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FINANCIAL SECTOR ASSESSMENT PROGRAM

June 2016

BANK RESOLUTION AND CRISIS MANAGEMENT— TECHNICAL NOTE

This Technical Note on Bank Resolution and Crisis Management on the United Kingdom was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed in March 2016.

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BANK RESOLUTION AND CRISIS MANAGEMENT

Prepared By
**Monetary and Capital Markets
Department and Legal
Department**

This Technical Note was prepared in the context of an IMF Financial Sector Assessment Program (FSAP) in the United Kingdom in November 2015 and February 2016 led by Dimitri Demekas. It contains technical analysis and detailed information underpinning the FSAP findings and recommendations. Further information on the FSAP program can be found at <http://www.imf.org/external/np/fsap/fssa.aspx>

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Glossary

ARF	Authorities' Response Framework
BA	Banking Act
BoE	Bank of England
BAP	Bank Administration Procedure
BIP	Bank Insolvency Procedure
BRRD	Bank Recovery and Resolution Directive
CCP	Central Counterparties
CET1	Common Equity Tier 1 capital
CMG	Crisis Management Group
COAGs	Cooperation Agreements
CoCos	Contingent Convertible Capital Instruments
DGSD	Deposit Guarantee Schemes Directive
ECHR	European Convention on Human Rights
EEA	European Economic Area
EBA	European Banking Authority
ELA	Emergency Liquidity Assistance
EU	European Union
FCA	Financial Conduct Authority
FMI	Financial Market Infrastructure (operators)
FPC	Financial Policy Committee
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
FSCS	Financial Services Compensation Scheme
FSMA	Financial Services and Markets Act
G-SIBs	Globally Systemically Important Banks
G-SIIs	Globally Systemically Important Insurers
HMT	Her Majesty's Treasury
IADI	International Association of Deposit Insurers
IAIS	International Association of Insurance Supervisors
MREL	Minimum Requirement for Own Funds and Eligible Liabilities
MoU	Memorandum of Understanding
MPE	Multiple Points of Entry
NCWO	No Creditor Worse Off
NLF	National Loan Fund
PRA	Prudential Regulation Authority
RD	Resolution Directorate
RRP	Recovery and Resolution Plan
RTS	Regulatory Technical Standards
RWA	Risk Weighted Assets
SAR	Special Administration Regime
SCV	Single Customer View

SPE	Single Point of Entry
SMF	Sterling Monetary Framework
SRR	Special Resolution Regime
TBTF	Too Big to Fail
TLAC	Total Loss-Absorbing Capacity
TM	Temporary Manager
TPO	Temporary Public Ownership

EXECUTIVE SUMMARY

The United Kingdom (U.K.) remains consistently committed to ending “too big to fail” (TBTF). Since the adoption of the Special Resolution Regime (SRR) in 2009, policy reforms have been geared towards ensuring that financial institutions, regardless of their size or complexity, become resolvable—meaning that they can be closed or resolved without risks to financial stability or to taxpayers. Ending TBTF has also become a medium-term policy objective of the Financial Policy Committee (FPC). Importantly, reforms are pursued in an integrated way, on multiple plans (supervision, resolution, and structural reforms), which maximizes synergies and effectiveness.

The framework for effective resolution in the United Kingdom is largely in place. The broad resolution powers and tools established through the SRR were further enhanced in 2013 and more recently 2015 with the transposition of the European Union’s (EU) Bank Recovery and Resolution Directive (BRRD) into U.K. law. At present, the resolution framework is broadly aligned to the Financial Stability Board’s (FSB) Key Attributes of Effective Resolution Regimes for Financial Institutions (KAs).¹ The Bank of England (BoE) is well positioned both legally and operationally to undertake its resolution mandate and close cooperation exists with Her Majesty’s Treasury (HMT), the Prudential Regulation Authority (PRA), and the Financial Conduct Authority (FCA). Resolution policies have been finalized and explained transparently in a significant level of detail in many important areas. Finalizing the approach for implementing the minimum requirement of own funds and eligible instruments (MREL), both domestically and internationally, remains a key priority.

Implementation of reforms to ensure resolvability is well advanced in many areas. At the domestic level, substantial measures have already been taken to ensure the continuity of depositors’ access (including the capacity to ensure prompt depositor repayments), an essential confidence preserving factor. The ring-fencing reforms are already producing operational transformations at the level of large U.K. banks, with the aim of achieving the insulation of their critical retail functions from riskier parts of the financial groups by 2019. At the international level, the U.K. authorities have been actively cooperating with foreign counterparts to bring crisis management Groups (CMGs) up to speed in designing credible and feasible cross-border resolution strategies.

Given the size, complexity, and internationalization of the U.K. financial sector, resolvability is going to be a journey, rather than a destination. The United Kingdom is at the core of the international financial system, being both home and host to many systemically important financial institutions (SIFI). The effectiveness of the resolution framework will thus crucially depend on strong cooperation with other countries’ relevant authorities. Mishandling at either end could have far-reaching effects on financial stability. The authorities are taking the right stance in building a framework based on transparency and close cooperation. A continuous and multilateral effort will need to be made to detect and address barriers to resolvability in an ever-changing market

¹ The FSAP did not conduct a formal and systematic assessment of the KAs, which represent the nonbinding international standard for the design of resolution regimes.

environment. This is a huge task, which requires seamless internal and external communication and coordination, adequate skills, sound policies, and working processes.

The following summarizes the team’s main recommendations:

The framework for effective resolution is robust but its scope should be broadened. The current resolution framework covers banks, building societies, investment firms, holding companies and central counterparties (CCPs). A bespoke insolvency regime exists for other financial market infrastructure (FMIs) operators and their key service providers. To complete the framework in line with the KAs, the authorities should develop, over the medium term, an effective resolution framework for insurance companies that could be systemically important at the point of failure, drawing from international and EU guidance in this area once finalized. Furthermore, the BoE should have an explicit power in the Banking Act to depart from *pari-passu* treatment based on financial stability considerations, when using all stabilization options.² The proposed amendments to the Banking Act (BA) providing for a temporary management (TM) power, should clarify the relationship between the Temporary Manager (TM) and shareholders of a company in line with company law.

The arrangements for system-wide crisis preparedness could also be expanded. The BoE has a lead operational role in crisis management based on an existing Crisis Management Memorandum of Understanding (MoU) between the HMT and the BoE (and PRA). To maximize synergies and avoid coordination gaps, system-wide contingency planning should be expanded to include the FCA and the Financial Services Compensation Scheme (FSCS), both in the Crisis Management MoU and in the periodic high-level discussions.

The U.K. authorities are actively working towards removing barriers to resolvability, domestically and internationally. Recovery and resolution planning is well-articulated conceptually, legally, and operationally. The transition to building sufficient MREL domestically and internationally will have to be carefully managed. On the domestic plan, the BoE will have to strike a good balance in setting MREL proportional to the firms’ risk profiles and resolvability. Supervision will have to be extra intrusive for medium-sized firms, to ensure that problems can be detected and resolved promptly in the run up to building sufficient firm-specific MREL. Implementation of the internal MREL/total loss-absorbency capacity (TLAC) in a cross-border context will require close coordination with foreign counterparts. A disclosure framework will have to be developed.

The United Kingdom has been a leader in implementing the FSB agenda on cross-border cooperation. For all the U.K. global systemically important banks (G-SIBs), the recovery and resolution plans (RRPs) have been shared and discussed within the CMGs and a first round of resolvability assessments has been completed in 2015. Cooperation agreements (CoAgs) have been discussed within CMGs for all U.K. G-SIBs. Many operational aspects are still to be addressed in a cross-border context, including on the implementation of the MREL/TLAC, the supply of services

² The authorities believe that the BoE has implicit power to depart from *pari-passu* treatment when using other stabilization powers subject to the No Creditor Worse Off (NCWO) rule.

from within the group that support critical economic functions, as well as on improving firms' systems so that the authorities can rapidly value the firm in resolution. The implementation of EU resolution colleges, in line with the BRRD, is at an early stage.

The legal framework largely supports cross-border resolution, although it remains untested.

EU legislation provides for automatic and mutual recognition of resolution actions undertaken by EU home authorities. In respect of non-EU bank branches operating in the United Kingdom, the BoE can recognize and give effect to resolution actions undertaken by their home jurisdictions, except in a few circumstances, for example, where the stability of the U.K.'s financial system or U.K. public funds are at risk. Under proposed legislation, the BoE will be able to initiate independent resolution actions in respect of U.K. branches of third-country banks as a fallback power. Information-sharing with foreign authorities is permitted, subject to confidentiality requirements. Nonetheless, cooperation could be still hampered by significant variations in resolution regimes, as well as differences in approaches to resolution, valuations, and creditor hierarchies, to mention a few.

The authorities should consider further strengthening the framework for cross-border resolution.

First, the authorities should finalize the framework for contractual recognition of bail-in governed by third party jurisdiction laws, as well as proposed legislation for independently resolving U.K. branches of non-European Economic Area (EEA) firms. Second, the authorities should establish, in the medium term, an approach for engaging with non-CMG hosts where U.K. G-SIBs have a systemic presence. This would include processes by the U.K. authorities to identify such jurisdictions and to appropriately tailor practical arrangements for cooperation. This is going to be a multilateral effort, in which host countries' engagement would also be necessary.

The authorities are advised to develop integrated operational principles for funding of firms in resolution.

The U.K. has a number of funding mechanisms that could be used to ensure the continuity of a firm's critical functions if the internal resources of the firm in resolution are not sufficient. The terms and conditions for access to the FSCS and resolution fund should be fully elaborated operationally based on the recent revisions to the law, and the HMT/BoE MOU could be updated to reflect the common understanding on the use of the resolution fund. When emergency liquidity assistance (ELA) is going to be provided to support the liquidity of a recapitalized (post bail-in) firm in resolution, the HMT should consider providing an indemnity to the BoE where there are concerns about the length of support, exit strategy, collateral, or scale of the liquidity need. Common efforts with foreign authorities will need to continue developing credible cross-border arrangements to ensure the funding of a G-SIB in resolution pending upcoming FSB guidance.

The authorities are encouraged to finalize the reforms introduced by the Deposit Guarantee Schemes Directive (DGSD).

The introduction of risk-based contributions will better reflect the risk incurred by the respective member, although the existing absolute caps on the annual contributions (per categories of institutions) might need to be reconsidered or redesigned. The protocol between the FSCS and the HMT should be updated to ensure that the FSCS will have prompt access to necessary funding. Although the current system has delivered on its commitments to promptly reimburse insured depositors, over the medium term, the authorities should re-examine the appropriateness of establishing a paid-in fund available to FSCS, with an appropriate target level.

Table 1. United Kingdom: Main Recommendations for the Bank Resolution and Crisis Management Frameworks

Recommendations	Time Frame¹
Resolution powers	
Work with international partners to develop an effective resolution regime for insurance firms that could be systemically significant at the point of failure (HMT, BoE, PRA)	Medium term
Provide the BoE with an explicit general power in the BA to depart from <i>pari-passu</i> treatment in resolution, where justified by financial stability interest (HMT, BOE)	Medium term
Institutional Arrangements	
Include the FCA and the FSCS in the Crisis Management MoU, as well as in the periodic high-level BoE/HMT discussions on contingency planning (HMT, BoE, Financial Conduct Authority (FCA), FSCS)	Near term
Early Intervention	
Recalibrate the supervisory approach to increase the monitoring of medium-sized banks in the run-up to the full implementation of MREL (PRA)	Near term
Revise proposed amendments to the BA to clarify the relationship between the TM and shareholders of a firm, in line with company law (HMT, PRA)	Near term
Cross-Border Cooperation	
Finalize and adopt the amendments to the contractual bail-in requirement (HMT, BoE)	Near term
Finalize and adopt the amendments to the BA to empower BoE to independently resolve U.K. branches of non-EEA firms where appropriate (HMT, BoE)	Near term
Eliminate less favorable treatment provided to deposits held with third-country branches of U.K. banks, to the extent legally feasible, given provisions of the BRRD (HMT, BOE)	Medium term
Establish an approach for engaging with non-CMG hosts where U.K. G-SIBs have a systemic presence, in line with FSB guidance (BoE)	Medium term
Funding of Firms in Resolution	
Build on current arrangements to develop operational principles for funding of firms in resolution (HMT, BoE, FSCS)	Near term
Update the crisis management MoU to reflect the common understanding on the use of the resolution fund (HMT, BoE, FSCS)	Near term
Clarify the circumstances in which an indemnity would be needed to deliver ELA (HMT, BOE)	Medium term
Deposit Insurance	
Introduce risk-based contributions (PRA, FSCS) and update the lending protocol between HMT and the FSCS to reflect the new target level (HMT, FSCS)	Short term
Re-examine the appropriateness of introducing an ex-ante deposit insurance fund with a target level adequate for the U.K. banking system (HMT)	Medium term

¹ Near term is one year. Medium term is two to three years.

