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Dear Sirs

CP/DP 11/16 Recovery and Resolution Plans – Consultation Response

We are responding to the invitation to provide views on the above consultation and discussion paper ('CP') on recovery and resolution planning ('RRP'). PwC welcomes the opportunity to comment on these important proposals and we support the overall direction taken. Our response reflects our views on the importance of viable recovery and resolution plans, consistency with the wider regulatory agenda, compatibility with developments globally, and the implications of RRPs on banks' business models.

Effective recovery and resolution planning is a multi-disciplinary exercise. Accordingly our comments draw on our experience with clients in the banking sector across a broad range of competencies including audit, risk management, regulation, insolvency and business recovery.

Our main comments are set out below. There are a number of questions posed in the consultation and discussion papers and we have responded to those questions in the appendix.

Interaction with wider UK regulatory reform

As numerous regulatory proposals are being developed and implemented a key challenge for the FSA is ensuring its policies take into account the cumulative impact of these changes, resulting in a regulatory landscape comprised of mutually supportive rules and legislation.

In some respects, the proposed RRP policies share their aims with that of the Independent Commission on Banking ('ICB'). The ICB's final proposals cross-refer to the CP and vice-versa. However the FSA's consultation does not explore in any detail how the principles espoused by the ICB may fit into the envisaged RRP regime. This is particularly relevant when considering ring-fencing of banks' retail businesses. Because ring-fencing and RRPs should be seen as complementary, rather than alternatives, it is essential that the FSA's final policy on RRPs is aligned with the legislation made pursuant to the ICB's proposals.

Global coordination

We support the overarching objective of RRPs as set out in the CP – facilitating the orderly recovery or resolution of firms without resorting to taxpayer support. Large, internationally active banks pose the greatest risks to meeting this objective given their scale, complexity and global reach. These banks operate in multiple jurisdictions, with disparate laws and regulations pertaining to resolution and insolvency. Some of these jurisdictions, the US for example, are also developing (or have developed) their own regulations on recovery and resolution planning.

Differences in concepts and terminology emerge when comparing rules and proposals; for example with respect to the analysis required of the separability of certain functions within a bank. The FSA proposes to require the identification of "critical economic functions"; the US rules refer to critical operations and core business lines; while the FSB describes resolution in terms of protecting systemically important functions. While we recognise that there will not be complete global harmony in RRP rules, it is crucial that the final RRP rules made by the FSA take this divergence into account by anticipating in more detail and allowing for the challenges faced in cross-border recovery or resolution situations.

Two major challenges posed by global differences relate to timing of adoption and sharing of information. Given that the implementation timetables differ between the UK and the US (for example), it is important that there is clarity on the implications for firms with regulated activities in both countries. Furthermore, given the global scale of many banking businesses, there will inevitably be interdependencies between UK businesses and overseas businesses that manifest themselves in RRPs. Consequently, it is imperative that arrangements are made to facilitate visibility of global and overseas RRPs thereby overcoming concerns about confidentiality or other legal aspects.

Resolution strategies

It is appropriate that the resolution authorities have ultimate responsibility for the resolution plan which includes resolution strategies for various parts of the business. However, coherent resolution planning requires effective contribution from banks to the development of resolution strategies. The CP envisages a resolution plan prepared by the authorities using information provided by firms, rather than active involvement by firms in the development of resolution strategies. By contrast, the US rules require the banks to go beyond information provision and to develop the resolution plan for discussion and agreement with the authorities. This level of involvement by firms is also contemplated by the Financial Stability Board in their description of attributes of effective resolution regimes. We question whether the FSA's proposals oversimplify input required from banks and the interaction with the authorities to developing resilient and credible plans and strategies.

Data requirements

The volume and nature of data that must be produced presents challenges. Information about derivatives exposures, key metrics of economic functions and legal entity structures are all highly relevant to recovery and resolution planning. Also, inter-bank exposure data will be useful for the authorities to understand the level of system-wide risk which must be managed in times of crisis. However, it is not clear what analysis will be performed on the data, and whether or not the data, in the format requested, will provide the most useful and necessary information to facilitate effective resolution planning.

Presumably the rationale for the data requirements is the need for an up-to-date view on both the size of any exposure issues for individual banks, and for the system as a whole. However, for many large global banks, the extremely high volume of data entailed may not be best represented in the somewhat simple formats suggested. In addressing how best to use and analyse this data, consideration should be given to the need for supplemental management information, enabling more effective interpretation and usage of the data.

With more clarity on the information usefulness and intended outcome of the data analysis, it might become evident that a different, potentially less frequent and/or less granular approach to data submissions is warranted.

