidiaries (we expect that such responsibility should rest primarily with the relevant subsidiaries); and
- how being resolvable impacts MREL/internal MREL requirements.

We stress the need for consistency between firms and the need for dialogue and mutual understanding of expectations.

Firms will also need to understand the Bank's expectations and mechanics for disclosure reporting, beyond those in the upcoming EBA RTS.

Surplus MREL

The CP states that the Bank is still developing its policy on surplus MREL, in conjunction with other authorities in CMGs. However, it is not clear how such a policy would apply to hosted firms which issue internal MREL only. We would welcome further clarification on the expected scope of any surplus MREL rules (i.e. applicable to UK firms only) given the expectation that comparable requirements would be set at the home authority level.

We would also caution that if the Bank sets expectations regarding surplus MREL (paragraph 6.13 of the CP) that take effect prior to 2022, this could impact firm's abilities to deliver on the existing 2022 targets with regard to MREL.

Valuations

<u>6. This CP does not propose any additional policy or guidance on valuations capabilities to that set out already. Are there any areas where you think additional clarity would be required on the valuation capabilities that firms will need to achieve the outcomes of resolvability?</u>

We note that the RAF does not propose any new policy with regard to valuation which is appreciated given firms are currently undertaking significant efforts to comply with the existing Valuations Policy by 1 January 2021.

However, with regard to required capabilities, we would like to draw attention to the issue of timing for compliance with the existing policy statement and the proposal for solvent wind-down capabilities, for which we understand a consultation paper will be published in 2020 (the Solvent Wind-Down Proposals). Given that firms will need to start the implementation of valuation capabilities well in advance of the 1 January 2021 compliance date, firms may incur significant additional cost and resource burden in order to amend those valuation capabilities to reflect any additional capabilities needed for solvent wind-down.

It would be helpful to understand the Bank's expectations regarding the EBA's 'Handbook on valuation for purposes of resolution' and the use of that guidance to inform the implementation of the valuation Statement of Policy.

Funding in resolution

7. Do you agree with the objectives and principles set out in this section?

General comment

Yes, we agree with the objectives and principles set out in this section. We would be grateful for confirmation that the requirements set out in this section will not apply until 2022.

In general, we support a proportionate and principles-based approach which permits firms to take into account their own circumstances and resolution plan when assessing funding in resolution. In our view, the analysis of the adequacy of funding in resolution must be done by making certain assumptions about the circumstances that have led to a resolution; for example, a firm-specific issue such as a catastrophic operational failure from a cyber-attack in comparison to an industry-wide market stress event affecting all firms. Firms should be able to determine what their modelling scenarios are, assisted by a degree of guidance from the Bank.

The focus for the assessment of liquidity analysis should be on the firm's capabilities; we would want to avoid any prescriptive 'template filling' approach to assessment, which could prove to be too inflexible in a resolution scenario.

We note that according to paragraph 4.8(a) of the CP, when considering their resolvability, firms should not make assumptions around the cause of the firm's failure or the prevailing macroeconomic context. It is hard to see how the Bank expects firms to undertake the liquidity analysis without making any such assumptions.

Timing capabilities

We do not believe it is appropriate to have comprehensive and granular information refreshed in a short period, but the focus should be more on ensuring accurate and appropriate BAU management information capabilities are in place so that board members and regulators clearly understand and can make quick decisions.

We do not consider the expectation that firms are able to produce a liquidity analysis within a timeframe of 'T+1 or more rapidly' feasible from a practical standpoint. We suggest that a timeframe of T+1 (but not sooner) is more realistic, especially in light of the current PRA Solvent-Wind Down requirements which contain an expectation of a 48-hour refresh. Similarly, expectations as to the quality of liquidity information needs to reflect the inevitable challenges associated with producing such an analysis on a short timeline in a resolution scenario.

Related to this, we ask for clarification of what is meant by the 'core part' of the liquidity analysis in paragraph 6.52 of the CP.

Modelling the future

Generally, more clarity is required around modelling capabilities, assumptions and expectations. In particular, paragraph 6.54 of the CP could be understood as requiring firms to model funding needs in stress and during resolution starting from a projected point in the future. We would ask the Bank to confirm whether that understanding is correct.

If it is correct, it would be particularly difficult to execute in practice and the benefit from a cost benefit point of view is questionable. We therefore query whether this is necessary and proportionate to achieve resolvability.

We would propose that firms should have the capabilities in place at t=0 on a spot basis and on a forward-looking basis.

Central bank funding

The CP identifies that firms should be able to project access to and usage of third-party facilities and collateral monetisation. In practice central bank funding is likely to be an important part of the overall picture for funding firms through periods of resolution and restructuring (paragraphs 6.62 – 6.64 of the CP).