INTRODUCTION³

1. The effectiveness of the U.K.'s resolution regime is key for global and local financial stability. The United Kingdom is at the core of the international financial system, being home to four G-SIBs (HSBC, Barclays, the Royal Bank of Scotland, and Standard Chartered) and two globally systemically important insurers (G-SIIs) (AVIVA and Prudential), and host to “material” group entities from 14 G-SIBs.⁴ A systemic event in the United Kingdom might, therefore, threaten not only local, but also global financial stability. At the same time, supporting one or several systemic banks in case of a failure might go beyond the country’s fiscal and monetary means. Consequently, since the crisis, the U.K. has been at the forefront of the international reforms to end TBTF.

2. The U.K.'s resolution and crisis management regime has been continuously improved since the crisis. The SRR under the BA was introduced in 2009, benefiting from practical lessons learned in the U.K.'s banking crisis of 2007/2008.⁵ The SRR has since evolved, with amendments taking effect in 2013, and more recently in 2015 following the transposition of the EU BRRD.⁶ The BRRD provides a harmonized resolution regime for the whole EU, broadly in line with the KAs. The United Kingdom is also subject to the European Banking Authority (EBA)'s regulatory technical standards and guidelines on the BRRD. Further legal reform proposals aim to finalize the transposition of the BRRD into U.K. law, and to operationalize all aspects of the legal framework.

3. The resolution reforms have been part of a bold and well-integrated package of reforms. First, micro and macro prudential supervision have been reinforced to strengthen the resilience of the financial system and safeguard financial stability. Second, a number of measures have been taken to protect critical services, including by ring-fencing of core retail activities, ensuring the continuity of critical shared services, and securing the access to insured deposits. Third, the authorities are working actively in enhancing the loss absorbency capacity of firms and ensuring that supportive legal, operational, and contractual arrangements will be in place.

4. Building a strong framework for cross-border cooperation is seen by the authorities as a long-term investment in the stability of the United Kingdom and global financial system. The U.K. authorities have devoted significant resources to develop, together with their foreign counterparts, a shared understanding of cross-border groups from a resolution perspective and to

³ Prepared by Oana Croitoru Nedelescu (MCM) and Elsie Addo Awadzi (LEG) as part of the 2016 FSAP Update of the U.K. The mission would like to thank the U.K. authorities, in particular the management and staff of the BoE's Resolution Directorate, and market participants for their excellent cooperation and open dialogue.

⁴ Bank of America, Citibank, Goldman Sachs, JP Morgan, Morgan Stanley, State Street, Bank of New York Mellon, Deutsche Bank, Mitsubishi UFJ FG, Mizuho FG, Sumitomo Mitsui FG, Santander, Credit Suisse, and UBS.

⁵ Temporary emergency legislation was passed during the crisis through the Banking (Special Provisions) Act (2008) to carry out resolutions. Four institutions were resolved under these arrangements, namely, Northern Rock, Bradford & Bingley, and two U.K. subsidiaries of Icelandic banks (Landsbanki and Kaupthing).

⁶ Among the new additions to the SRR are the inclusion of mixed financial holding companies/groups to the scope of entities covered, the minimum requirement for own funds and eligible liabilities (MREL), further safeguards on the use of public support or resolution funds, the recognition of third-country resolution actions, and a general prohibition against automatic termination of financial contracts as a result only of the entry into resolution.

define best practices in resolution planning. The authorities recognize that, over time, this intense engagement helps strengthen capacity across the international resolution community and effectively contributes toward minimizing the risks of uncoordinated actions. At present, the organizing framework for international cooperation related to G-SIBs is closely aligned to the FSB policy engagements with many operational aspects still to be firmed up, pending—among others—further international guidance in key areas.

5. The present technical note is organized as follows: First, it describes the architecture for resolution and crisis management. Second, it outlines the resolution policies and operational arrangements currently in place. Third, it discusses the measures taken by the authorities to ensure resolvability⁷. Fourth, it refers to cross-border cooperation issues in resolution. Finally, it describes the frameworks for resolution funding and deposit insurance.

THE ARCHITECTURE FOR RESOLUTION AND CRISIS MANAGEMENT

A. Strong Institutional Framework

6. The U.K. financial safety net is underpinned by strong institutional arrangements. The financial safety net is made up of HMT, the BoE, the PRA, the FCA, and the FSCS. Significant institutional reforms have been undertaken since the last crisis, with the transfer of microprudential regulation from the Financial Services Authority to the PRA and the FCA, and the establishment of a macroprudential oversight mandate within the BOE, executed through an independent FPC. Roles and responsibilities are supported by strong legal mandates (Box 1).

7. The authorities have mutually-reinforcing roles and responsibilities. The BoE's financial stability and resolution mandates are supported by HMT, as well as the PRA, FCA, and the FSCS. HMT works closely with the BoE to monitor and respond to financial sector risks, while the PRA and FCA contribute to maintaining financial stability through their respective regulatory and supervisory mandates. In particular, the PRA ensures that its regulated firms carry out business in a safe and prudent manner and that, if the need arises, they can be resolved in an orderly manner. The FCA, from a consumer protection and market integrity perspective, seeks to ensure that the resolution strategy/resolution tools applied when an institution fails, promotes depositor protection, continuity of access, and adequate redress and remediation where necessary. The FSCS ensures prompt compensation of insured depositors or, otherwise works with other authorities to facilitate maintaining continuity of access to deposits, thus promoting depositor confidence. The FSCS also works on public awareness of depositor protection.

⁷ The FSAP team did not have access to RRP, playbooks, COAGs, CMG meetings and records, etc., so the ability to draw conclusions on the actual resolvability of firms was limited.

Box 1. Overview of the U.K. Financial Safety Net

- **HMT:** HMT is the ultimate policy maker for the financial sector; ensures that the appropriate legal framework is in place; and, where needed, provides a fiscal backstop to facilitate resolution and crisis management, subject to specified conditions. It also issues a Code of Practice to guide resolution actions, which is periodically updated.
- **BoE:** The BoE is the U.K.'s monetary authority and has a statutory financial stability mandate which is executed by its FPC, the macroprudential authority. It is also the U.K.'s resolution authority and lender-of-last-resort, and supervisor for financial market infrastructures FMIs. Its resolution mandate is executed by the resolution directorate, which is responsible for resolution policy development, resolution planning (including resolvability assessments), contingency planning, and the execution of resolutions.
- **PRA:** The PRA is the prudential regulator and supervisor of deposit-taking institutions,¹ insurance firms, and large investment firms.² Further changes are anticipated under the BoE and Financial Services Bill, which is currently before the U.K. Parliament.⁸ Under the bill, whose key proposals reflect a “one Bank” policy, the PRA—currently a subsidiary of the BoE—will be rolled back into the BoE, and a Prudential Regulation Committee (PRC) will be established to execute the microprudential mandate.
- **FCA:** The FCA is the conduct regulator of all financial institutions, and the prudential regulator of financial institutions not prudentially regulated by the PRA.
- **FSCS:** The FSCS is a company limited by guarantee that operates the U.K.'s deposit insurance scheme in line with the EU DGSD, while subject to oversight and rules set by the PRA and FCA. It fulfills a statutory “pay-box plus” mandate. The FSCS is an integrated scheme – it also protects insurance policy holders and investors.

¹ Banks, building societies, and credit unions.

² Currently, nine such firms with capital of €730,000 are under the PRA's rules including the PRA's transposition of the EU's CRD IV.

8. HMT plays a very important role in the financial safety net, which reflects its interest in safeguarding financial stability and the use of public funds. HMT reserves decisions involving the use of public funds and is able to take direct action to stabilize failed institutions under exceptional circumstances⁹ through use of the temporary public ownership (TPO) tool, while having regard to the special resolution objectives.¹⁰ The BoE has a statutory duty to consult with HMT in the

⁸ The Bill has since been enacted as the Bank of England and Financial Services Act of 2016.

⁹ In addition to the general conditions for resolution, special conditions must be met for the use of the TPO. Before determining whether the special conditions have been met, HMT must consult the PRA, FCA, and the BoE.

¹⁰ Under Section 13 of the Banking Act (BA), HMT may place a bank under TPO and for that purpose make one or more share transfer orders in which the transferee is a nominee of HMT or a company wholly owned by HMT. The Code of Practice further provides for arm's length management of institutions in TPO in line with the BA provisions.

process of determining whether conditions for resolving banks, building societies and certain investment firms have been met. HMT may also direct the BoE to provide ELA to a financial institution, or to use a stabilization option or other resolution options, where there is a material risk to public funds and such action is necessary to resolve or reduce serious threats to the U.K. financial system.¹¹ The authorities consider HMT's directive powers as backstop powers, which they believe are not likely to be used except when absolutely needed in the public interest. The authorities appear mindful of the need to ensure that the BoE as monetary and resolution authority maintains its operational autonomy.¹²

9. Strong cooperation exists among the domestic authorities in the area of crisis management and resolution, aided by a number of mechanisms. In particular:

- **Statutory requirements:** There are a number of statutory requirements for cooperation. For example, the BA establishes consultative processes between the BoE, PRA, FCA, and HMT for determining whether conditions have been met to trigger resolution for banks, building societies and certain investment firms. The PRA and the FSCS, and the FCA and the FSCS are under a duty pursuant to the Financial Services and Markets Act (FSMA) 2000 as amended, to cooperate with each other, while the BoE is under a similar duty to cooperate and share information with HMT, PRA, and FCA. In particular, the BoE has a statutory duty under the Financial Services Act 2012 to notify HMT immediately when there is a material risk of circumstances arising in which public funds would be put at risk.
- **MoUs:** Various MoUs among the domestic authorities are in place to promote cooperation. A statutorily required MoU between HMT and the BoE (including the PRA) governs crisis management arrangements, in line with requirements under the Financial Services Act 2012. The crisis management MoU sets out their understanding of their respective responsibilities, lays down procedures for notification and approvals, and modalities for external communication with the Parliament and the public. Under the MoU, the BoE has the primary operational responsibility for financial crisis management while the Chancellor and HMT have the sole responsibility for any decision on whether and how to use public funds. To mitigate moral hazard, the MoU clarifies that the fiscal backstop powers are not anticipated to be used in the majority of crisis situations. Proposed revisions to this MoU¹³ will strengthen cooperation in the resolution planning process and formalize regular high-level engagements between the BoE and the HMT. Other bilateral MoUs exist between the PRA and FCA; the PRA and FSCS; and the FCA and FSCS, clarifying, among others, cooperation and information sharing protocols. There are

¹¹ Financial Services Act, 2012 Section 61 on "Treasury Power of directions" and paragraph of the HMT/BoE crisis management MoU. HMT is required to lay such directions before Parliament unless it would be against the public interest, in which case HMT must subsequently review the direction from time to time and lay it before Parliament once that publication is no longer against the public interest.

¹² The BRRD requires EU member states to ensure the operational independence of prudential regulation and resolution functions. In this regard, the BoE Bill requires the BoE to make arrangements to comply with these requirements.

¹³ https://www.gov.U.K/government/uploads/system/uploads/attachment_data/file/468209/draft_MoU_resolution_planning_and_financial_crisis_management.pdf

also bilateral MoUs between the FCA and BoE's Resolution Directorate (RD), the PRA and RD, and the FSCS and RD to cover arrangements for contingency planning/firm failure. A framework document between FSCS and HMT exists, in addition to a lending/funding protocol.

- **Regular Engagements and Crisis Simulations:** Bilateral and multilateral discussions occur periodically among the safety net providers. Discussions tend to focus on matters of mutual interest and contingency planning where risks of failure appear to escalate. Regular simulation exercises test the authorities' well-established framework for coordination during major operational disruption.¹⁴ Targeted exercises are also organized to test coordination in implementing specific crisis intervention measures.

10. Arrangements for information sharing, information analysis and decision-making among the relevant domestic authorities are adequate. The legal framework permits information sharing among the domestic authorities for the purpose of carrying out a public function, but restricts sharing of information that is subject to confidentiality requirements under U.K. or EU law. The BoE is allowed to share information relevant to the financial stability of individual financial institutions or to one or more aspects of the U.K. financial system with HMT or the other regulators (the FCA or the PRA), under section 246 of the BA 2009.

11. The institutional framework ensures a fair amount of operational autonomy. The PRA and the FCA are designed to be operationally independent from Government and the industry in the execution of their regulatory and supervisory mandates. The BoE's internal governance arrangements ensure that its multiple mandates are executed under distinct governance arrangements (overseen respectively by the MPC, FPC, and the proposed PRC) that enhance operational autonomy in each area. The BoE's resolution mandate is carried out by its RD currently staffed with some 50 individuals. The FSCS is a stand-alone company limited by guarantee under the oversight of the PRA (and FCA with regards to its non-deposit work) fulfilling the primary operational function in bank failures of protecting insured depositors.

12. The mandates of the individual institutions are inbuilt with appropriate accountability mechanisms. The current framework promotes transparency and accountability to the U.K. Parliament by the domestic authorities involved in resolution and crisis management. Furthermore, there are statutory requirements for the PRA and FCA to submit a report to Parliament (through HMT) where there has been a regulatory failure, while the Chancellor of the Exchequer is under a statutory duty to report to Parliament on the use of the stabilization powers, including the "temporary public ownership" (TPO) stabilization option.

¹⁴ The Authorities' Response Framework (ARF) aims at ensuring coordination among BOE, HMT, and FCA with the objective of keeping retail and wholesale markets open and functioning in the face of shocks with a high probability of having an impact on the financial sector. The framework has a high degree of operationalization setting clear triggers, decision-making processes, and individual responsibilities.