Assessing viability and credibility

We agree that in order for RRPs to be an effective tool to promote financial stability they need to be substantial, credible, and capable of being effectively implemented. While the CP gives a broad indication of the criteria for making this assessment, the process and mechanism for supervisory assessments of firms' plans are not set out in any detail.

We assume that plans are being made to address this issue as well as the capability and resource needed for the analysis and potential validation of the data requested given the number of firms, the volume of data, and the breadth of firms' operations involved. The differences in level of complexity between a large global bank and a domestic, narrowly focused bank cannot be underestimated; not least because of the challenges posed by untangling complex legal entity structures and relationships and cross-border transactions.

Business changes and implementation timeframe

The timeframe for initial implementation of RRPs is, necessarily, ambitious. We support the level of urgency in the proposed policy. However, as noted above we have concerns about the disparity with the US approach to implementation timing and the implications this will have on banks with businesses in both locations.

The CP recognises, and we agree, that an iterative approach to implementation is appropriate. A major reason this is necessary is the operational and business model changes that may come about as a result of recovery and resolution planning in combination with the changes driven by the implementation of the ICB proposals. For example, some business functions are centralised to achieve operational efficiency. This approach might come into question when evaluating the separability of critical economic functions, forcing a change in operating model. Banks will face a host of issues emanating from performing the requisite operational and strategic review, including transfer pricing and tax, product pricing and profit margins, capital allocation, liquidity and other elements of risk management.

The questions in the CP and the associated discussion paper are directed at a level below the business model and strategic implications, but the importance of recognising and implementing changes in these areas should not be underestimated as they are vital to effective recovery and resolution planning.

In conclusion, we are supportive of the direction taken by the proposed rules and guidance on RRPs as it represents an important step towards bolstering the stability of the UK financial services sector. However, we have outlined above a number of areas for further consideration including the practicalities of assessing viability given varying levels of complexity and the potential for significant changes in business models, data usage, challenges with cross-border planning and information sharing, and interaction with wider regulatory and legislative changes – most notably, those emanating from the recommendations of the ICB. How these matters are addressed will have a significant impact on the extent to which the objectives of RRPs are met.

We would be pleased to discuss these issues further with you. If you would like to do so, please contact me on 0207 804 2093 /anne.e.simpson@uk.pwc.com, or Duncan McNab on 0207 804 2516 / duncan.mcnab@uk.pwc.com.

Yours faithfully

Anne Simpson
Partner

Appendix: Comments on specific consultation questions

Q1: Does the detailed guide to the preparation of RRPs, set out in the RRP guide, give adequate instruction and assistance to prepare an RRP? Are there areas which require further explanation?

Overall, we feel that the instructions and assistance provided are adequate in aiding the preparation of a firm's initial RRP documents. As is recognised in the CP, producing the information and analysis in RRPs will require an iterative process. We therefore think that such an approach should be reflected in the guidance for the entire RRP as opposed to only beyond the point at which a firm's critical economic functions are established.

Q2: Please give your views on the proposals for:

- Governance;
- Key Recovery Plan options; and
- Assessment criteria.

We support the proposed governance framework for the recovery plan. To ensure the plan is effectively embedded within the business it should be integrated into a firm's risk framework and governance (including scrutiny at non-executive director level). This necessitates clear methods of monitoring at lower levels within a business and a linkage to a firm's risk appetite.

Furthermore, there may also be a need for specific and distinct governance processes over those parts of the plans covering the set of functions that are highlighted as critical economic functions (or those that become 'ring fenced' in the future).

We think that the nature of the suggested recovery options and their assessment criteria are sensible, but we emphasise the need for firms, and the FSA, to evaluate the credibility of the options presented by firms. While credibility to stakeholders is indeed reflected in the listed criteria, we question the ability to demonstrate that certain disposal options are realistic; especially when these actions would be considered amidst system-wide market stress resulting in potentially very few interested buyers. In these circumstances, the suggested 'acceptable timeframe' of six months may not be realistic.

Q3: Please give your views on the proposals for the Recovery Plan trigger framework.

We agree with the general proposed construct of the trigger framework, but we feel that further clarity is needed when defining the nature of the triggers. For example, it should be defined up front whether an action plan must be invoked if a trigger is breached or whether the trigger merely prompts consideration of alternatives or even whether a plan should be implemented.

Because of the numerous and unpredictable variations of future scenarios under which a trigger could be breached, automatic action would not always be the best course of action. Therefore we expect it to be more likely that a trigger event prompts a suitable escalation process culminating in a decision by the full board as to the appropriate course of action (or rebuttal of a presumption that some action is required).