Solvent Wind-Down requirements

We ask the Bank to confirm whether the proposals on funding in resolution will be consistent with the solvent wind-down proposals. In particular:

- We note the proposal in the CP that firms should be able to produce a liquidity analysis within a timeframe of "T+1 or more rapidly" differs from the PRA's expectations for refreshing resolution liquidity analysis within 48 hours under the Solvent Wind-Down Phase 4 Information Request and Update on Future Work (1 August 2018): we consider the latter to be more workable.
- It would be helpful to have alignment between the Bank's and the PRA's expectations on the ability to run a forecast based on a future balance sheet (paragraph 6.54 of the CP): is this intended to be comparable to the 2019 solvent wind-down exercise requirement to forecast a future balance sheet based on a six-month systemic stress period?

<u>8. Do you agree with the proposed approach to determining which entities and currencies are considered material, and the proposed scope of analysis?</u>

In general, AFME welcomes the proposed approach which gives firms a degree of discretion in determining material entities and currencies. The level of guidance from the Bank provided in the CP is appropriate to ensure consistency across firms but it would be helpful to have further guidance on what firms should be considering with respect to liquidity subgroups (paragraph 6.48 of the CP).

That said, we do query whether currency analysis for resolution might be a case of spurious accuracy, overcomplicating the liquidity analysis. In our view, it would be better to deal with this through qualitative analysis of how currency would or would not be a problem. Additionally, the Bank has already said that it stands ready to undertake FX swaps in resolution for any bank that needs them, so we question the value of producing this liquidity analysis.

The Bank's approach also needs to align with other regulatory frameworks so that firms that are subject to multiple regimes are not faced with conflicting or diverging requirements; for example, if different regimes had tests for material entities and currencies that resulted in different answers.

9. To what extent do you consider that firms' existing capabilities and arrangements already meet the proposed principles? Where are significant gaps likely to exist?

Generally, AFME cannot comment in its response to the CP on the capabilities of its individual member firms.

10. What do you consider the practical obstacles which firms would need to overcome in order to implement the proposed principles?

The key practical obstacles are likely to be derived from the areas discussed above in Question 7. Modelling assumptions around cashflows, eligibility for central bank funding and the identification and mobilisation of collateral are all likely to be key to a successful resolution.

11. Are there any further liquidity risks or additional considerations which may arise in resolution which are not covered in this section? What approaches would firms take to mitigate the impact of these?

We do not anticipate any further liquidity risks or considerations.

12. Do you consider that the proposed policy and appendix provide sufficient clarity on what is expected of firms?

We have highlighted above a number of areas in which confirmation or additional clarification would be welcome.

Additionally, Principle 5 proposes that the outcome of liquidity analysis should be embedded into internal governance frameworks. Firms have existing BAU and crisis governance frameworks in which funding in resolution capabilities are already considered. As such, there should be no new additional requirements.

Principle 6 proposes requirements for testing the capabilities and governance arrangements. We would welcome clarification on the Bank's expectation with regard to testing; for example, whether this relates to general model governance, or also includes requirements for testing in the form of simulation exercises.

Continuity of financial contracts in resolution (stays)

13. Do you think that the proposed principles regarding the early termination of financial contracts are appropriate?

Scope of application of Principles 1 to 4

We believe that the scope of application of these Principles is too broad. In particular:

- Principle 4 requires that firms' understanding of the risk of early termination of out of scope financial contracts extends to contracts entered into *"by any entity subject to consolidated supervision by the PRA*".
- Principle 1 requires firms to identify their main counterparties *"across their legal entities*".
- Principle 2 refers to *"relevant subsidiaries"*.

Principle 4 would capture minority held participations, as well as subsidiaries. Principles 1 and 2 are unclear, and potentially also very broad (especially in the case of Principle 1).

This scope is problematic because firms may have very little access to the data and records of certain minority held participations, and may not be able to comply with such requirements. Moreover, each Principle (except possibly Principle 2) would capture subsidiaries that are irrelevant for the purpose of resolution, and which the Bank may intend to allow to fail.

We would propose limiting each of these Principles to material legal subsidiaries within a firm's resolution group (where the firm is a resolution entity). Where a firm is not a resolution entity, we believe that it should be left to the home resolution authority to determine its own approach to such matters (and the Bank's principles should apply to the UK material subsidiaries only).

Principle 3: Communication Capabilities

A firm's communication plan (paragraph 7.13 of the CP) will need to align with the Bank's strategy in relation to stays. It will be difficult for firms to have robust and effective communication plans until there is clarity as to the Bank's strategy in relation to the use of stay powers.

Firms will take guidance from the regulatory authority when in resolution. For the 'proactive and reactive' communication plans the working assumption has always been that communication on stays would be done in a proactive way where there would be a joint announcement (in the appropriate financial press) declaring to the market that a stay has been evoked. For the reactive aspect, we assume the Bank is referring to communication with counterparties that do try and close-out during the stay period, informing that they cannot do so.