Recommendations

13. The authorities are encouraged to continue their efforts to operationalize, test, and refine the crisis preparedness framework, while exploring mechanisms to make it even more robust. While a fair amount of cooperation exists among the relevant domestic authorities in crisis preparedness and management, the extent to which this could be further strengthened could be explored. In this regard, the scope of the contingency planning and crisis management arrangements could be broadened. Currently, system-wide contingency planning discussions occur regularly at the relevant director and technical levels of the safety net providers, but these appear to be informal, with the exception of periodic meetings at the FPC (which oversees broader financial stability) where HMT, BoE, and FCA are represented. The draft Crisis Management MoU between the BoE and HMT proposes to formalize regular meetings between the BoE's Deputy Governor for Financial Stability and HMT's Director General for Financial Services. This may be a good vehicle for discussing, on a regular basis, system-wide crisis preparedness. To maximize synergies and mitigate the risks of coordination gaps, it would be useful to bring in FCA and the FSCS as part of these high-level regular discussions on contingency planning. The authorities may consider expanding signatories to the crisis management MoU to include the FCA and FSCS, to help further promote a common understanding among all relevant parties. Furthermore, system-wide contingency plans should include all relevant financial subsectors.

B. Robust Resolution Powers and Tools

14. A broad range of resolution powers and tools are provided for in the legal framework, and reflect international best practices. The BoE is mandated to take official control of a failed institution and to initiate resolution at a fairly early juncture upon the determination by the PRA or the FCA that a regulated institution is failing or likely to fail (Condition 1) and upon the BoE's determination (and the advice from the PRA or FCA) that it is not reasonably likely that further action will be taken by or in respect of the firm that will result in it no longer failing or being likely to fail (Condition 2). The objectives of resolution are explicitly set out in law, in line with international best practices. In all, the authorities must have regard to seven equally-ranking objectives (including protecting and enhancing financial stability, ensuring the continuity of critical financial services and functions, and protecting public funds) and must balance these objectives according to the circumstances of each resolution case.

15. The BoE is the designated resolution authority in all cases, except where an institution is to be placed under TPO, in which case HMT will conduct the resolution in conjunction with the BoE. The SRR covers banks, building societies, investment firms, mixed financial holding companies/groups, and CCPs. It comprises a stabilization regime which is implemented administratively, as well as a number of court-based modified insolvency procedures namely, the Bank Insolvency Procedure (BIP) the Bank Administration Procedure (BAP), the Building Society Insolvency Procedure, and the Building Society Administration Procedure. In addition to the SRR, a bespoke insolvency procedure called the "Special Administration Regime" (SAR) is available for investment firms holding client assets and a number of hybrid insolvency procedures such as the BIP/SAR and BAP/SAR are available for firms that hold both deposits and client assets.

16. These court-based insolvency procedures are the default resolution tools where the public interest test is not met in a given resolution transaction. These court-based proceedings are initiated by the BoE (or, in certain circumstances, the PRA or FCA) and are based on a modified version of the insolvency law. The BIP involves liquidation of the failed firm and prompt pay out of FSCS-insured deposits, or an FSCS-funded transfer of deposits held by the firm to another institution. The BAP, on the other hand, is used for the administration of residual parts of a failed firm after the use of the partial transfer powers, to ensure that any essential services or facilities continue to be supplied by the residual bank in the BAP to a bridge bank or private sector purchaser. The BAP reverts to an ordinary administration only when this purpose no longer needs to be met. The SAR is used in the case of an investment firm that also holds client assets, with the key objective of returning client money or assets as soon as is reasonably practicable and ensuring continued access to FMIs where necessary. Where a bank in resolution holds client assets, hybrid special insolvency proceedings that combine the BIP or the BAP, together with the SAR¹⁵ may be initiated by the BoE, to ensure protection of depositors as well as clients whose assets are held by the firm.¹⁶ The SAR is currently under review by HMT, with a view to further strengthening it.¹⁷

17. The stabilization regime consists of five stabilization options, one or more of which can be exercised when the “public interest” test is met.¹⁸ These options provide stabilization powers for the BoE to transfer (i) some or all of the business (i.e., the shares or property) of the failed firm to a private sector purchaser; or (ii) to a bridge bank established by the BoE; or (iii) to transfer some or all of the firm’s assets, rights or liabilities or bridge institution to one or more asset management vehicles. The two other stabilization options are the bail-in tool which the U.K. implemented in line with the BRRD, in January 2015, and lastly, TPO. The use of TPO also requires there to be a serious threat to financial stability and is permitted only after shareholders and creditors of the bank have absorbed losses to the minimum extent of the equivalent of 8 percent of the total liabilities (including own funds) of the institution (measured at the point when the action is taken).¹⁹

¹⁵ See the Investment Bank Special Administration Regulations (2011).

¹⁶ Prior to the BIP-SAR proceedings, the FCA reviews the client assets to ensure that they are protected and available for prompt return to clients during insolvency proceedings.

¹⁷ See Bloxham Report 2014 which makes recommendations intended to facilitate a more rapid and efficient return or transfer of client assets, and (where applicable) swifter payment of compensation in any future investment firm failures. <https://www.gov.uk/government/publications/review-of-the-special-administration-regime-sar-for-investment-banks-final-report>.

¹⁸ In addition to Condition 1 and Condition 2, a further two conditions must be met to enable the use of the stabilization options. The BoE must determine (in consultation with the PRA, FCA, and HMT) that (i) the exercise of the stabilization powers is necessary having regard to the public interest in the advancement of one or more of the special resolution objectives and (ii) one or more of the special resolution objectives would not be met to the same extent by the winding up of the bank.

¹⁹ The rule of 8 percent of loss absorbency in resolution (before resolution funds may be used) applies to the use of any resolution tool.

18. The BoE outlined a proposed approach to exercising the bail-in powers, which has not been tested so far.²⁰ The bail-in power enables the BoE to recapitalize a failed firm through a cancellation, conversion, transfer or write down of claims of equity holders and unsecured creditors,²¹ if alone or together with other stabilization powers, there is a reasonable prospect of return of the firm to viability in accordance with a business reorganization plan. The BoE would prefer to execute the bail-in on the existing firm (“open bank” approach)²² which remains open for business throughout the process. Bail-in is to be executed in a way that ensures that post bail-in, the firm is able to meet regulatory capital requirements and continues to participate in the payment and settlement systems and access market funding and have access to BoE’s liquidity facilities.

19. The BoE is currently preparing extensive internal procedures for bail-in execution. In the run-up to a resolution, the BoE would create a draft resolution instrument to give effect to the bail-in and identify its scope. During the resolution “weekend,” the BoE will confirm which liabilities are bailed-in²³ and will transfer the legal title of the shares to a third-party depository bank which will hold them on trust, until they can be distributed to creditors entitled to compensation. Until the completion of the valuation work and the announcement of the final bail-in terms, the creditors could be issued temporary instruments (“certificates of entitlement”) that could be traded. The resolution administrator will continue to exercise voting rights on behalf of the creditors until a sufficient number of them came forward to claim their shares. Depending on the number of shares issued to an individual bondholder, a formal approval of a change in control may be needed.

20. The U.K. authorities have made progress on establishing a nonbank financial institutions (NBFIs) resolution regime, a key recommendation of the 2011 FSAP. There is a framework for dealing with FMIs that have failed or are likely to fail. The BoE has administrative resolution powers under sections 89B through 89G of the BA, in respect of U.K.-based CCPs, by which it could transfer some or all of the business of the CCP to a private sector purchaser or to a bridge CCP. Anticipated EU proposals in this regard are expected to further strengthen the U.K.’s statutory toolkit in the near future. Other FMIs (e.g., other clearing systems, payment and settlement systems operators and their key service providers) may be subject to a court-based administration procedure under which an administrator is appointed by the court to manage the affairs, business and property of the FMI with the objective of ensuring continuity of its critical functions.²⁴

²⁰ Other stabilization tools have been used in practice, for example the use of transfer powers in the resolution of Dunfermline Building Society in 2009.

²¹ With the exception of specified unsecured claims including insured deposits.

²² See “Bank failure and bail-in: an introduction” by L. Chennells and V. Wingfield, BoE. Notably, the BoE could apply both an “open bank bail-in” and a “closed bank bail-in” which involves the establishment of a new operating entity (bridge). The U.S. approach is to carry out a “closed bank bail-in” which involves the transfer of the assets of the holding company to a bridge bank holding company controlled by the FDIC while the liabilities are left in the failed bank (consistent with powers available under the Title II of the Dodd-Frank Act).

²³ The listing of these liabilities is suspended by the FCA.

²⁴ Part 6 of the Financial Services (Banking Reform) Act 2013.

21. More work is however required on the resolution framework for nonbank financial institutions (NBFIs). In the case of insurance firms, the U.K. has tools for intervening before and after an insurance failure to protect policyholders and ensure an orderly transfer or run-off of the business, however they remain largely untested at least in respect of a systemic insurance firm. The BoE has no bespoke resolution regime for insurance firms in the U.K. including those that may be systemically important. The FMI administration regime has yet to be operationalized pending the adoption of secondary legislation under the Financial Services (Banking Reform) Act 2013.

22. Sufficient safeguards are in place to protect creditors as well as investors, which helps mitigate legal risks from resolution. Among other things, the “public interest” test helps to ensure that individual property rights are not unduly interfered in violation of the European Convention on Human Rights (ECHR). Furthermore, the “no creditor worse off” (NCWO) rule enshrined in the legal framework ensures that investors are not left worse off in resolution than they would have been in insolvency proceedings against the failed institution. Mandatory compensation is required to a claimant who is made worse off, as determined by an independent valuation. In this regard, the creditor hierarchy for payment of claims in insolvency, with a preferential ranking for insured depositors,²⁵ is to be respected also in resolution, with holders of the same class of claims treated equally by virtue of the *pari-passu* rule enshrined in law. Under the BA and BRRD, the power to depart from the BoE *pari-passu* rule is explicitly provided only in the context of bail-in, based on well defined exceptional circumstances, although the BoE believes that it is also able to do so in the case of uses of other stabilization powers, subject to the NCWO rule.²⁶

23. The legal framework provides for legal certainty for resolution actions, while resolution officials enjoy legal protection in the execution of their functions. Resolution actions of the BoE or HMT cannot be suspended or overturned by a court of law under judicial review, if such actions are taken in good faith and are not in violation of the relevant provisions of the Banking Act or the ECHR. Where a claim is found to have merit, relief is limited to monetary damages. The BoE, its directors, officers, staff, and resolution (bail-in) administrators appointed by the BoE,²⁷ generally enjoy sufficient legal protection in pursuing the objectives of resolution.

Recommendations

24. The following could further improve the existing resolution powers. First, the authorities should develop a resolution regime for insurance firms that could be systemically significant or critical if they fail, drawing from international and EU guidance in this area once

²⁵ Under the BRRD, insured deposits are preferred to deposits of households and SME above the insurance limit, which in turn are preferred to other uninsured deposits (which rank equally with senior unsecured claims).

²⁶ The U.K. authorities emphasized that the BoE has the implicit power to depart from *pari passu* in resolution when any resolution tool is used, not just bail-in, and that while it can only do so in certain defined exceptional circumstances if the bail-in tool is used, this restriction does not apply to other stabilization tools, so arguably the BoE has more scope to do this if these other tools are used.

²⁷ Bank liquidators (under the BIP) and bank or special administrators (under the BAP or SAR), enjoy protections from court under ordinary insolvency law, and in any event are deemed to be agents of the institution in insolvency, with indemnity from the institution for any liabilities arising in the course of their work.

finalized. Second, the authorities should consider providing the BoE with an explicit power in the BA to depart from *pari-passu* treatment more generally (in addition to when bail-in is used) if necessary to contain the potential systemic impact of a firm's failure or to maximize the value for the benefit of all creditors as a whole. This will help ensure that the circumstances and reasons for which the *pari-passu* principle would be departed from, are spelt out in a transparent manner, in line with the KAs. Furthermore, the existing court-based administration procedures for other FMIs (apart from CCPs) should be operationalized by the adoption of secondary legislation under the Financial Services (Banking Reform) Act 2013.

C. Well-Articulated Early Intervention Framework

25. A wide range of early intervention actions can be taken to address supervisory concerns. The FCA and PRA have extensive legal powers²⁸ to take formal remedial actions against banks where a firm infringes, or is likely to infringe in the near future (next twelve months) the requirements of CRR/CRD4. These include, among others: requiring the management to implement measures from recovery plans, changing senior management or board members, and asking for changes to the legal or operational structures of the bank or to the business strategy. While such powers provide legal certainty, moral suasion has worked well in practice and thus formal actions have rarely been required.

26. The authorities should exercise caution with the use of the proposed TM power. Draft legislation proposes to grant the PRA early intervention powers to place a firm under TM in the pre-resolution stage.²⁹ While this regime may work well in cases of persistent conduct-related violations, its potential benefits for remedying deteriorating financial situations are unclear. Given that the firm would remain under the control of its shareholders at this stage, the TM will have no power to override shareholders' rights of approval of key corporate decisions such as recapitalization, mergers, or sale of assets to help recovery efforts. Also, the possible impact of the power on market confidence should be considered, while possible legal risks should be weighed.