Q4: Do you agree it is appropriate for the FSA/PRA to collect interbank exposure data as outlined? What changes, if any, would you suggest to the data template?

We agree with the rationale behind the collection of this data since it is necessary to understand the degree of inter-connectedness of exposures and potential contagion in the system. Unlike trade-level data, however, it is not clear that this information is necessary to facilitate the resolution of a particular firm. However, we are also aware of how variable this exposure data could be over time, especially in times of stress. We therefore question whether the recurring six month maximum exposure requirement provides data appropriate to achieve the policy's objectives and whether the information is being required at the appropriate frequency.

With more clarity on the intended usage of this data by the FSA, and the implications on firms' plans, it may be more appropriate to ensure that there are systems and processes in place to rapidly produce the information required as needed.

Q5: Please give your views on the suggested information requirements for both derivatives and securities financing, the ability of firms to produce the information quickly (recognising that some modifications to systems may be needed) and comments on whether it would be possible to achieve the same ends through alternative means.

• Specifically, we welcome feedback regarding the appropriateness of individual data fields. To what degree is there variation in the documentation in place, particularly for exchange traded trades? Are there other pieces of data that firms consider would be of use to understand the derivatives or securities financing position?

• We would also welcome feedback on the proposed frequency of derivatives data collection, and feasibility (and preferred method) of delivering potentially large quantities of data, including the possibility of the authorities collecting data 'on-site' ahead of resolution. Please detail where there may be fields where data would need to be provided separately to the main data tape, for example in a different format.

• We invite feedback on the suggested information requirements for both derivatives and securities financing, the ability of firms to produce the information quickly (recognising that some modifications to systems may be needed) and comments on whether it would be possible to achieve the same ends through alternative means.

As with the inter-bank exposure data requirement, we recognise the relevance of this trading data and the need for firms to be able to produce it quickly and reliably. We are supportive of the focus on the ability to produce the data rather than a recurring requirement to submit it.

However, further clarity would be useful about the intended usage of this data including the nature and timing of the analysis that will be performed, and the implications on the ongoing development of firms' RRPs. This is especially important for large, global banks where the volume and complexity of trading data needed may not be best represented in the simple formats suggested. Raw, granular trading data, unless accompanied by relevant management information and analysis, will be of limited use when resolving trading books. Furthermore, while point-in-time trade-level data is necessary, adequate retention of historical data is also vital to winding down a trading book.
Understanding the use and implications of detailed trading data is important given the significant time and resource that will likely be needed to produce it, and the resulting costs. As noted in the cost-benefit analysis accompanying the CP, this requirement is estimated to give rise to a very significant component of the total cost of complying with all modules. Indeed, it appears that for 'Medium High'

firms the range of estimated costs per firm for producing this data has an upper bound which is greater than the estimated total range for producing all of modules 1 to 6.

Q6: Please give your views on the list of economic functions. For example, have we failed to identify any important economic functions?

The list appears fairly comprehensive although we note that it seems to be inconsistently granular in some cases. For example, corporate loans can be described as a relatively narrow function compared with derivatives which represents a very broad function collection of disparate activities with different objectives, risks, systems, and people. We comment further on the challenges posed by derivatives under question 18.

That said, we do not see the need for a prescriptive approach to this area as the definition of economic functions will differ from firm to firm, requiring flexibility in the approach to this element of resolution planning.

Additionally, we urge the FSA to consider the definition of an economic function in the context of the ring fencing proposals put forward by the ICB in an effort to work towards a consistent framework in time for full implementation of the ICB proposals.

Q7: Resolution planning: give your views on the proposals for the provision of information and analysis on:

• Group structure and legal entities;
• Economic functions; and
• Barriers to resolution.

We support the FSA's overall proposals for the provision of information and analysis with respect to resolution planning. Understanding complex legal entity structures is an essential part of effective resolution planning.

We have the following additional observations regarding barriers to resolution:

- Further clarity could be provided over the meaning of "critical" in the context of economic functions;

- Barriers to resolution are currently embedded within UK legislation in the form of limits to the powers of the Special Resolution Regime, particularly when addressing investment firms and international issues; and

- Avoiding Lehman-like consequences when winding down trading books is likely to require modification of standard legal documentation such as ISDAs and the development of new tools including bail-in debt securities. Our comments on bail-in are provided in our response to question 19.

Q8: Do you support the proposal to assign responsibility for RRPs to an executive director of the firm?

We agree that board level ownership and accountability is crucial to the success of implementing RRPs, and while assigning responsibility to an individual executive director may be appropriate in

some cases, we encourage the FSA to provide more explicit guidance on the specific responsibilities of the nominated individual, vis-a-vis the responsibility of the board as a whole.