Furthermore, additional guidance on when a communications plan for use in pre-resolution contingency planning is 'necessary' should be given, particularly given that firms will already be required to have a communications element in their recovery plan. Is the communications plan to be standalone? If so, more guidance should be given on how this should interlink with the recovery plan.

In practice, the communications plan will be extremely sensitive as a communication could indicate to counterparties that they could be facing a write-down. The unintended consequences of making such communications will need to be carefully thought through and taken account of in the Bank's expectations on communications plans.

Principle 4

We consider that paragraph 7.14 of the CP should provide for recognition of the reduced risk of early termination of contracts governed by third country laws that ensure equivalent outcomes to the PRA Stay Rules/recognise the interaction with other regulatory regimes that global banks are subject to.

Principle 5

We would ask the Bank to provide more detail on what is required to evidence satisfaction of the PRA Stay Rules, other than what is covered in Principles 1 and 2.

Operational continuity in resolution (OCIR)

14. In order to be resolvable, what broader set of functions and services should operational continuity apply to?

The potential future approach to OCIR

We note that the Bank has proposed to extend the scope of its OCIR Policy, as outlined in the PRA rule and Supervisory Statement on Operational Continuity in Resolution 2016, to services other than critical functions. While some of our members do not think there should be any extension to the scope of OCIR Policy, others can see that there is logic to extending the scope but that this should be considered within the context of recent efforts by firms to implement OCIR requirements.

In this light we would appreciate more detail on the Bank's thinking on the specific set of functions that would be brought into the scope of OCIR, when revised policy reflecting this change of direction is expected to be published and relevant implementation timelines. We would hope that firms that have chosen to expand the scope of their OCIR arrangements to non-critical services would not be disadvantaged by any extension of the scope of OCIR expectations.

Any change to the scope of OCIR requirements should also take into account the incremental resource implications for firms (in particular relating to the prevention of barriers to resolvability, assurance work and resolution reporting). Any requirements should be proportionate to the degrees of separation of each additional service or function from a critical service.

To the extent any changes to the scope of OCIR requirements are made, firms will need an appropriate implementation period.

The CP proposes to expand OCIR requirements to all functions and not just those deemed to be critical post the completion of the OCIR Policy review. We also note that the CP states this applies to UK firms whose preferred resolution strategy is bail-in. Given hosted firms are currently subject to OCIR requirements, we would welcome clarification from the Bank and the PRA as to whether hosted firms would be in scope of the extended set of functions as part of the OCIR Policy review.

We would also welcome further clarity on the following points:

- The CP proposes that 'firms operations would be able to continue in other material jurisdictions'. We would welcome further guidance in any future OCIR proposals on how the Bank proposes that the definition of material is applied, including the extent to which the assessment is to be documented. For example, it is not clear whether 'material' is relative to the franchise value of the entity, or relative to the size of the financial services sector and real economy in that jurisdiction.
- What specifically is meant by OCIR 'supporting the execution of the resolution strategy over the resolution weekend'?
- Is the Bank able to distinguish between supporting continuity by separability (i.e. through selling entities/portfolios/business lines in recovery/restructuring) vs supporting in-firm continuity? We accept the need to support continuity through separability. However, we think that the level of detail required in OCIR service catalogues may vary according to the entity business line/portfolio: if an entity/business line is run on a distinct system with its own governance and operational structure, it is not clear that a bottom up OCIR cataloguing exercise is necessary. In the context of a bail-in firm, we do not understand what it is that would cause in-firm continuity to be jeopardised. The key aim of the bail-in is itself continuity. Could the Bank clarify this and, if it does require in-firm continuity, could it set out how its expectations relate to its emerging policy on operational resilience?

- Paragraph 7.21 of the CP sets a requirement to maintain a plan for the firm's communications to its stakeholders. How should "stakeholder" be interpreted in this context?

The current approach to OCIR

In some cases the CP goes beyond the current OCIR rules even where it is discussing the expectations set out in SS9/16. Clarity is required on whether these new expectations are considered to be in force/must be met by 2020, and if so why. For example (paragraph 7.23):

- References to a 'dynamic' service catalogue as a way to demonstrate that required information can be accessed reliably: We would appreciate further clarification on the granularity of information that would be required and why this dynamic catalogue is needed. This would be very expensive to implement and would require a change to the operating models relating to contract management, cost management and so forth. Typically firms' OCIR service catalogues are updated on a twice-annual basis. We would therefore like to understand why the approach typically currently adopted is not sufficient.
- Using OCIR arrangements to identify 'financial disruptions' resulting from divestments: OCIR policy to date has not addressed financial disruptions (its focus is operational), so it is not clear what is intended here.

<u>15. What capabilities do firms need in respect of operational continuity to deliver resolvability?</u>

AFME cannot comment in its response to the CP on the capabilities of its individual member firms. However, the industry has made great strides to ensure the operational continuity of critical functions.