27. Substantial improvements have been introduced to bridge supervisory assessments and enforcement. The Proactive Intervention Framework (PIF) introduced in 2014³⁰ captures the PRA's judgment about a firm's risks and its proximity to failure, which is reviewed annually or in response to material developments. Upgrades enforced in January 2016 link the breach of triggers

²⁸ FSMA 2000 with further amendments. Also see BCP Assessment.

²⁹ HMT published in December 2015, a consultation on a draft statutory instrument (Bank Recovery and Resolution Order 2016) to clarify and strengthen the U.K.'s transposition of the BRRD.

³⁰ This has been a recommendation of the 2011 FSAP Update. The PIF gives effect to the common European Supervisory Review and Evaluation Process framework by directly mapping PIF scores to SREP scores (i.e., PIF stage '1' = Overall SREP Assessment '1', and so on).

in the various risk areas³¹ to a menu of supervisory measures.³² As firms move to higher PIF stages, senior management is expected to take appropriate remedial actions and the intensity of supervision increases. Firms at heightened risk of failure are subject to closer and more regular scrutiny by the PRA and RD, and discussions with the FSCS will be initiated when relevant.

28. The PIF framework serves as a link between ongoing supervision and resolution³³ (Table 2). Once the RD is notified of a firm's entry into Stage 3, the engagement with the PRA on contingency planning is intensified and the RD will gather any additional information necessary to carry out resolution, depending on the applicable resolution strategy. An overall PIF score of 5 is likely to trigger an assessment of whether the conditions for resolution are met. The main criteria for assessing *Resolution Condition 1* ("institution is failing or likely to fail") are clearly spelled out in The Bank Recovery and Resolution Order 2014 (item 12)³⁴ and further detailed in PRA guidance, ensuring that such determination supports the entry into resolution before the bank is balance sheet insolvent and when it has no reasonable prospect of return to viability. The PRA's determination takes into account objective elements³⁵ and expert judgments.

29. A clear sequence of assessments undertaken by the BoE in close consultation with relevant authorities leads to the decision to implement resolution. The RD evaluates, in consultation with PRA, FCA, and HMT, if it is not reasonably likely that (ignoring stabilization powers) action will be taken by or in respect of the bank that will result in Condition 1 ceasing to be met (*Resolution Condition 2*). If Condition 1 and Condition 2 are met, the RD will go on to consider whether the exercise of stabilization powers is necessary having regard to the public interest in the advancement of one or more of the resolution objectives (*Resolution Condition 3*) and whether one or more of the special resolution objectives would not be met to the same extent by winding up the bank (*Resolution Condition 4*).

Recommendations

30. The supervisors are advised to increase their attention to the challenges that could emerge from mid-size and smaller, nonsystemically important institutions. The risk-based supervisory approach ensures a "continuous assessment" of the major systemically important banks

³¹ Risks cover: external context, business risk, management and governance, risk management and controls, capital and liquidity.

³² The triggers are: an overall PIF score and pre-defined combinations of the overall PIF score and scores for individual PIF elements; material changes or anomalies identified in the monitoring of key financial and non-financial indicators under PIF revealing that the conditions for early intervention are met; and significant events indicating that the conditions for early intervention are met.

³³ The PRA has transposed the EBA Guidelines on common procedures and methodologies for the supervisory review and evaluation process (SREP) EBA/GL/2014/13.

³⁴ These are further detailed in EBA/GL/2015/07: http://www.eba.europa.eu/documents/10180/1156219/EBA-GL-2015-07_EN_GL+on+failing+or+likely+to+fail.pdf/9c8ac238-4882-4a08-a940-7bc6d76397b6.

³⁵ Including idiosyncratic quantitative and qualitative factors (i.e., capital, liquidity, or any other requirement for continuing authorization, or failed implementation of recovery plan) and significant adverse developments in the macro-economic environment or in the market perception that would threaten the firm's viability.

(Category 1 banks), which would facilitate the preemptive determination of factors conducive to nonviability. However, as noted in the BCP Assessment, this reduces the supervisory attention paid to mid-size and smaller firms, which may possibly prevent the timely identification of problems, although they may negatively affect the viability of those firms and possibly the financial stability. In particular, dealing with the failure of a mid-size bank may be more challenging during the transition towards building sufficient firm-specific loss absorbency capacity.

31. The authorities should revise proposed provisions relating to the TM power, to minimize legal risks. A number of revisions should be made to the provisions to the draft Statutory Instrument to promote clarity. In particular, the proposed section 72G should clarify the precise relationship between the TM and shareholders of an institution. Also, and consistent with Article 29 of the BRRD, the authorities should explicitly require the TM to comply with relevant company law provisions, and clarify that the TM is not a shadow or *de facto* director under company law. Lastly, the proposed section 71G of the BA grants the firm, its parent, a director or senior manager the right to appeal against the application of this power, but it is unclear what reliefs the court may grant in such circumstances. This should be clarified in the draft Statutory Instrument.

RESOLUTION POLICIES AND OPERATIONAL ARRANGEMENTS

A. Clear and Transparent Overarching Policy

32. The BoE has a clear and transparent policy for resolution. A number of policy statements have been issued on either general resolution policies³⁶ or on various operational aspects regarding the exercise of resolution powers.³⁷ Extensive consultations with relevant authorities and the financial industry precede the issuance of the final policies. Although the BoE retains discretion in exercising its resolution powers based on legal and regulatory provisions, the policy statements help achieve clarity in communication and in setting the expectations on the side of firms.

33. At no point of resolution planning can the use of public funds be assumed. The achievement of the resolution objectives appropriately guides the preparedness for and the execution of resolution.³⁸ Among these, the BoE has to protect public funds, including by minimizing reliance on extraordinary public financial support.

³⁶ The BoE's approach to resolution, October 2014.

³⁷ BoE's approach to setting a MREL, Consultation on a Proposed Policy Statement, December 2015.

³⁸ See BA 2009, further amended. The BoE's resolution objectives are to ensure the continuity of banking services and critical functions, protect and enhance the stability of the financial system, protect public funds, protect depositors, protect—where relevant—client assets, and avoid interfering in property rights in a manner inconsistent with the ECHR.

Table 2. United Kingdom: PRA's PIF—Bridging Supervision and Resolution

Stage¹	Characterization	PRA Actions	Other entities' involvement
1	Low risk to viability of firm	Firm subject to normal supervisory risk assessment process and actions	Not applicable
2	Moderate risk to viability of firm	More intense supervisory monitoring	The FSCS evaluates the quality of the data provided to support a single customer view and any obstacles to payout or transfer of deposits
3	Risk to viability absent action by the firm	Impose supervisory actions as needed including based on the RRP's	Regular meetings between PRA and RD are held The PRS and RD will intensify engagements on contingency planning for resolution and will have all means necessary to obtain the information considered necessary to carry out the task
4	Imminent risk to viability of firm	Increase the scale of the recovery actions needed. The PRA will set out a timetable for implementation of recovery actions. PRA may carry out an assessment of Resolution Condition 1, but the possibility of corrective action remains	The RD and FSCS, where relevant, will confirm that all necessary actions to prepare for resolution of the firm have been taken, including that relevant data were readily available
5	Firm in resolution or being actively wound up		RD initiates resolution, where appropriate The FSCS may be required to effect a payout of deposits and/or to fund a deposit transfer or resolution

¹ Every firm sits in a particular stage at each point in time.

As such, resolution planning is conducted on the basis that there is no access to sources of public funding, and that losses are absorbed by shareholders and unsecured creditors of the firm.³⁹ A minimum equivalent of the 8 percent of the total liabilities (including own funds) of the firm in resolution must be exposed to loss before any use of resolution funds, which could be activated only in exceptional circumstances.

34. In the preparedness process, the BoE's efforts are geared towards achieving resolvability of firms. A firm is deemed to be resolvable if the BoE concludes that it would be feasible and credible to take resolution actions (i.e., use stabilization powers) or insolvency proceedings in respect of the institution while avoiding any significant adverse effect on the financial system, maintaining the continuity of the institution's critical functions, and without using public funds.

35. The BoE has also defined some broad considerations in its approach to choosing the resolution strategies. The choice of the resolution strategy ultimately emerges from the process of resolution planning, where the BoE and the PRA will carefully consider the individual institution's RRP based on the characteristics of the firm. In principle, U.K. banks are likely to be resolved by one of three broad strategies: modified insolvency, partial transfer, and whole firm bail-in (Box 1). The first strategy is, broadly speaking, liquidation with prompt insured-depositor payout or transfer, while the last two imply the use of stabilization powers in the public interest.

36. A resolution approach for cross-border firms has also been fleshed out. Similar to resolution strategies applicable to larger firms, the BoE is likely to apply the bail-in strategy for G-SIBs. The Single Point of Entry (SPE) strategy is preferred for firms with integrated legal, operational, and management structures, whereas Multiple Points of Entry (MPE) strategy may be more appropriate for firms that operate across borders through more independently managed and funded legal structures (Box 3). In essence, the SPE would be applied where there are interdependencies between operating companies, but where separation of operating companies is feasible at the resolution "weekend", then the MPE may be considered. These approaches have been discussed and agreed in crisis management groups (CMGs) which are the platforms for ensuring effective cross-border cooperation.

³⁹ There is an explicit requirement against a presumption that the institution will receive any extraordinary public support, ELA, or any nonstandard liquidity assistance (Order No2. Art.60 (2.c)).

Box 2. The BoE's Proposed Indicative Thresholds for Resolution Strategies¹

The approach is simply indicative as the actual resolution method will depend on the circumstances (up-to-date information on the condition of the firm, as well as economic and financial markets conditions) at the point of failure and be implemented in a way that best meets the resolution objectives at that time.

Bank insolvency procedures (liquidation): The bank insolvency procedure would be applicable to institutions whose failure would not require the use of stabilization powers in the public interest. Such firms would be for example smaller, less-complex institutions that do not provide a material number of transactional accounts (BoE proposed an indicative threshold of less than 40,000 accounts used for day-to-day payments and cash withdrawals). The firms may enter a bank insolvency procedure which relies on the FSCS to promptly compensate insured depositors, followed by the liquidation of the firm in a manner that best protects its creditors.

Transfer powers: Where a firm's only critical economic function is the provision of current (i.e. transactions) accounts (or with similar features), the BoE would aim to use its powers to transfer retail and small- and medium-sized enterprise deposits, together with certain (good) assets, to a third party purchaser or bridge bank. The indicative boundaries for this group of institutions would be total transactional accounts over 40,000 and a balance sheet up to GBP 15–25 billion.). Uninsured deposits, liabilities arising from derivative contracts, and other senior (i.e., non-preferred) liabilities are likely to be left behind in insolvency along with loss absorbency instruments subordinated to senior operating liabilities. The actual part of the balance sheet (assets and liabilities) to be transferred to a third party will depend on how resolution objectives could be best achieved and based on the interests of the potential private acquirers.

Bail-in: Institutions above a certain level of size (indicative benchmark is a balance sheet larger than GBP 15–25 billion.) and complexity would be generally resolved under a bail-in strategy. In such cases, the use of transfer powers is less feasible (given the large size of the deposit book) and the BoE may need to quickly take measures aimed at ensuring the continuity of critical functions. As such, the BoE would use the bail-in tool to write down and/or to convert certain liabilities to equity (or other securities) in order to stabilize the firm in resolution, followed by a business reorganization of the firm to address the causes of failure.

¹ Box draws on the "BoE's approach to setting a minimum requirement for own funds and eligible liabilities, Consultation on a proposed Statement of Policy," issued in December 2015 for consultation.

Box 3. SPE versus MPE Resolution Strategies for U.K. G-SIBs

Under the SPE, the BoE would apply the bail-in tool at the level of the parent holding company (the resolution entity for the whole group) and would cooperate with relevant host resolution authorities to ensure that losses at material subsidiaries are passed upwards to the U.K. holding company without those subsidiaries entering resolution. This requires the U.K. holding company to issue TLAC or MREL externally. The material subsidiaries or material subgroups issue internal TLAC/MREL.

Under the MPE, the BoE would cooperate with relevant host resolution authorities, but this time bail-in or other resolution tools could be applied to resolution entities (i.e., parent or intermediate holding companies) in the U.K. and abroad.

B. Well-Developed Recovery and Resolution Planning

37. The recovery and resolution process applies to all banks and is geared towards achieving resolvability. There is a clear expectation that “a firm must prepare for resolution so, if the need arises, it can be resolved in an orderly manner with a minimum disruption of critical services” (PRA’s Fundamental Rule 8).⁴⁰ All U.K.-incorporated banks, building societies, qualifying parent undertakings⁴¹ and certain investment firms are required to prepare recovery plans annually and to submit “resolution packs” every two years or when material changes occur/when prompted by the PRA or BoE. Branches of foreign G-SIBs would not be typically required to prepare recovery plans.⁴²

38. Detailed expectations, including on governance and oversight guide the RRP process. The overall requirements regarding the scope and content of recovery plans are legally set in the Order No. 2.⁴³ PRA has issued detailed requirements for recovery plans,⁴⁴ which are directly applicable to firms together with the EBA’s regulatory technical standards (RTSs).⁴⁵ [once adopted by

⁴⁰ PRA Rulebook.