Furthermore, we encourage flexibility in whether that individual must be a member of the board. Given the diverse nature of the board structures across institutions of various sizes and complexity levels, it may be sufficient to prescribe that a person of appropriate seniority be charged with this responsibility.

Q9: Do you agree with the approach set out in Chapter 5 for the preparation of RRPs for internationally active firms?

We support the proposed approach for internationally active firms and encourage the FSA to continue to work towards a cohesive multi-jurisdictional approach to the preparation and regulation of RRPs.

Clearly, global coordination between regulators is needed to ensure efficiency in data gathering and analysis. Where certain information is being gathered by overseas regulators, the overall regulatory burden on firms can be reduced if regulators are able to work together in agreeing on the consistency of information requests.

Cross-border dialogue between regulators is vital to the development, maintenance and execution of RRPs. Moreover, it will reduce the regulatory burden on firms if the regulators were to inform firms of any cross-border dialogue and where possible, include the firms in this dialogue.

Q10: Do you agree with our stated policy objective, which is to promote the speedier return of client money and assets?

We support the stated policy objective and the establishment of the CASS resolution pack. We consider that use of the CASS RP should contribute to the prompt return of client assets.

Q11: Do you agree that we should establish a CASS RP to help achieve this objective, and to contribute toward better CASS outcomes in general?

As Q10.

Q12: Do you have any comments on the proposed policy, as set out in Chapter 6 of the CP11/16, and in Annex 4 of this document?

We broadly support the proposed policy. We suggest that the application criteria set out in paragraph 6.3 of the CP be amended to make it clear that the CASS RP requirements do not apply to firms which do not hold either client money or assets in the course of their normal business, but have inadvertently held client money and assets at some point during the period.

We suggest that the form of attestation proposed in Annex 4 paragraph 8 should allow for firms to separately attest for client money and custody assets that the firm was either in compliance with the requirements or did not hold client money/custody assets.

We suggest that paragraph 3.6 of Annex 4 be amended to state 'If applicable, details of the accounts with third party institutions used by the firm to deposit or transfer client money and the contact details

of those institutions.' rather than 'Details of the accounts with third party institutions used by the firm to deposit or transfer client money and the contact details of those institutions.' to allow for firms which hold custody assets but not client money.

Q13: Do you agree that the CASS RP will contribute to promoting the speedier return of client money and assets?

As Q10.

Q14: Should firms be required to take steps to ensure that services to UK entities containing critical economic functions are covered by effective, insolvency resistant service agreements?

There is a prima facie case for ensuring that service provision is resilient in the event of a failure of either the UK entity or its wider group. Accordingly there is merit in considering the implications of cross default clauses and other termination rights under contracts which could result in operational issues which might exacerbate the consequences of insolvency.

We note that the SRR powers under the Banking Act 2009 include provisions that allow the Bank of England and/or HMT to override certain contractual terms (s22 and s38). Accordingly, to the extent that contracts fall within UK law and the proposed resolution method involves a partial property transfer or transfer of securities the contractual terms may present a less serious obstacle.

Notwithstanding the SRR powers, there is merit in ensuring contracts with counterparties include continuity provisions for critical service to the continued operation of the regulated entity or group in the event of insolvency. This would support continuity of services supplied under legal arrangements which fall outside the UK SRR powers (foreign law, etc.) and to provide similar protection for all contracts in insolvency. Including such clauses in contracts would also signal to the market the intention that continuity should be maintained and remove some of the uncertainty over how service arrangements might be treated.

The practicalities of including these clauses in a workable form may require some further investigation, for example there would need to be some certainty that counterparties would honour the clauses and/or other legal/regulatory would recognise and enforce them.

Q15: Should the companies which provide services to UK entities be required to be capitalised adequately so that they can resist collapse in circumstances of group-wide failure?

A separate bankruptcy remote service entity appears to offer some benefits in resolution in terms of making identification of critical services, systems, people and processes more straight forward and providing some certainty over ongoing provision of these services. However, there are challenges in defining the perimeter for the service entity in terms of both services and staff to be included and the costs including any VAT and other tax burdens this might impose would likely to be significant. Equally there is a question as to what an adequate level of capitalisation might be needed and whether or not it might be preferable to pre-pay service costs rather than inject equity capital into the entity.

On balance it is not clear that the resolution benefits could not be achieved through other methods, for example mapping dependencies, developing and maintaining an inventory of key service contracts, amending improving legal and contractual arrangements to improve continuity provisions,

establishing clear principles around the ownership of IP and allowing the group or entities to step-in and take over key staff and systems relevant to their continued operations.

Q16: What other steps should be taken to help ensure the continuity of critical banking services?