Continuity of access to FMIs

<u>16. Do you agree with the proposal that firms should engage with all of their providers of critical FMI services to understand how those FMIs and FMI intermediaries will use discretion in resolution? If not, please explain what limitations firms may face in doing so.</u>

We have concerns that it is unlikely to be practical to require bilateral engagement with FMIs. Firms can have many critical FMI providers and it would be a significant undertaking, both for firms and for FMIs, to have individual bilateral engagement. Further, such engagement may not yield useful information as critical FMI providers are likely to want to retain discretion in a resolution scenario.

Further to this, we believe that a proportionate approach should be taken, whereby FMIs that provide critical services to the resolution group are prioritised. The Bank could consider aligning the geographic scope of this requirement to CMG jurisdictions as a measure of criticality.

Coordinated regulatory and industry-wide efforts (e.g. through the establishment of a working group) could help achieve some standardisation of contractual terms and playbook templates to promote consistency in the approach of FMIs and FMI intermediaries and avoid the risk of fragmentation that could arise from bilateral engagement.

17. Should firms put in place back up providers of critical FMI services as a matter of course? What can a firm do in order to ensure that such relationships would be a credible alternative in resolution?

We note that where possible firms already have alternative arrangements; however, the availability depends on the type of FMI and services provided. Alternative options generally include alternative settlement agents, clearing members, CCPs and internal entities for indirect clearing. The viability of these options at the relevant point in time will be dependent on a number of conditions, both firm specific and industry-wide.

We question whether a mandatory requirement to put in place back-up providers would in fact help to remove any barriers to resolvability. This is because:

- Generally, there is limited benefit to firms in establishing an active back-up provider strategy as there is little fungibility between the FMIs themselves. In most instances the FMIs have evolved similar capabilities, but to meet specific market or product requirements. For example, ICE Clear Europe Ltd (ICE) will clear Equity Index Futures traded on ICE Futures Europe but if the firm lost access to ICE there is no back-up CCP that the firm could then utilise to continue clearing the exact same instrument. There are a couple of exceptions to this including the interoperating equity CCPs (LCH Ltd, x-Clear & EuroCCP) and ICSDs (Clearstream Lux and Euroclear) where the services they provide are generally agnostic to the instrument.
- Even where a back-up provider is available, it is unlikely that the back-up provider would facilitate continuity of access in resolution in circumstances where the original provider has discontinued access. The back-up provider is likely to have the same level of discretionary powers to discontinue access and is likely to use them in the same way as the original provider.

In light of the above, we believe that the fees and operational overheads of maintaining a back-up provider are not proportionate to the limited benefits that may be achieved.

Where putting in place a back-up provider is not feasible, barriers to access to critical FMIs could be addressed by reducing the incentives for a critical FMI provider to discontinue access. For example, a critical FMI provider that accepts collateral should not have an incentive to discontinue access if sufficient collateral has been provided. The focus in this case should therefore be on whether the firm has the ability to provide sufficient collateral in resolution.

We note that the CP does not address arrangements for FMI intermediaries, unlike the guidance issued in December 2017 by the Federal Reserve Board and Federal Deposit Insurance Corporation for U.S. firms, which highlights the roles firms play as both users and providers of payment, clearing and settlement services and prescribes requirements for playbook content related to both of these roles. Paragraph 7.30 of the CP states that the Bank will 'seek alternative ways to address' FMI intermediaries. We would appreciate further clarification on the Bank's expected approach, as this is an important component of ensuring continuity of access to FMI services. As part of this, we would welcome greater clarity around the intended definition and scope of 'FMI Intermediaries' and more specifically the definition of 'indirect access' in the context of the CP.

18. Do you consider that firms have enough information to make credible predictions about client behaviour should the firm enter resolution?

There are significant challenges when trying to predict client behaviour which would be further increased in a resolution scenario. Firms therefore tend to adopt fairly conservative assumptions around this.

Firms have capabilities to monitor client activity (e.g., payments, securities settlement, clearing) and related risk (e.g., liquidity, intraday credit, margin exposure). Such monitoring tools, in addition to a review of contractual arrangements with clients, could be used to observe client behaviour and potentially predict trends. That said, it is difficult to predict with precision client behaviour as a firm enters into resolution.

If the firm was in a resolution situation it is likely that the CCP would call for additional margin and the firm may well pass this call on to the client. As a result of this and the risk associated in using a clearing member that is in a stress situation, the clients are likely to wind-down or transfer positions to an alternate clearing provider. For CSDs the situation is likely to be more fluid and may depend on the continued provision of any credit lines provided by the firm to facilitate settlement.

<u>19. Is it sufficient for firms to only consider defensive actions against a full range of plausible actions that providers of critical FMI services may take should the firm enter resolution? Or should firm's contingency plans extend to all possible measures critical FMIs would be able to take?</u>

It is not possible to identify all possible measures critical FMIs could take and it is important for a proportionate approach to be taken. FMI providers typically have extensive powers, most of which will not be used in resolution. Firms should only need to consider the plausible actions *likely to be relevant and successful* rather than all plausible actions that critical FMI providers could take. This could be done by firms developing a toolkit of responses by category of critical FMI action.