⁴¹ A “qualifying parent undertaking” is a parent holding company which has a subsidiary which is PRA/FCA authorized. Such entities are not regulated, but are required to make arrangements to facilitate the preparation of a group recovery plan and the exercise of resolution powers in relation to their subsidiaries and to themselves.

⁴² Branches of third-country (non-EEA) firms might be required to prepare recovery plans only when there are concerns related to the group plan (a wide set of information is received by the PRA regularly through the “Branch Returns”). Resolution plans could also be considered for foreign G-SIBs established in the United Kingdom if the BoE would not be satisfied with the home country’s plan.

⁴³ The Bank Recovery and Resolution (No. 2) Order 2014 transposed the BRRD into national legislation with effect from January 2015, superseding the existing requirements for recovery plans.

⁴⁴ Requirements are set in the Recovery Planning Part of the PRA Rule Book and SS18/13.

⁴⁵ Draft EBA/RTS/2014/11 and EBA/RTS/2014/12 are to be adopted by the European Commission (<http://www.eba.europa.eu/documents/10180/760167/Draft+RTS+on+content+of+recovery+plans.pdf> and <http://www.eba.europa.eu/documents/10180/760181/EBA-RTS-2014-12+Draft+RTS+on+assessment+of+recovery+plans.pdf>).

the European Commission] and guidelines].⁴⁶ For resolution reporting purposes, PRA has also published comprehensive informational requirements⁴⁷ (“resolution packs”). Responsibility for the firm’s recovery plans (preparation and execution) lies with the Board of Directors or other appropriate senior governance committee or group.⁴⁸ All resolution plans are reviewed and signed-off by BoE’s senior officials and a summary is shared with the firms, together with other relevant issues.

39. The authorities take a proportional approach to the RRP. Proportionality is reflected at all stages: recovery, resolution, and resolvability. Smaller firms, with straightforward business models are subject to simpler RRPs and may take a more qualitative (or narrative) approach to scenario planning. The larger and more complex firms are subject to elaborated RRPs, based on additional information requested (“Phase 2 packs”) and embedding extensive quantitative analyses and more stringent underlying assumptions. For smaller firms for which the preferred strategy is the bank insolvency procedure, resolvability assessments are likely to be more straightforward than for firms whose preferred strategy involves the use of the BoE’s stabilization powers.

40. There is close cooperation between PRA, FCA, and the BoE to ensure consistency across the RRP process. The PRA sets the range of information requirements for both recovery and resolution planning purposes, although on the latter it cooperates closely with the BoE’s RD. Recovery plans are regularly discussed with the BoE at annual reviews. Resolution plans are prepared by the BoE upon close consultation with the PRA, which helps verify the information provided by the firm and provides firm-specific information based on their expertise and experience. HMT may also be involved as necessary.

41. There is a process for ensuring cross-border cooperation in the RRP process. Where the U.K. firm is part of an EEA group, the PRA assesses the recovery plan along with the other relevant European authorities and seeks to reach a joint decision with them on a group recovery plan. In practice, PRA may share group recovery plans with non-EEA authorities, subject to confidentiality agreements. The BOE coordinates resolution planning for G-SIBs on a cross-border basis through the existing CMGs. In addition, the U.K. authorities are required to cooperate with other EU member states in reaching joint decision on resolution planning (applicable since 2015). Information can be shared with non-EU authorities, but there must be agreement within the resolution college for the resolution plans to be shared.

42. The authorities have improved the RRP process continuously based on the extensive experience accumulated so far. RRPs have been prepared since 2012 and submissions have been adapted to ensure efficiency and relevance of information transmitted by firms. The recovery planning, recently improved through the implementation of the BRRD and related standards, is currently in a phase where the authorities are currently sharing best practices and supervisory

⁴⁶ EBA/RTS/2014/11; EBA/GL/2014/6; EBA/GL/2015/02.

⁴⁷ PRA SS19/13.

⁴⁸ See PRA SS18/13.

expectations. For resolution planning, the information requests made to firms have been adapted once the preferred resolution strategy has been determined, ensuring that subsequent requests for information were proportionate, and better tailored. Most importantly, the intense interaction along this process helped change the mindset of firms and effectively orient actions towards achieving resolvability.

ENSURING RESOLVABILITY

A. Integrated and Far-Reaching Policy Measures

43. The structural reforms will ensure that large banks insulate, operationally and financially, core retail activities. From January 1, 2019, banks with core deposits greater than GBP 25 billion (broadly those from individuals and small businesses) will be required to ring-fence their core retail activities into separate ring-fenced bodies (RFBs).⁴⁹ In essence, the RFB will have a restricted scope of business activities and will be reasonably insulated⁵⁰ from shocks originating in other parts of the group or the global financial system. The PRA has published near final rules on governance, legal structure and continuity of services and facilities and recently consulted on the approach to ring-fencing transfer schemes, prudential requirements, intragroup arrangements and the use of FMIs.

44. Parallel proposals have been made for ensuring operational continuity in resolution. The PRA's draft rules⁵¹ seek to ensure that firms structure their operational arrangements in a way that allows critical shared services to continue to be available before, during and after resolution. Three structures have been proposed as potentially effective: a dedicated intragroup service company providing critical shared services to one or more entities; an operational division providing critical shared services from within a regulated entity with attributes that would allow the BoE to implement a separate service company model should they need to; and a hybrid model. The firms will be expected to comply from January 1, 2019.

45. Efforts have also been made to improve the capability of the FSCS to process depositor information quickly. Deposit-taking firms have been required since 2010 to hold their FSCS-eligible customer data in a single customer view (SCV) file. Firms have 72 hours to produce an SCV file, upon request from the PRA or FSCS, and this timeline will be shortened to 24 hours from

⁴⁹ The PRA is required under the FSMA 2000, as amended by the Financial Services Act 2013, to make policy to implement the ring-fencing of core U.K. financial services and activities. The PRA will issue final rules in 2016. See PRA Consultation Paper CP37/15 on the Implementation of ring-fencing: prudential requirements, intra-group arrangements and the use of financial market infrastructures, October 2015.

⁵⁰ Among these, the RFB should not depend on resources which are provided by a member of its group and which would cease to be available to the RFB in the event of the insolvency of the other member and should be able to continue to carry on core activities in the event of insolvency of other members of the group.

⁵¹ PRA Discussion Paper DP1/14 on "Ensuring Operational Continuity in Resolution," October 2014.

December 1, 2016. These changes effectively enable the FSCS to verify SCV files and make the subsequent payment of claims or support the deposit transfers more quickly.

46. Finally, both BoE and PRA have legal powers to require individual firms or classes of institutions to take measures for removing obstacles to resolvability. The BoE is required to undertake annual resolvability assessments⁵² for all banks and has extensive directive powers to require changes in the legal and operational structures of a firm if that is necessary to ensure continuity of critical functions in resolution.⁵³ The PRA is also mandated to assess resolvability of firms as part of their annual supervisory assessments⁵⁴ and is legally empowered to require firms to take action, including restructuring, to improve the feasibility of orderly resolution.

47. The risk of misalignment in the use of the PRA and BoE resolvability powers is minimized through an extensive consultation process. When the PRA identifies obstacles to resolvability, it provides its findings to the BoE, which is responsible for undertaking the formal resolvability assessment and communicating the measures required to be taken by firms to address obstacles to resolvability. The BoE must consult the PRA or the FCA (in the case of an FCA solo-regulated firm) and, where appropriate, the FPC before requiring the institution to take specified measures to address or remove impediments to resolvability. Where there are common impediments affecting a range of institutions, the PRA could require the impediments to be addressed through rules of general application made pursuant to its statutory rule-making powers, or the BoE could give a direction with general effect or with respect to a particular class of institutions.

B. Bringing MREL to Life

48. To facilitate the implementation of stabilization powers, all U.K. banks are subject to a MREL. The MREL has been introduced by the BRRD and will be set by the BoE (in close coordination with the PRA or FCA) for all banks, regardless of size, at both individual and group consolidated basis.⁵⁵ The MREL will be tailored to the risk profile and resolvability of individual institutions and enforced through BoE's powers of direction. The four U.K. G-SIBs will be also subject to MREL, which will reflect their characteristics and resolvability, and will be set so as to implement the TLAC⁵⁶ requirements.

⁵² The structure and content of the resolvability assessments follow the mandatory EBA's RTS on Contents of Resolution Plans and Resolvability Assessments.

⁵³ Section 3B of the BA requires that, before it can exercise the powers under section 3A of the BA to remove impediments to the exercise of stabilization powers, the BOE must publish a Statement of Policy setting out how it intends to use the powers. The Statement can be found at: <http://www.bankofengland.co.uk/financialstability/Documents/resolution/barriersresolvabilitydec15.pdf>.

⁵⁴ This supports the PRA's general objective to promote the safety and soundness of authorized institutions.

⁵⁵ See BoE Consultation on a proposed Statement of Policy, "The BOE's approach to setting an MREL," December 2015. BoE may also set MREL for certain other group entities, including holding companies.

⁵⁶ See FSB "Principles on Loss-absorbing and Recapitalization of G-SIBs in Resolution; Final TLAC Term Sheet,"

49. The MREL and TLAC are conceptually similar, but the MREL's operational features are more flexible, given its broader scope. Both MREL and TLAC aim at ensuring that a sufficient loss absorbency cushion is available within institutions, should the need arise, to support their orderly resolution without recourse to public funds. To ensure credibility and feasibility, both MREL and TLAC instruments have to be legally enforceable for the purpose of loss absorption and should not give rise to systemic risk. Eligibility for MREL is broadly aligned to the TLAC, although the MREL embeds more flexibility, which reflects its broader scope of application (Table 3). The expected macroeconomic benefits of MREL will exceed costs.⁵⁷

50. The MREL will be aligned with the proposed resolution strategy of the firm (Table 4). The BoE has a degree of discretion in establishing the individual firm's MREL quantity and quality.⁵⁸ The firm-specific MREL will be established as a sum of two components: a loss absorption amount (the amount needed to absorb losses in resolution) and a recapitalization amount reflecting the preferred resolution strategy (the amount needed to recapitalize the firm in resolution as necessary to meet the resolution objectives).⁵⁹ The PRA also expects firms not to double count common equity tier 1 (CET1) capital towards, on the one hand, MREL, and, on the other hand capital buffers (Basel III/CRD IV combined buffers and Pillar 2 buffers) or leverage ratio buffers.⁶⁰

51. The authorities envisage a phased in implementation of MREL. The BoE proposes to make use of the transition period allowed under the BRRD and implement MREL from 2016 to 2019 for G-SIBs or 2020 for other firms. Preliminary expectations on the MREL requirements will be communicated to firms by end 2016. Until 2020, the MREL is set in an amount equal to the applicable individual firm's capital requirements (i.e., not operationally binding), although the BoE retains discretion to set additional MREL requirements on firms where action is needed to enhance resolvability.

November 2015.

⁵⁷ The BoE estimates that the macroeconomic benefits of MREL (0.3-0.9 percent of GDP) will exceed the costs (0.04 percent of GDP) by a considerable margin, a finding which is in line with the FSB's TLAC impact study.

⁵⁸ The BoE has a degree of flexibility in setting the eligibility criteria for instruments to count as MREL as long as three conditions are fulfilled, i.e. the instrument must: a) be within the scope of bail-in, b) not be subject to preference in insolvency, and c) not contain features which are likely to make it difficult to bail-in or otherwise expose to loss in resolution in a manner that meets the statutory objectives of resolution. These conditions mean that the scope of the bail-in tool extends widely to include many liabilities that would not count as MREL.

⁵⁹ See BOE CP44/15 "The minimum requirement for own funds and eligible liabilities (MREL)—buffers and threshold Conditions," December 2015.

⁶⁰ From January 2016, U.K. banks with retail deposits greater than GBP 50 billion implement a minimum leverage ratio requirement of 3 percent.