Cross-border contractual arrangements are often significant issues threatening the continuity of services. Reducing this threat may require some degree of regulatory and legal consensus on how to deal with such contracts.

Also, directors fiduciary duties may in some circumstances be a barrier to continuity of services (for example where the financial situation of their entity is threatened by the cost of providing continuity of service to another entity) and cause delay in provision of critical services while discussions and negotiations take place.

Q17: What are the changes to payments, clearing and settlement mechanisms that would allow banks to be more resolvable and would ensure continuity in the provision of vital payment, clearing and settlement functions?

No comment.

Q18: Trading book: Matters which we would particularly appreciate views or comments on are:

• Alternative approaches to resolving large trading books;
• Alternative approaches to the valuation and realisation of collateral which mitigate market instability in the event of an entity with a trading book being placed into an insolvency procedure;
• Changes in regulatory or contractual working practices which could make unwinding trading books speedier and less costly (e.g. default rules applied under the ISDA Master Agreement); and
• financing of trading book wind-downs.

Trading books, particularly over-the-counter derivatives, represent one of the most difficult areas of a bank to resolve. While the CP notes that the authorities will ultimately determine the resolution strategy, we believe that the only realistic option for OTC derivatives is to wind down the book (rather than transfer which would likely prove impracticable).

Notwithstanding the challenges in winding down a derivatives trading book, actions can be taken now that would ease the process in the event. For instance, contractual terms in ISDA agreements typically provide discretionary termination rights to the surviving counterparties in the event of a default. Variations of these terms to create more certainty in resolution situations would be beneficial. Also, efforts to reduce the gross notional exposures across the system will make resolution more manageable such as increased use of central counter-parties as well as undertaking portfolio compression (via 'tear-ups' of outstanding derivative contracts).

To avoid the practical challenges of winding down trading books whilst in resolution the authorities should consider ways to enable the bank to trade out of its positions before activating the resolution mechanism.

Q19: Bail-in:

• Do you believe that bail-in could be an effective tool in helping to recapitalise a firm that is either at the point of or is failing, in order to avoid a public injection of funds?
• What are the pros and cons of using the various tools: private sector contingent capital, contractual resolution bail-in and statutory resolution bail-in?
• Are the various tools best used separately or in tandem?
• Do you think it will be necessary to regulate the quantum and the maturity profile of bail-in-able instruments if use of the resolution bail-in tools is to be successful?
• Do you see any alternatives to provision of liquidity assistance to a recently bailed-in firm by the public sector?
• Do you think that, as a result of the bail-in arrangements, the cost of capital for banks will increase, or decrease, in a material way? And, what will be the effect on the capital structure?

Given the wider objective of ensuring that firms are resolvable without exposing the public sector to losses, bail-in is likely to be a necessary part of the resolution tool kit. However bail-in is not without risks. In particular if the exposure of other financial firms and the 'real economy' to senior unsecured and subordinated debt is significant, there is a risk that bail-in will result in contagion across the system and may exacerbate uncertainties over the viability of other entities. Unless there is clear messaging on how and when bail-in might be used and a strong indication that practice will be consistent there is a risk that uncertainties will be magnified resulting in wider contagion.

Equally, given the cross border nature of capital markets, effective resolution bail-in tools would be likely to require some form of international consensus on the legal arrangements around bail-in or an amendment of all capital instruments making clear the circumstances under which bail-in will take place (which would its self probably require local regulatory approvals).

A firm which is subject to bail-in at the point of non-viability is also likely to be seen as a failed business and having no other options for restoring it its capital position. It is therefore unlikely that the firm would be able to return to normal operations after bail-in. As such, bail-in seems to be more likely to be appropriate as a part of resolution under the SRR or some other arrangements. It is arguable that this issue might be mitigated to some extent by using high-trigger private sector contingent capital in the capital structure of firms. However even in this situation creditors and others may conclude that the firm had no other options for capital raising and conclude that although adequately capitalised, that they do not wish to be exposed to an impaired business leading to further discrimination.

Further considerations in the use of bail-in debt include:

- Banks and regulators need to address a range of practical and operational issues, including what metrics to use for conversion triggers, the level of triggers, assurance of key financial data and trigger metrics

- The FSA should further consider the impact of any bail-in mechanism on potential contractual default of financial contracts i.e. cross default and panic sales/withdrawals etc.

- There are a number of tax considerations in relation to bail-in instruments that may affect the attractiveness of these instruments for both issuers and investors. We encourage the FSA to engage with HM Treasury and HMRC as relevant regarding the design of these instruments and policy development in order to mitigate any tax uncertainties that may arise.