<u>20. To what extent do firms' existing capabilities and arrangements already meet the proposed principles? Where in particular are significant gaps likely to exist?</u>

AFME cannot comment in its response to the CP on the capabilities of its individual member firms.

However, the industry has already done a lot of work in assessing operational continuity in resolution, at least in respect of critical services, which would include access to FMIs where relevant.

Additionally, as part of the U.S. Global Resolution Planning process, firms are required to identify the key relationships and services with FMIs. A significant uplift would be required in order to identify all FMI relationships and subsequently all of the critical services that they provide.

Standardising information collection across FMIs will be challenging and, if required, automating this capability would involve a costly and lengthy implementation period. We recommend leveraging existing reporting where possible and supplementing with additional reports where necessary.

<u>21. Do you consider that the proposed policy and appendix provide sufficient clarity on what is expected of firms?</u>

AFME agrees with a principles-based approach to ensuring continuity of access to FMI.

However, further guidance would be welcome on the capability to provide information to the Bank on request. It is not clear whether there would be a requirement to collect and store information on a daily basis, including whether the requirement to provide information would be on an ad-hoc or formal resolution filing basis. We would also appreciate clarification that there is no expectation for firms to understand the resolution plan of each FMI.

Restructuring

22. This CP does not propose for firms to identify restructuring options and develop associated capabilities beyond what is expected under the PRA's Supervisory Statement on recovery planning. Are there situations where it might be appropriate for restructuring options and associated capabilities to go beyond what is expected under the PRA's Supervisory Statement on recovery planning?

Given the wide range of scenarios that could have led to a firm entering resolution, it may be challenging for firms to identify specific restructuring options beyond those identified in the recovery planning process. AFME does not expect there to be many options and associated capabilities beyond what is expected under SS9/17. Nevertheless, it is something firms should give consideration to in their restructuring planning.

Any documentation and testing expectations for restructuring options should not exceed corresponding expectations in recovery planning.

For third country headquartered firms with an SPE resolution strategy, the group should define global restructuring plans and we would not expect that additional and separate UK-specific restructuring plans would be required.

23. To what extent do firms' existing capabilities and arrangements already meet the proposed principles? Where in particular are gaps likely to exist?

AFME cannot comment in its response to the CP on the capabilities of its individual member firms.

24. Do you consider that the proposed policy and appendix provide sufficient clarity on what is expected of firms?

A solvent wind-down of a firm is generally seen as one of the key restructuring measures. As laid out by the FSB in the guidance about Funding Strategy Elements of an Implementable Resolution Plan (June 2018), business run-offs and disposals of subsidiaries are considered as potential sources of funding and hence are an integral part of the estimation of liquidity and funding needs in resolution. Therefore, we believe that the two barriers 'Funding in Resolution' and 'Restructuring' of the consultation paper would benefit from containing clear cross-references.

Management, governance and communications

25. What are your views on whether the proposed principles included cover what is needed to achieve the desired resolvability outcomes? Are there any other measures that should be included?

We agree that the proposed principles are the correct principles. However, further regulatory guidance and clarity is needed on:

(i) directors' duties and the Senior Managers Regime (the 'SMR');

(ii) the role of boards, including subsidiary boards;

(iii) regulatory approvals; and

(iv) planning for changes to management.

Directors' duties and SMR

Governance in resolution refers to capabilities and arrangements to empower and support the Bank and/or the bail-in administrator (BIA) in making decisions in resolution. This is somewhat vaguely referred to as a 'bespoke role in the management of the firm' with 'certain key decisions' likely reserved for the BIA and/or the Bank. We believe that explicit legal clarity is required on:

(i) how the Bank/BIA decision-making interacts with directors' duties under the Companies Act 2006 and other applicable law and accountability frameworks such as the SMR; and

(ii) what are the anticipated 'key decisions [that] will likely be reserved for the BIA or the Bank' as stated in the CP at paragraph 8.6.

Unless such explicit legal clarity is given, it remains possible that in resolution directors and executives within the scope of such duties and accountability frameworks will believe themselves still wholly accountable for decisions and therefore may disagree with the Bank/BIA and/or be unwilling to approve or implement their decisions.

At best this will create a situation of legal uncertainty at a time when prompt action is required and cause delay to the execution of the resolution strategy while all relevant parties deal with difficult legal issues in the absence of legal precedent and regulatory guidance. At worst, it may create decision-making gridlock and ambiguity over who is making decisions and who is accountable for them. It is therefore critical that the scope of the directors' duties and executive SMR accountabilities is sufficiently and clearly delimited from the scope of the BIA's/Bank's duties.