Table 3. United Kingdom: Comparison Between FSB TLAC and BRRD MREL Proposals

	FSB TLAC	EU BRRD / MREL (EBA Guidelines)
<i>Scope</i>	Applicable to G-SIBs	Applicable to all European banks
<i>Quantum</i>	Common minimum: 16-18 percent RWA and 6-6.75 percent of leverage ratio denominator + Additional firm-specific (bank-by-bank): considering risk profile and resolvability Basel III capital buffers to be met on top of the TLAC requirements	No common minimum requirement, but: - G-SIBs will be subjected to the FSB TLAC requirements - Firm specific MREL requirements will be set as a percentage of own funds and total liabilities, based on firm risk profile, resolvability etc. Treatment of capital buffers not specified
<i>Eligible instruments</i>	"Legal enforceability" Capital and debt liabilities (paid in, unsecured, residual maturity longer than a year)	"Legal feasibility" Own funds and eligible liabilities (fully paid up, unsecured, remaining maturity of at least one year)
<i>Exclusions</i>	Insured deposits Liabilities from derivatives, structured notes, preferred liabilities, or otherwise excluded from bail-in	Insured and other preferred deposits Liabilities arising from derivatives
<i>Subordination</i>	Requirement for subordination (contractual, structural, or statutory) to operational liabilities on which the performance of critical functions depend	No explicit subordination requirement
<i>Implementation</i>	January 1, 2019 (16 percent RWA and 6 percent leverage ratio denominator), January 1, 2022 (18 percent RWA and 6 percent leverage ratio denominator)	January 1, 2016, but authorities can make use of a transition period and set MREL requirements starting in 2020

Table 4. United Kingdom: Proposed Indicative Parameters for MREL Application			
Scope	Indicative resolution strategy	Indicative MREL	Subordination
Institutions with fewer than 40,000 “transactional accounts”	Modified insolvency	No greater than minimum capital requirements (i.e., greater of own funds requirements, applicable leverage ratio, and Basel I floor)	Not applicable
Institutions with more than 40,000 “transactional accounts” and balance sheet less than GBP 15–25 billion	Partial transfer (P&A, bridge)	Equal to current minimum capital requirements plus a proportion of the minimum capital requirements corresponding to the balance sheet transferred	Generally no subordination requirement (senior operating liabilities will be left behind in insolvency, along with the MREL resources, thus avoiding the need to depart from <i>pari passu</i> treatment)
Institutions with balance sheet greater than GBP 15–25 billion (including G-SIBs)	Bail-in	Equal to two times current minimum capital requirements minus any changes to post-resolution capital requirements. Level necessary to support group resolution strategy	Subordinated to senior operating liabilities
Subsidiaries of foreign institutions for which the home authority is to lead an SPE resolution	These subsidiaries are not subject to U.K. resolution, but resolved as part of the SPE resolution	Subject to internal MREL as necessary to support the group resolution strategy	Subordinated to senior operating liabilities

Source: The BoE’s approach to setting MREL, December 2015.

52. U.K. G-SIBs will be required to meet the minimum MREL/TLAC requirement on a consolidated basis by January 2019. By then, the U.K. G-SIBs are required to achieve the minimum consolidated TLAC of 16 percent of risk-weighted assets (RWAs) or 6 percent of leverage exposures (the common minimum TLAC). BoE will require that TLAC be structurally subordinated through external debt issuance by the holding company⁶¹ and proceeds be down-streamed to key operating subsidiaries as equity, other regulatory capital instrument, or loans that are subordinated (statutory or contractual) to senior liabilities of those subsidiaries. The U.K. authorities have started

⁶¹ The holding company should not provide critical functions itself. When losses arise in an operating entity such that it is no longer viable, intragroup liabilities are written down or converted to equity, passing losses up to the holding company. If losses cannot be sufficiently absorbed by the resolution entity, the bail-in tool will apply (see BOE’s approach to setting an MREL, Consultation on a proposed Statement of Policy, December 2015).

cooperating closely with relevant foreign authorities regarding the implementation of the MREL/TLAC within CMGs.

53. The MREL framework goes a long way in supporting resolvability of banks, but its implementation will be challenging. The BoE estimates⁶² that the U.K. banks' MREL long-term debt restructuring need is around GBP 223 billion, while the estimated net shortfall is relatively small—at GBP 27 billion. While U.K. G-SIBs have a relatively small net shortfall of overall MREL/TLAC, efforts will be needed to make sure that the internal MREL/TLAC is positioned appropriately within the groups. Clearing the legal and operational hurdles for effectively implementing the MREL/TLAC framework in a cross-border context will be a complicated process. Many firms with a domestic profile will need to adjust their funding strategies and to issue additional MREL-eligible debt.

54. The FCA has taken proactive measures to protect retail customers from investing in certain riskier and less transparent debt instruments. Specific measures have been taken in regard to contingent convertible capital instruments (CoCos), given risks that such loss-absorbing instruments may pose to retail customers that are neither sophisticated nor high net worth. The FCA has introduced product intervention rules restricting the retail distribution of CoCos.⁶³

Recommendations

55. The transition to building sufficient firm-specific MREL will have to be carefully managed. The authorities' preferred resolution strategies may be more challenging to implement in the absence of sufficient MREL and given limitations in using the resolution funding mechanisms (i.e., the resolution fund or last-resort public interventions can only be used after a minimum 8 percent of total liabilities (including own funds) of the firm in resolution have been exposed to loss. Supervision will need to remain particularly intrusive and take preemptive corrective actions where needed. Reforms on ring-fencing critical functions and improving resolvability will also have to proceed decisively. Also, a communication strategy with the public/investors will need to be developed.

56. On the domestic plan, the BoE will have to strike a good balance in setting MREL proportional to the firms' risk profile and resolvability. Setting requirements at the lower end of the MREL range may limit the freedom that the BoE would have in resolving smaller firms, especially if problems arise at the same time in multiple parts of the financial system giving rise to systemic concerns. Setting requirements that are too high may, on the other hand, overburden smaller banks, increase their funding costs, and limit their capacity to support certain segments of the economy.

57. For cross-border groups, the MREL/TLAC will have to be set and implemented in close coordination with other authorities. Further guidance⁶⁴ on the operational features of the internal

⁶² BOE's approach to setting MREL, December 2015.

⁶³ See <https://www.fca.org.UK/static/documents/policy-statements/ps15-14.pdf>.

⁶⁴ Operational aspects related to the quantum and forms of internal TLAC, mechanisms for triggering, writing down,

MREL/TLAC is expected to help catalyze international cooperation, but the interests of various home and host countries may still diverge.⁶⁵ Close home-host coordination will be needed in establishing the amount and forms of internal MREL/TLAC and a common understanding on the mechanisms for triggering and executing the bail-in (including the use of market infrastructure for such purpose, meeting disclosure requirements in multiple jurisdictions, delivering compensation per bail-in terms, etc.). These are complex operational aspects which will take time to implement.

58. As MREL gets implemented an appropriate disclosure framework will have to be developed. Investors, creditors, counterparties, customers and depositors should have clarity about the order in which they will absorb losses in resolution. In time, an approach for disclosing information on a legal entity basis for, at a minimum, all resolution entities and each legal entity that forms part of a material subgroup and issues internal TLAC to a resolution entity, will have to be developed, pending international guidelines in this area.

CROSS-BORDER COOPERATION

A. Legal Framework for Cross-Border Cooperation

59. The U.K. authorities have taken a participatory and cooperative approach in developing effective cross-border arrangements. As both a home and host authority, the United Kingdom has an incentive to ensure that both interests are treated equitably in resolution. As a home authority, the BoE is committed to leading a cross-border resolution with the objective of ensuring that financial stability is maintained in both home and host jurisdictions.⁶⁶ where the United Kingdom is a host to a foreign firm that needs to be resolved, the U.K. authorities aim to coordinate closely with the home authorities and only seek to take independent action in exceptional cases, in line with the approach for cross-border cooperation set out in the KAs.

60. The legal framework helps to promote cross-border resolution, although it remains untested. The BoE, as resolution authority, is authorized to enter into cooperation arrangements with foreign authorities. To this end, a number of MoUs have been signed with counterparts in foreign jurisdictions. Legal gateways for information sharing with foreign authorities (EU and non-EU) are broad, where information is required by foreign authorities for the carrying out of a public function. In the case of non-EU authorities, the BoE is however required to assure itself that such information would be held under the same standards of confidentiality to which the U.K. domestic authorities are subject. This sometimes involves BoE “equivalence assessments” in respect of the confidentiality regimes of the foreign authority.

and converting internal TLAC are still debated in international fora. In the EU, the EBA is working on preparing guidance on the internal MREL implementation, while the FSB is also expected to issue similar guidelines for G-SIBs by the end of 2016.

⁶⁵ For example, in regards to pre-positioning internal TLAC (established in the form of claims of the parent that are paid in or secured by high-quality and liquid collateral). Host countries may wish to preposition more internal TLAC, which may be less efficient for the home country from both a business and resolution perspective.

⁶⁶ See BoE’s Approach to Resolution, October 2014.

61. Resolving a cross-border bank could involve a number of legal and practical challenges for the U.K. authorities. Cooperation could be hampered by significant variations in resolution regimes (particularly for jurisdictions which have not fully adopted the KAs), as well as differences in approaches to resolution, valuations, and creditor hierarchies, to mention a few. The incorporation of the BRRD treatment into the U.K.'s legal framework may result in discrimination in favor of U.K., EU, or EEA interests, at the expense of third-countries and their creditors. The U.K.'s creditor hierarchy for insolvency and stabilization options post-BRRD reflects a less favorable treatment for deposits held through non-EAA branches of U.K. banks. This may affect cooperation of third countries where the U.K. undertakes resolution of cross-border banks, in cases where an operating company in the U.K. with branches in a third-country may need to be resolved by the U.K. authorities. In such cases, the third country may find the need to ring-fence local assets held by the branch in their jurisdiction to protect domestic deposits, instead of transferring them to the U.K. in support of the U.K.'s resolution actions. Similarly, differences in domestic resolution frameworks in relevant jurisdictions may impede cross-border resolution efforts.

62. The U.K. authorities are determined to implement resolution in the cross-border context in a manner that does not discriminate against third country depositors and hence avoids the above risks. The BoE's preferred resolution strategy for major cross-border U.K. banks would only involve the application of resolution tools to the holding company, whose creditors would be treated equitably regardless of the location of their claim or their nationality. Under this strategy, the key operating companies, where deposit-taking takes place, would not enter resolution, so depositors at their non-EEA branches would not be discriminated against compared with depositors of the U.K., EU, or other EEA branches.

63. Recognition and enforcement of cross-border resolution actions is critical to ensuring effectiveness of the resolution regime. The BRRD and the EU Credit Institutions Reorganization and Winding-up Directive provide a clear framework for cooperation and coordination among EU member states, reflecting among other things, responsibilities of home jurisdictions for resolving EU banks, and for mutual recognition of resolution actions undertaken by the home authorities. The U.K. legal framework also empowers the BoE to recognize (with the approval of HMT) third-country resolution actions in respect of a third-country institution operating in the U.K., except in limited circumstances including where the stability of the U.K.'s financial system is at risk, or where U.K. public funds are implicated.⁶⁷ Recognition by the BoE of third country resolution actions gives effect to such actions with the same effect as it would have under the third country's legal framework, although BoE could also exercise its stabilization powers in respect of a U.K.-based branch or entity, in support of such third-country actions. There are however plans underway to empower the BoE to

⁶⁷ Recognition of third-country resolution action may only be refused where (i) recognition would have an adverse effect on financial stability in the U.K. or other EEA state; (ii) the special resolution objectives are best realized by a U.K. resolution action in respect of a U.K. branch of a third-country bank; (iii) there would be discrimination by the third-party country resolution action, against EAA creditors (especially depositors) relative to third-country creditors; (iv) there would be material fiscal implications that would arise for the U.K. from recognizing such foreign resolution action; or (v) the foreign resolution action is unlawful under the ECHR.

initiate independent resolution action against U.K. branches of third-country banks where a third country resolution action is not recognized for reasons specified in the BA.⁶⁸

64. Recognition of U.K. resolution actions outside the EU could be a challenge and potentially, a major impediment to orderly resolution of a G-SIB. Unlike the U.K., several jurisdictions where U.K. banks have operations or hold assets and liabilities do not have statutory provisions for recognizing and giving effect to foreign resolution actions, resulting in the need for parallel resolution actions or the risk of ring-fencing of U.K. banks' assets in those jurisdictions. This may impede the effectiveness of U.K. resolution powers (such as the power to stay termination rights of counterparties) and resolution tools such as bail-in and transfers. Execution risks are partly mitigated by the build-up of sufficient loss absorbency capacity in the form of enforceable MREL/TLAC that would enable the application of the bail-in or partial transfer at the level of the holding company.

65. The U.K. has sought to minimize this risk by pursuing contractual approaches to recognition of its resolution actions. The U.K. authorities support the ISDA Resolution Protocol, to which U.K. G-SIBs are signatories. U.K. legislation also requires U.K. banks to provide for contractual bail-in recognition clauses in contracts governed by foreign law, in line with Article 55 of the BRRD, while proposed rules will require contractual recognition of temporary stays of terminations rights in resolution.⁶⁹ Implementation of the contractual bail-in requirement in the U.K. has however been challenging due to concerns raised by foreign authorities with respect to the implications of the requirement for their jurisdictions and by firms concerned about the wide scope of Article 55. The PRA has proposed to modify this rule to clarify the scope of covered liabilities⁷⁰ and is consulting on a disapplication of the rule to certain liabilities on the basis of impracticability. The limitations of the contractual recognition approach are clear, and in any event, the scope of the Article 55 requirement relates only to bail-in and not to other resolution tools such as transfers. Ultimately statutory recognition by foreign (third country) authorities of U.K. resolution actions would be useful, in order to make cross-border resolution effective.

Recommendations

66. The authorities should continue to strengthen the legal and operational regime for cross-border resolution. The authorities should consider creating a level playing field for non-EU interests by doing away with any discrimination in the creditor hierarchy in particular. Given the "supranational" nature of the BRRD, addressing this issue will require action by the EU authorities to

⁶⁸ The proposed rules would allow the BoE to transfer, in the specified limited circumstances, the "business of the branch," including any assets and liabilities held locally, to an entity incorporated in the U.K., to which bail-in powers could be applied.