Role of boards, including subsidiary boards

Linked to the point on directors' duties and SMR accountabilities, we believe more detail is required on the expected roles of boards in making decisions in resolution. In particular, the extent to which the board of a ring-fenced sub-group is expected to be 'independent' and what this means in practice in the context of applicable company law and during the execution of the resolution strategy by the Bank and/or a BIA are areas which require sufficient legal clarity if the resolution regime is to operate harmoniously and seamlessly with the existing legal framework.

Our expectations are that decisions in resolution will be taken by the Bank and/or the BIA and that decision-making and accountability should be indivisible. We would therefore also question the emphasis of the sections on conflict resolution processes in the CP.

In our view, while boards and senior management should be consulted and have a clear role in implementing decisions, the Bank and/or the BIA should be the parties centrally making decisions in resolution, taking into account their resolution objectives and applicable legislation and rules, such as the ring-fencing legislation rules. The boards and senior management of the group in resolution should not be subject to any legal or regulatory requirement which could impede their execution of the instructions given to them by the BIA/Bank in resolution. The Bank should explicitly state that the boards must act in accordance with such instructions. Given the BIA's/Bank's role in resolution as the central directing authority and the overriding nature of the BIA's/Bank's instructions, no conflict should arise between the boards and this should be reflected in the final Statement of Policy.

We believe that this is supported by section 48O of the Banking Act 2009, which enables the Bank to issue directions to the directors of the firm and any compliance with such directions means that the director "is not to be regarded as failing to comply with any duty owed to any person". The Bank should make clear that all the instructions issued by the BIA/Bank will be issued under the authority of section 48O in order to facilitate compliance by the boards and senior management and remove any doubts about the overriding nature of such instructions.

Regulatory approvals

Principle 2 calls for firms to be able to make 'timely and complete' applications for regulatory approvals, including 'in urgent situations.' While firms should be able to put together an application with sufficient expedition, it would be helpful for the regulators also to expedite such applications. The Bank should therefore include information on to what extent UK regulators will expedite their consideration and approval process in such circumstances. Such guidance would be valuable as firms could incorporate the timings associated with such approvals in their expected resolution timelines.

Planning for changes to management

The proposals appear to rest on the premise that there will be high levels of staff turnover/exit in contingency planning and resolution. We would be keen to see the evidence from recent contingency planning cases that this is in fact the case: in reality, we think that staff – and in particular most operational staff – will not leave en masse.

The financial crisis demonstrated that, in any failure related to a market-wide scenario, the ability of many individuals to get jobs simultaneously in other institutions will be highly curtailed. We therefore think that the requirements to identify large numbers of people who may be critical (but may turn out not to be at risk of leaving) is unduly onerous, in particular when firms already have retention and succession frameworks that can be used in resolution and existing remuneration rules (deferrals) already reduce the incentive for senior staff to move.

We suggest that the Bank should set clear parameters for the level of seniority that it expects to be covered by the requirement to 'identify job roles that are likely to be critical in any resolution scenario' (and explain how this would be different from the identification of 'further job roles that would be critical based on the particular circumstances at hand'). The Bank should also be mindful that changes to employment contracts (e.g. to introduce extended notice periods) reduce flexibility for firms to rationalise and remove staff in recovery/resolution and that this may hinder cost cutting exercises.

Beyond this, we note some inherent difficulties around planning for changes to management in a resolution and would therefore appreciate additional guidance on this. For example:

- Beyond what can be achieved by training and briefings, there are likely to be limits to the effectiveness of incoming managers in firms that are potentially facing instability through departures of other senior management during a resolution.
- Questions in reconciling adequate incentivisation for managers and the regulatory remuneration code. Firms might be constrained in the nature of information they can offer to candidates. There is also clearly a disincentive for incoming managers taking on senior management responsibilities in a firm in resolution that may need to be offset by remuneration.
- Firms will need to coordinate with the Bank and the BIA when hiring senior management in resolution. It would undermine the resolution strategy for the Bank/BIA to reverse an appointment of a senior manager that it did not agree with during a resolution. Principles of such a coordinated approach may need to be discussed at the planning stage.

- How far should firms go to pre-empt changes in management (or governance structures)? For example, must firms identify potential candidates that could be brought in during a resolution?

<u>26. To what extent do firms' existing capabilities and arrangements already meet the proposed principles? Where in particular are significant gaps likely to exist?</u>

AFME cannot comment in its response to the CP on the capabilities of its individual member firms.

<u>27. Do you consider that the proposed policy and appendix provide sufficient clarity on what is expected of firms?</u>

The proposed policy is not sufficiently clear on how a firm could demonstrate that it has the ability to increase communication infrastructure as needed to deal with increased usage.

We understand that the Bank could expect firms to change their articles of association, as set out in paragraph 7.11 of the CP. We question what the policy objective of this proposal is and whether, ultimately, the law would rather prevail over the firm's articles of association.

Assurance of firms' resolvability

<u>28. Do you agree with the Bank's proposed approach to assurance?</u>

We broadly agree with the proposed approach to assurance. We agree that, to a certain extent, the Bank will rely upon assurance conducted by firms and that the Bank will gain a degree of confidence and assurance from firms' own processes, self-assessment reports and the attendant board governance. We believe that the most effective approach to assurance is to fully embed it within firms' existing control and assurance frameworks. We would urge the Bank not to require the creation of additional frameworks specifically for the purposes of resolvability assurance. Assurance can and should be obtained by leveraging existing frameworks within firms.

We believe that transparency is required from the Bank on the level of assurance required to support its resolvability assessment.

While we understand and support the Bank's objectives in seeking its own assurance through information and evidence (including 'live evidence') requests, our expectation is that the Bank will be pragmatic when doing so and attempt to avoid any unnecessary burden on firms. One example would be to recognise in an evidence request that data retrieval times in resolution, when all resources would be dedicated to execution of the resolution strategy, would be different to those for evidence requests in a BAU scenario. Our expectation is that the Bank will work closely with banks' recovery and resolution teams to provide notice of impending tests and, to the extent possible, to embed and coordinate with banks' existing assurance programmes. The Bank should consider the practical impact of live evidence for assurance purposes, whether initiated by the firm or in response to "fire drill" information requests.

Consistent with this, expectations as to assurance should balance, among other things: (a) the testing frequency of the different RAF components; (b) the testing scope (global vs local); (c) the seniority of management involved; and (d) the speed with which the existence of a capability can be demonstrated, recognising that activities can be carried out more quickly in an actual resolution scenario.

Finally, we would find it helpful to have a view from the Bank as to what level of assurance it is expecting (i.e. what degree of testing, how this should be conducted). This will ensure alignment of expectations, efficient allocation of resources and the avoidance of surprises in the Bank's first public statements on banks' resolvability. We would also welcome guidance on whether – and if so when – it envisages internal audit functions and/or third parties being involved in this assurance.

29. Are there any additional measures that the Bank could reasonably use to gain assurance around a firm's resolvability (other than those covered above)?

We believe that the measures outlined provide a good summary of the relevant categories of assurance measures. There are many types of assurance measure within each category, such as different types of testing, which will provide assurance on different aspects of resolvability. The combination and extent of testing used will be dependent on the workstream and which key aspects must be evidenced.

The Bank's public statement concerning firms' resolvability

30. How much detail should the Bank's public assessment of firms' resolvability contain?

When making its public statement, the Bank must balance two imperatives. First, the need to communicate clearly and simply, in a manner which does not result in confusion among investors and the general public. Secondly, the need to provide sufficient detail on the reasons for reaching its determination on firms and providing sufficient context on where firms are on the path to resolvability, in order to make the public statement meaningful. This is particularly critical in the 2021 public disclosure, which occurs before the compliance deadline for some aspects of relevant policy.

In our view, the public statement should include some detail against each of the resolution workstreams and clearly refer to work that the firm is undertaking to improve its resolvability, where relevant. Each resolution workstream needs to be considered separately in the public statement, for it to be a useful description of a firm's path to resolvability.

In setting the context of the path to resolvability, we agree with the CP that the Bank should avoid binary statements on firms' resolvability and put the emphasis upon increasing the likelihood of successful and orderly implementation of the resolution strategy. The Bank's statement should focus on the overall assessment of firms on a group-wide basis in its capacity as lead resolution authority. The statement should not refer to resolvability barriers relating to specific jurisdictions, entities, products or client segments.

31. Are there any examples of information that may be sensitive that the Bank should not disclose? Why would such information be considered sensitive?

In any disclosures, the Bank should be mindful about how statements could be extrapolated to a firm's BAU activity. For example, a statement about valuation capabilities in resolution could be misunderstood as relating to a firm's ability to properly value its business.

The Bank should avoid statements that:

- imply material structural changes may be required by a firm as this could cause market uncertainty. For example, if a firm has breached or is close to breaching the clean holding company requirement, disclosure may cause difficulties if the firm looks to offload certain liabilities. The firm's public communications functions are more appropriate for managing these kinds of messages in accordance with the firm's own regulatory requirements on such disclosures;
- contain financial information or projections that are not public; or

- could impact negotiations with third parties, for example providing information on the degree of progress regarding the "resolution proofing" of contracts.

<u>32. What are your views on the Bank's preferred option for firms and the Bank to disclose their summaries and statement (respectively) on the same day, including how it could be implemented?</u>

Some, but not all, of AFME's member firms have doubts about the value of public disclosures made by firms in general:

- Firms already publicly disclose items relating to resolvability in their ordinary reporting (e.g. MREL/ internal MREL) and investors can (and do) ask questions about this. Given the technical/detailed nature of resolution we do not think that it follows that the general public is interested, beyond knowing that 'banks are resolvable'. We are not sure that a public statement by firms helps here. The single statement from the Bank should suffice.
- Investors and others, for example, the Treasury Select Committee can – as they currently do – ask firms directly more questions on the detail at any point.
- If the goal of the public disclosures is to persuade firms to take more responsibility for their own resolvability, we think this is already achieved through the resolvability assessment requirements, the SMR and existing regulatory dialogue and mechanisms. This goal can therefore be achieved more effectively by focusing effort on work to remove barriers and maintain assurance etc. rather than distracting senior managers with the task of making public disclosures.