⁶⁹ The PRA's proposed rules requiring contractual stay provisions in financial contracts governed by third country law will be effective from June 1, 2016 in respect of financial arrangements with counterparties that are credit institutions or investment firms, and from January 1, 2017 in respect of financial arrangements with all other counterparties.

⁷⁰ The scope of Art. 55 is rather broad and could potentially affect all financial and non-financial obligations of U.K. banks.

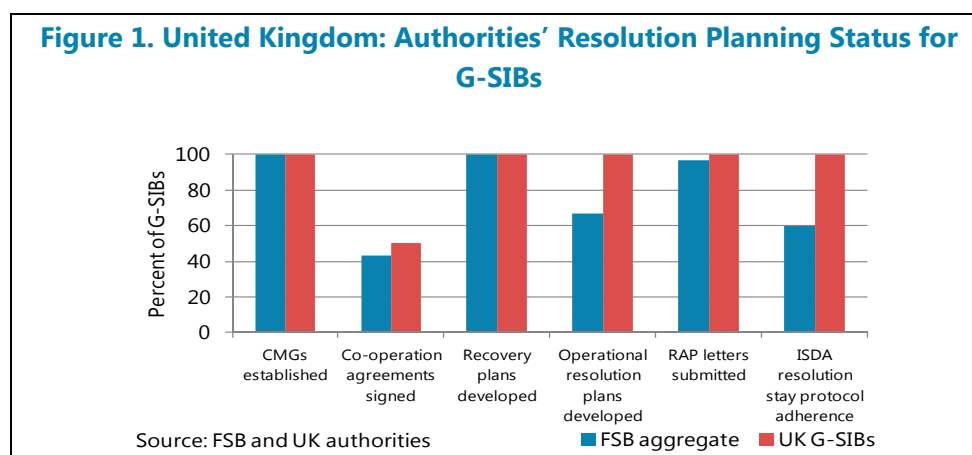
amend the BRRD. The U.K. authorities are encouraged to engage with the EU authorities on the way forward. The authorities should continue to enhance the contractual bail-in requirements, while exploring the benefits of extending it to cover other resolution powers and tools where appropriate. At the same time, the authorities should continue to foster collaboration with foreign authorities, in order to facilitate cross-border implementation of resolution actions. Lastly, the authorities should continue to engage at the FSB level to help persuade other jurisdictions to remove differences in domestic resolution frameworks that may impede cross-border resolution efforts.

B. Making Cross-Border Cooperation Work

67. The operational features of the cross-border cooperation in resolution are shaped up by the EU framework and of the United Kingdom's adherence to the FSB agenda. As an EU member, the United Kingdom is required to implement cross-border arrangements for cooperation resulting from the implementation of the BRRD, including by establishing or participating in EU resolution colleges. The United Kingdom is not part of the EU Banking Union and, as such, does not participate in the Single Resolution Mechanism. At the same time, the United Kingdom has already accumulated a lot of experience in implementing the international framework for cooperation related to G-SIBs. CMGs for the U.K. G-SIBs have been established since 2013 and have become an essential forum for cross-border coordination in the area of resolution planning.

68. The United Kingdom has been a frontrunner in implementing the FSB agenda on cross-border cooperation. For all the U.K. G-SIBs, the RRP have been shared and discussed within the CMGs and a first round of resolvability assessments has been completed in 2015 (Figure 1). As a result, operational resolution plans are in the course of being updated. Cooperation Agreements (CoAgs) have been discussed within CMGs for all U.K. G-SIBs, two have been approved, and two are to be signed soon. The U.K. authorities are recognized by their main foreign counterparts for their open and constructive engagement and thought leadership in both bilateral and multilateral relationships (including in FSB and EU fora).

69. A number of practical measures are currently being taken to support operationalizing cross-border resolution planning. The CoAgs are an important (nonbinding) basis for outlining the broad roles and responsibilities of the CMG members and establish a shared understanding of resolution procedures. The authorities have found it useful to start developing complementary bilateral resolution playbooks, embedding a greater level of detail with regard to implementation of specific resolution work streams (i.e., bail-in mechanics, communication, valuations, etc.) that need to be undertaken in coordination with other counterparts.



70. The U.K. and U.S. authorities have engaged closely in developing common approaches to the resolution of G-SIFIs. A joint FDIC-BoE paper published in 2012⁷¹ outlined the authorities' common considerations on implementing resolution actions under an SPE strategy, including on the need to ensure sufficient loss absorbency at the top of the group. Outside the CMG process, the U.K. and U.S. authorities have also worked together to develop a common understanding of how the two jurisdictions might interact during a resolution. Such interactions are planned with other jurisdictions.

71. Other operational impediments to resolvability will need to be addressed in a cross-border context. The effective implementation of the MREL/TLAC standard across relevant resolution entities will require support of other relevant jurisdictions to pre-position the internal MREL/TLAC across the group and will have to be accompanied by supportive legal, contractual, and operational arrangements. Other measures will need to be taken to ensure the supply of services from within the group that support critical economic functions, as well as for ensuring flexibility and coordination in the firms' systems so that the authorities can rapidly value the firm in resolution. Many of these are work in progress in the international fora.

72. The EU resolution colleges are only at inception given the relative recent entry into force of the relevant BRRD provisions. Membership⁷² in the resolution colleges is restricted to EU Member States, while other countries can only be invited as nonvoting observers. Group level resolution authorities chair the resolution colleges. Resolution colleges are expected to become fully operational in 2016. In 2015, the BoE has set up resolution colleges for three of the largest banking groups, and is in the process of reviewing whether there are any additional colleges which need to

⁷¹ <http://www.bankofengland.co.uk/publications/Pages/news/2014/128.aspx>.

⁷² BRRD (Art. 88.2) provides for membership from all member countries with subsidiaries covered by consolidated supervision, significant branches, or where a parent of the institution subject to the BRRD is established. It also includes, apart from relevant resolution authorities, all relevant supervisory (competent) authorities, as well as representatives from the competent ministries and of the authorities responsible for the deposit guarantee schemes. EBA is also a participant.

be established in 2016. The authorities expect to be invited to participate in a number of resolution colleges as a host country and participation will be prioritized depending on the importance of the firm for the U.K.

73. Unlike CMGs, resolution colleges impose legally binding procedural and decision making requirements on members in key areas. Members of the resolution colleges have to take joint decisions on the resolution plan, resolvability assessment, setting the MREL, and measures to remove obstacles to resolvability. The EBA has binding mediating powers in regard to disagreements within colleges in the event that one of the members refers the matter to the EBA. The cooperation framework for EU colleges is expected to evolve further pending the adoption of the EBA binding standards in 2016, which will draw on the general principles outlined in the BRRD. For colleges with significant involvement of countries participating in the Banking Union, the participation of the Single Resolution Board is expected to help streamline coordination.

74. The EU resolution colleges are closely coordinated with the CMGs for the U.K. G-SIBs. Given the importance of non-EU global operations of U.K. banks, the U.K. took an inclusive approach and invited already the non-EU CMG members to participate as observers in the relevant resolution colleges. The CMGs are expected to remain the main vehicle for communication across the groups and to coordinate closely with the resolution colleges. Given the early stages of the resolution colleges, their members will be likely benefit from the substantial experience already accumulated in the CMGs.

75. The U.K. authorities have been forthcoming in cooperating with non-CMG countries where the G-SIBs operate. Participation in CMGs on a global basis is subject to materiality of the local operations to the whole group. Many U.K. G-SIBs have widespread global presence,⁷³ and as such, there is a large number of host countries which are not involved in CMGs. Some of these are hosts of U.K. banks which have a systemic importance in the context of the host financial sectors. With some of these host countries, lines of communication have been opened, upon request, to the extent that they had appropriate legal frameworks to protect the information received. In some cases, the U.K. authorities built awareness on cross-border issues in the context of regional sub-groups.

Recommendations

76. In line with the FSB guidance,⁷⁴ the authorities are advised to establish an approach for engaging with non-CMG hosts where U.K. G-SIBs have a systemic presence. The authorities have had a cooperative approach in accommodating requests for cooperation whenever legally and practically possible (given resource constraints). A more articulated framework for interaction with host jurisdictions where U.K. G-SIBs have a presence of systemic importance for the local financial

⁷³ For example, HSBC's network spans over 72 countries and territories in Europe, Asia, the Middle East and Africa, North America and Latin America, serving 48 million customers.

⁷⁴ FSB Guidance on Cooperation and Information Sharing with Host Authorities of Jurisdictions where a G-SIFI has a Systemic Presence that are Not Represented on its CMG, November 2015.

systems would be highly beneficial in an international context. This would include processes to ascertain those jurisdictions that are not members of the CMG but that assess the local operations of the firm to be systemically important as well as practical arrangements, tailored appropriately for ongoing communication, cooperation, and information sharing with the relevant authorities from host jurisdictions. This is going to be a multilateral effort, in which host countries will also need to contribute in the spirit of cooperation and mutual support in resolution.

FUNDING OF FIRMS IN RESOLUTION AND DEPOSIT INSURANCE

A. Preparing an Operational Framework for Funding of Firms in Resolution

77. The BoE, as a resolution authority, may need to mobilize temporary sources of funding (resolution funding) to enable the orderly resolution of a firm. As part of the resolution planning and resolvability assessments, the BoE requires firms to build sufficient MREL to restore the solvency of the failing firm (or its successor). The solvency shortfall that might arise at the point of resolution is inherently subject to a certain degree of uncertainty given hard to anticipate market or economic conditions at the time of the entry into resolution.⁷⁵ In addition, restoring the solvency may not be sufficient to ensure the continuity of a firm’s critical functions if the firm does not have adequate liquidity. In line with the KAs, temporary sources of funding may need to be mobilized to maintain essential functions and to enable the orderly resolution.

78. The BRRD implementation has introduced new conditions for the provision of funding of firms in resolution. At present, the U.K. has three funding mechanisms that could be used to ensure the continuity of a firm’s critical functions if the internal resources of the firm in resolution (i.e., MREL or liquidity) are not sufficient. First, the FSCS could contribute its funds where resolution actions aim at ensuring depositors’ access. Second, the BRRD introduced the possibility for the BoE to request the HMT to release the resolution fund (in an amount up to 1 percent of the deposits protected by the FSCS) to support a variety of resolution actions. Third, the BoE’s regular and exceptional liquidity insurance frameworks could be deployed, more generally, for solvent banks in resolution experiencing temporary liquidity pressures. These options are subject to specific conditions and limitations, as outlined below.

Use of deposit insurance funds

79. Given its “pay-box plus” function, the FSCS can make contributions towards the resolution costs. The FSCS can be called to contribute where resolution actions are taken to ensure that depositors continue to have access to their deposits. The FSCS can contribute both when the

⁷⁵ Resolution specific data needs are very granular (daily position forecasts for the resolution timeframe, legal entity information, currency liquidity positions, intraday liquidity requirements), while the balance sheet might be subject to heightened volatility (due to runs, rising asset encumbrance, restructuring, etc.).

bail-in tool is applied or when other resolution tools are applied (in the case of bail-in the FSCS can only contribute to cover losses, not recapitalization),⁷⁶ but only with amounts not greater than the amount that it would have paid out if the firm had gone into insolvency and the FSCS had paid out to depositors, net of the expected recoveries. The contributions towards resolution are capped to a maximum of 50 percent of the target level.

80. In practice, the contributions of FSCS towards resolution actions are expected to be very limited. As a result of the depositor preference in the creditor hierarchy, expected recoveries by the FSCS in the case of insolvency could be very large (i.e., close to full recovery). As such, contributions by the FSCS could be very limited in a narrow interpretation of these provisions (i.e., FSCS cannot make gross disbursements upfront above its ultimate contribution net of recoveries would be less than in liquidation). This could be a significant constraint to using FSCS funds in scenarios where bank assets are not easily sellable (e.g., a systemic scenario). If this is the case, it should be reconsidered to allow the FSCS to disburse greater funds upfront in a resolution if the estimated final cost to the FSCS, net of recoveries, would be lower than its estimated net liquidation costs. Clarifications are pending on how these provisions will be applied, including from EBA.

Resolution fund

81. In line with the BRRD, resolution financing arrangements have to be established for the purpose of ensuring the effective application of the resolution tools and powers. Such arrangements are financed by ex-ante contributions of banks into a dedicated resolution fund or otherwise made available to the resolution authority in an amount equivalent to 1 percent of the covered deposits.⁷⁷ The resolution financing arrangements could be used to support a variety of resolution actions including (but not limited to): make loans or provide guarantees to the entity under resolution, make contributions to a bridge institution, an asset management vehicle, or to a bail-in in lieu of creditors excluded. It can also be used to make a contribution to loss absorption and recapitalization, but only after the shareholders and creditors have been exposed to loss equivalent to at least 8 percent of the total liabilities of the firm including own funds.⁷⁸

82. The resolution fund requirements under the BRRD will be met through contributions to the bank levy. HMT is committed to make available, at the request of the BoE, a notional fund up to the equivalent amount of the target level, based on contributions collected through the bank levy. Section 228 of the BA 2009 provides the legal basis for HMT to pay out of the Consolidated

⁷⁶ When the bail-in tool is applied FSCS would contribute the amount by which covered deposits would have been written down in order to absorb the losses in the institution, had covered deposits been included within the scope of bail-in and been written down to the same extent as creditors with the same level of priority. When one or more resolution tools other than the bail-in tool is applied, the FSCS would contribute the amount of losses that covered depositors would have suffered, had covered depositors suffered losses in proportion to the losses suffered by creditors with the same level of priority.

⁷⁷ Target level to be reached by 2024.

⁷⁸ For resolution actions surrounding an institution, the resolution fund could be used up to the lower of 5 percent of total liabilities including own funds or the means available to the resolution fund and the amount that can be raised through ex-post contributions.

Fund (where money is raised via the bank levy) expenditures incurred in connection with the exercise of the resolution powers. Ex-post recoveries from the industry can be made through the bank levy, with the government having the ability to make any adjustments as necessary.

83. A number of operational challenges will have to be resolved to enable the effective implementation of this resolution funding mechanism. First, a clear determination will have to be made regarding the amounts (entitlements) that could be mobilized by the BoE under the parameters of this mechanism. Second, an operational procedure will have to be established to enable the disbursement of such funds from the Treasury as deemed necessary by the BoE for the objective of ensuring orderly resolution. These elements will need to be clarified in order to make this mechanism operational.

BoE liquidity support

84. A firm in resolution that has been recapitalized through bail-in may, under certain conditions, access the regular or exceptional liquidity facilities of the BoE. A firm in resolution (or its successor) that is adequately capitalized (i.e., following the write down and conversion of MREL) may be able to tap liquidity through the Sterling Monetary Framework (SMF),⁷⁹ provided that relevant conditions of access are met and under the applicable terms of the facilities. Nevertheless, funding may be required while plans to recapitalize the failed entity or to create a bridge bank are put into effect, during which the bank may not fulfill the conditions for or the terms of the SMF.⁸⁰ In such cases, the BoE could provide ELA⁸¹ to a bank in resolution, based on the Chancellor's approval, and in line with the crisis management MoU procedures.

85. The BoE's ELA framework is flexible. ELA could be provided to any financial institution,⁸² in sterling or in foreign exchange, either at the decision of the BoE (with HMT authorization), or at the instruction of the Chancellor. Counterparties must be solvent (on a balance sheet basis) and are expected to provide collateral. The BoE will duly consider how the firm would expect to repay the ELA and may impose special restrictions and monitoring arrangements. Under the terms of the Crisis Management MoU the Chancellor may direct the BoE to provide ELA to an insolvent firm. Risks to the BoE's balance sheet are mitigated by an indemnity provided by HMT according to the existing Crisis Management MoU. Although this arrangement is not backed by explicit legal provisions, the authorities consider that the close consultation process between the BoE and HMT in crisis

⁷⁹ See TN on the "Review of the Bank of England's Liquidity Provision Framework". In principle, both short term repo and the Indexed Long Term Repo (ILTR) operations and the discount window facility (DWF) could be used by a solvent bank.

⁸⁰ The BOE requires counterparties to be solvent to receive DWF funding and other conditions may be constraining to a firm in resolution. The DWF provides short term (30 day) sterling liquidity in the form of a collateral swap which may be rolled over at the discretion of the BOE. The cost of liquidity is on a sliding scale dependent on the amount borrowed and the nature of the collateral.

⁸¹ The ELA is considered to be all liquidity insurance provided outside of the published SMF (see the Technical Note covering the Liquidity Provision framework for details).

⁸² The ELA may in principle be provided to any institution, although the expectation is that it will be provided mainly to financial institutions. There is no statutory requirement for ELA recipients to be systemically important.

management, as well as the existing MoU, whose terms are publically disclosed, provide sufficient reassurance that the indemnity would be provided by the HMT for ELA directed by the Chancellor. The BoE may also seek an indemnity from the HMT in cases where the risks associated with the lending operation are assessed to be higher than the BoE can sustain.

86. Any funding shortfall is likely to increase the operational complexities in effecting the orderly resolution of a G-SIB or a large cross-border firm. The availability of temporary funding in resolution is essential to ensuring that the G-SIB can be credibly resolved and that market participants can be confident in the viability of the entity under resolution. The U.K. authorities have started working closely with some of their key foreign counterparts on issues surrounding temporary funding in resolution. More work lies ahead to define a well-articulated framework to assess, coordinate, and mobilize the necessary temporary liquidity (including in different currencies) for the orderly resolution of a group. The determination of the group funding needs will require availability of very granular information from the various entities of the group⁸³ and a detailed understanding of conditions for accessing payments systems and using local backstop facilities as needed.⁸⁴

Recommendations

87. The authorities are advised to build on the current arrangements to develop an integrated operational framework for funding of firms in resolution. At present, the terms and limitations in the use of the FSCS and resolution fund have not been fully elaborated from an operational point of view (i.e., outlining key legal constraints related to purpose or amount of financing, conditions related to the resolution strategy, etc.). The HMT/BoE MoU could be updated to reflect the common understanding on the use of the resolution fund. As a general rule, ELA should be provided only to solvent banks, against sound collateral, and at penalty rates. When ELA is going to be provided to support the liquidity of a solvent firm in resolution (i.e., recapitalized post bail-in), the authorities should contemplate the provision of an indemnity by HMT where there are concerns about the counterparty, length of support, exit strategy, collateral or scale of the liquidity need. Lastly, the authorities should clarify the circumstances in which an indemnity would be needed to deliver ELA.

88. Common efforts with foreign authorities will need to continue to develop credible cross-border temporary funding arrangements for to support the orderly resolution of a U.K. G-SIBs. Pending FSB guidance on developing arrangements around the temporary funding in resolution has a potential to catalyze cross-border efforts in this important area. The U.K. authorities should continue to work closely with relevant foreign authorities to establish a good understanding of the resolution funding plan of a G-SIB and to coordinate on the planned allocation of funding throughout the group if market funding would not be available. Furthermore, it will be essential to

⁸³ For example, location of assets, encumbrance, transferability, intraday liquidity management within the group, etc.

⁸⁴ See FSB Consultative Document on the Guiding principles on the temporary funding needed to support the orderly resolution of a G-SIB, November 2015.

ensure that the firms' liquidity risk management information systems are capable of producing accurate and timely information to support the coordination.

B. Strengthening Deposit Insurance

89. The FSCS protects eligible depositors in all authorized deposit-takers in the U.K. The FSCS is the U.K. deposit insurance scheme, although its functions are broader (i.e., compensation fund of last resort for customers of all authorized financial services firms). FSCS carries out "pay-box plus" functions (insured deposits' repayment or transfer plus contributions towards cost of resolution under strict conditions). The PRA is the authority providing governance and oversight of the FSCS. The PRA and the FCA appoint the members of the FSCS's Board of Directors while the HMT approves the appointment (and removal) of the Chairman and its CEO, who is also an accounting officer.

90. The FSCS has a hybrid model of financing, with a large ex-post component. The levies raised annually⁸⁵ from the industry are set within forecasted repayments⁸⁶ and other expenses for the year and are subject to an overall current limit of GBP 1.5 billion to the deposit taker class.⁸⁷ As such, the FSCS is able to meet promptly the repayment needs corresponding to failures of small institutions, as demonstrated in the post-crisis failures of small credit unions. Nevertheless, the funds of the FSCS would not be sufficient, for example, in the event of an unexpected failure of a medium-sized bank. In such cases, the PRA has to decide whether additional ex-post levies can be accessed from the industry or if backstops (commercial or public) have to be accessed. The FSCS has access to a commercial revolving credit facility (of GBP 750million-GBP 1.5 billion) to meet a prompt payout deadline. In order to repay that annual facility, the PRA decides whether additional ex-post levies can be raised or whether access is needed to funds raised by the Bank Levy, by borrowing from the National Loan Fund (NLF) or other HMT funds as appropriate.⁸⁸ During the crisis, the FSCS model of financing proved to be highly procyclical as the fund had to borrow substantially from the government at a time when pressures on public finances emerged from different parts of the economy.⁸⁹ It may take another decade to the FSCS to amortize its large outstanding obligation to HMT.

⁸⁵ For example, levies raised in 2013/14 were about GBP 0.8 billion, compared to GBP 0.3 billion in 2012/13.

⁸⁶ These are based on a historical approach regarding observed failures of small credit unions (i.e., about 10 small credit unions fail per year).

⁸⁷ FSMA 2000, Section 213. The FSCS raises levies from the industry to cover expenses incurred or expected to be incurred, in paying compensation, borrowing, or insuring risks.

⁸⁸ The NLF was established on 1 April 1968 by the National Loans Act 1968 to separate government revenue and expenditure (Consolidated Fund) on the one hand and government borrowing and lending on the other. There is no upper limit on borrowing from the NLF, although public finance constraints at the time would apply.

⁸⁹ During the recent crisis, the FSCS paid out compensations in sum of GBP 23.6 billion. The funds required to cover the compensation costs were borrowed by the FSCS from HMT (initially borrowed from the BoE and subsequently refinanced by the HMT). At present, FSCS has an outstanding obligation of GBP 15.9 billion towards the HMT.

91. Given the institutional construct and its narrow “pay-box plus” mandate, the FSCS has relatively limited operational independence. Rules and regulations are exclusively set by the PRA or the FCA and the FSCS annual management expenses limit is set by the PRA and the FCA. In setting the rules for the FSCS, the PRA and FCA must act within their statutory duties and objectives, including financial stability. The PRA must also ensure that depositors are appropriately protected. The FSCS’s accounts are consolidated within HMT Group Accounts and in discharging its functions the scheme manager must have regard to the need to ensure efficiency and effectiveness.⁹⁰ The directors of the FSCS are appointed on terms to secure their independence.

92. The transposition of the EU Deposit Guarantee Scheme Directive (DGSD) brought some important changes in the deposit insurance system. The FSCS’s⁹¹ coverage extends now to large corporates; in addition to previously covered individual depositors and small and medium enterprises (no netting is allowed). From 1 January 2016, the deposit limit for bank accounts has been reset to GBP 75,000 per person per firm, lower than the previous GBP 85,000 level (equivalent to the uniform EU protection limit of €100,000). The authorities took adequate measures to ensure a smooth transition to the lower coverage. Previous measures taken to improve the capacity of producing the SCV file already enable the FSCS to make quick depositor repayments, well within the seven days maximum mandated by the DGSD. Finally, the FSCS has to reach a target level of ex-ante financing of 0.8 percent of the amount of covered deposits.⁹²

93. The requirements of the DGSD for ex-ante financing of DISs⁹³ are proposed to be met through bank levy contributions. New EU-wide policy⁹⁴ asks, in line with the international standards, that funding of DGSs be provided on an ex-ante basis and reach a target level of 0.8 percent of the amount of covered deposits by mid-2024. The U.K. will meet this requirement by allowing the FSCS to access, when needed, and when PRA determines that the FSCS is not to raise an ex-post levy, a notional fund equivalent to the relevant target level from HMT. The existing lending protocol between the FSCS and HMT is in the process of being updated to this effect.⁹⁵

⁹⁰ See Banking Reform Act 2013, Section 14, Article 224 ZA.

⁹¹ The FSCS provides protection for a wide range of industry sectors and its activities are not restricted to deposit-taking institutions.

⁹² This is the EU DGS target to be achieved by January 1, 2024 by all EU-DGSs.

⁹³ In line with the 2014 IADI Core Principles, IADI CP 9 Sources and Uses of Funds, EC 1 “Funding for the deposit insurance system is provided on an ex ante basis”. In IADI’s acceptance, ex-ante funding refers to the regular collection of premiums, with the aim of accumulating a fund to meet future obligations (e.g., reimbursing depositors) and cover the operational and related costs of the deposit insurer.

⁹⁴ DGSD Article 10 Financing of DGSs. These requirements can be met through existing schemes of mandatory industry contributions, under the condition that an equivalent amount of the target level is made immediately available at the DGS’s request.

⁹⁵ The authorities confirm that the protocol has been updated after the finalization of the FSAP Update.

Recommendations

94. The authorities are encouraged to finalize the reforms introduced by the DGSD. The introduction of risk-based contributions will better reflect the risk incurred by the respective member, although the existing absolute caps on the annual contributions (per categories of institutions) may limit their effectiveness, as the impact each year is therefore restricted. In this context, the PRA and FCA might need to reconsider or to redesign the existing caps. Furthermore, the protocol between the FSCS and HMT should be updated to ensure that FSCS will have prompt access to necessary funding.

95. There are merits in ex-ante funded deposit insurance. An ex-ante funded deposit insurance system, as recommended by the international standards and best practices, would have a greater capacity to spread the cost of insurance losses over time, allowing buffers to accumulate during stronger economic conditions. It would protect the government against contributing towards deposit insurance at a time when financing pressures may arise from different parts of a weaker economy.⁹⁶ The improved resolution regime offers new tools to avoid imposing undue losses on the taxpayer, but MREL remains largely untested. Although the current system has delivered on its commitments to promptly reimburse or otherwise protect insured depositors, over the medium term the authorities could reevaluate the appropriateness of establishing a paid-in fund available to the FSCS, with a target level adequate for the U.K. banking system.

⁹⁶ See IADI “Funding of Deposit Insurance Systems”, Guidance Paper, May 2009.