In light of these considerations, we suggest that the Bank and the PRA refrain from making a decision about whether any firm disclosures are required until the first cycle has been completed and the Bank has made its first disclosure. The Bank and the PRA will then be in a better position to assess the value of firm disclosures.

If firm disclosures are to be required, it is our strong preference that the initial 2021 disclosure should be a Bank-only disclosure, based on self-assessment reports submitted privately by firms. Given that the 2021 disclosure is taking place ahead of the compliance deadline for a number of the relevant statements of policy, it would not be appropriate for firms to be compelled to publicly comment (and be judged) on capabilities and arrangements they are not yet required to have in place. We are concerned that public disclosures by firms in advance of 1 January 2022 could send confusing messages to investors and analysts given that firms may have different trajectories towards meeting the 2022 requirements. Further reasons for not having a firm disclosure in the first cycle are:

- Governance processes such as Board (and potentially pre-Board) approval will mean that any public disclosure would need to be broadly complete months in advance of the first disclosure. This further increases the period between the finalisation of the statement and the time when the requirements actually apply, accentuating the issue outline in the paragraph above.
- The gap between the submission to the PRA and the public disclosure is significant (and disproportionately long compared to the time to submit to the PRA). This gives more time for the PRA's/Bank's assurance work than it does for work by firms to close any gaps, to design the self-assessment framework and to submit the report to the PRA. The public disclosures would need to be significantly updated compared to the reports to the PRA as work will have progressed. In particular some of the policies come into force in the intervening period (valuations).
- The first submission and disclosure cycle will be 'experimental'. (The Bank noted this expectation in the firm workshop.) Firms will inevitably interpret the high-level requirements differently and take

different approaches to the PRA submission and the public disclosure; this reflects the fact that resolvability is not binary and there is not currently a mandated format/content for the disclosures. We expect the Bank would want to avoid any firm being unfairly identified as an outlier.

If the initial 2021 disclosure cannot be a Bank-only disclosure, then we suggest the timing of the assessment/reporting cycle is pushed back by a minimum of six months in order to ensure that the timing of the initial report aligns more closely with the timing of the relevant requirements. This means that the first self-assessment would be submitted no earlier than March 2021 and the first public disclosures by firms would be made no earlier than the end of November 2021.

In terms of implementation, we believe that messaging is critical and that the Bank should be setting the context with the media in advance of the releases, in particular to manage media expectations about the purpose of the exercise. For any 2021 disclosure, the Bank should pre-empt and manage any potential negative messaging about firms being 'not resolvable'. Our preference would be for the Bank to liaise closely with firms in the run-up to any disclosure, ensuring that there is consistency between the firm's summary and the Bank's statement. This suggested approach has the advantage of avoiding favouring of any firm over another while conferring the benefit of sequencing.

Further to this, we believe firms should be given a prescriptive format for the public disclosure to ensure investors and the public have a consistent basis on which to review firms' progress and to prevent any one firm providing, in good faith, significantly more or less detail than others and potentially being advantaged or disadvantaged as a result. Similarly, in our view, the Bank's statements on firms should follow a consistent format and this format should be aligned to that of firms' own disclosures.

We agree with the proportionate approach that the PRA has taken by applying its reporting requirements to only those firms with the largest retail deposits. However, we do not think that it would be proportionate, given the Bank's statutory objectives, to extend this requirement to other firms in future as contemplated by paragraph 3.3 of the CP.

33. What are your views on the alternative option, whereby there would be a short gap between firms' publication date and that of the Bank?

We believe this raises a significant risk of investors receiving incomplete information and confusion being caused in the market. There is a risk of inconsistent messages between firms' summaries and the Bank's statement and, in the possible event of delay and a longer gap, there is a risk of changes to the resolvability status of firms between the publication of their summary and the Bank's public statement. Any variability in the length of the gap period for different firms could cause a disparate market effect on firms.

Preliminary impact assessment

34. What costs would firms anticipate being incurred to comply with the proposed new policies? Please provide quantitative estimates where possible.

No response

35. What commercial benefits do you consider might arise from improvements made in order to comply with the proposed new policies?

No response

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Notes:

1. AFME (Association for Financial Markets in Europe) promotes fair, orderly, and efficient European wholesale capital markets and provides leadership in advancing the interests of all market participants. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME participates in a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the U.S., and the Asia Securities Industry and Financial Markets Association (ASIFMA) through the GFMA (Global Financial Markets Association). For more information please visit the AFME website: www.afme.eu.

2. AFME is grateful to Allen & Overy for their assistance with preparing this consulation response.