



Recovery & Resolution Plans

FSA consultation – August 2011

All UK deposit-takers and large investment firms will have to draw up Recovery and Resolution Plans (“living wills”) by the end of 2012, according to proposals by the UK Financial Services Authority (FSA).

Background

In an effort to prevent a repeat of the fallout from the collapse of Lehman Brothers in 2008, the FSA published Consultation Paper 11/16 that proposes to require banks and building societies, as well as investment firms with total assets exceeding £15 billion, to prepare, submit and maintain recovery and resolution plans. The announcement by the Independent Commission on Banking’s on 12 September has brought recovery and resolution to the top of the agenda.

Summary of the proposals

While requirements will vary depending on the type and size of the institution, its systemic importance, its operating model and interconnectedness with other entities, over 250 financial institutions will be required to prepare:

- a recovery plan: showing how the firm will use a series of predefined recovery options in order to recover in the face of a range of negative financial shocks
- a resolution plan: showing how the firm intends to wind-down in an orderly manner that reduces the impact on financial stability and minimises the need for government support
- interbank exposure information: showing the 20 largest interbank exposures over the previous six month period in order for the UK authorities (FSA, Bank of England and the Treasury) to better understand the links between financial institutions
- derivative and securities finance position information: showing derivatives and securities financing positions, both by position and by counterparty, in an attempt to have sufficient information to determine how to manage each position and where to transfer each counterparty upon resolution.

Recovery Plans

Under the proposals, the recovery plan should be integrated into the firm’s existing governance framework and processes, including regular monitoring of early warning signs and predefined triggers that would spark action; be regularly reviewed and updated; and be overseen and approved by the firm’s board / senior governance committee.

The proposed components of a recovery plan are as follows:

- detailed explanation of how the implementation of the recovery plan fits within the existing risk management framework
- explanation of the triggers for action under the plan
- summary of the complete list of recovery options i.e. actions that could be taken to aid recovery
- a list of key executives / managers who will be involved in the recovery action
- both internal and external communication plans to accompany each recovery option.





In order to facilitate recovery planning, firms will be required to extend their current stress testing in order to consider additional actions that may be taken in instances where the impact or speed of a crisis turns out to be more severe than the current scenarios used as part of the current stress testing framework.

Resolution Plans

By showing what firms would do if they fail, resolution plans will address the financial, legal and operational obstacles to resolution. This enables the regulator to make an assessment of the potential effect on financial stability and then determine whether this is acceptable. Resolution plans should help regulators understand an institution's ownership structure and exposures to, and connections with, other affiliated and unaffiliated entities and market and payment infrastructures.

The proposed components of the resolution plan are as follows:

- details of significant entities in the group and the key structural and operational issues relevant to the separation of significant entities – this should include an overview of the legal structure of the firm, how capital and funding is allocated and managed across the firm, and the dependencies between different legal entities in the group
- key metrics on economic functions to illustrate the relative importance of those functions – this will allow the UK authorities to understand the scale of each economic function and the potential impact of closure of each economic function. It will also provide detail of which legal entity or entities each function sits within
- Critical Function Contingency Analysis (CFCA) covering separation and / or 'controlled wind-down' for each critical function of the firm. After agreement between the firm and the UK authorities over which functions are considered critical, a firm will be expected to prepare an analysis of how each critical function can be separated, while either preserving continuity of the function or winding-down in an orderly fashion, depending on the nature of the function. The UK authorities will then use this analysis to write a resolution plan for the firm
- plans to overcome any barriers to resolution which the UK authorities consider unacceptable. In preparing the CFCA, a firm is expected to identify barriers to the separation and / or orderly wind-down of each function in resolution, agree these with the UK authorities, and propose and agree ways of eliminating them.

CASS resolution pack

In addition to the above proposals, firms holding client money and custody assets will be required to prepare a pack detailing vital information that will be readily accessible to the insolvency practitioner or resolution authority. The aim of the pack is to promote the speedier return of client money and assets to customers, once a firm has failed, which has been a significant challenge in the Lehman insolvency.

The aim of the proposed update to the CASS rules is to provide the ability for relevant documents and records to be retrieved within 48 hours while the firm is a going concern, as well as when the firm has become a gone concern.

Scope

Under these proposals, the new regulation will apply to:

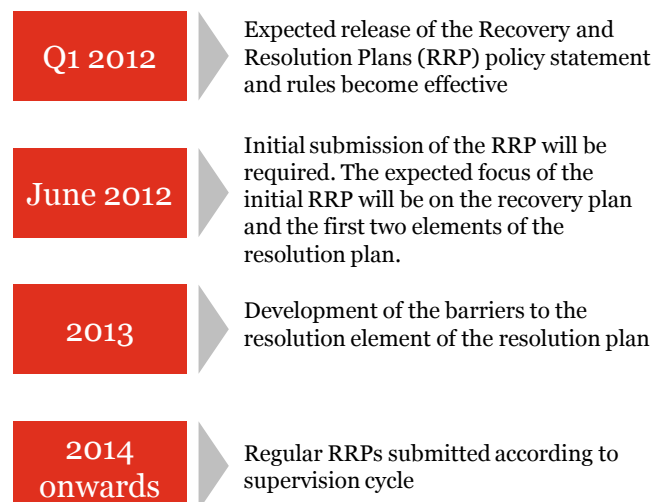
- UK incorporated deposit-takers
- BIPRU 730k investment firms with assets exceeding £15 billion

The proposals relating to CMA (CASS RP) will apply to:

- all firms subject to CASS 6 or 7

Recovery and Resolution Plans from UK branches of overseas entities will not be required.

Proposed Timeline



How the proposals may impact you

Within the Consultation Paper (CP), the FSA has provided certain insights into how these proposals may impact you directly.

Link to current prudential regime

The FSA has recognised that requirements under the proposals for RRPs can be seen as a development of existing prudential requirements already imposed on firms:

- Current stress testing requirements over capital and liquidity are seen as useful inputs into recovery planning, as long as the actions proposed take into account the potential impact of scenarios turning out to be more severe in both speed and impact.
- Although there is a difference between the objective of the RRP and reverse stress testing, it has been identified that in practice, current reverse stress testing requirements could be used to inform RRP and vice-versa
- Actions identified as part of a firm's contingency funding plan or capital restoration plan may also be amongst the options included in the firm's recovery plan.

Interactions with the PRA

- The CP has indicated that there will be several instances where the UK authorities will be involved in the RRP process.
- The UK authorities will assess the adequacy of the firm's recovery plan, using the resolution planning analysis submitted to develop resolution plans for each firm.
- The critical economic functions requiring a CFCA will be agreed in discussions between the firm and the authorities once the initial analysis has been performed.
- It is proposed that once the RRP has been established, the review by the UK authorities will be built into the ARROW process.

Governance expectations

There are certain expectations laid out in the proposals regarding governance over the RRP:

- the recovery plan should be integrated into the firm's existing governance framework and process, with the plan being subject to oversight and approval by the board / senior governance committee
- it is proposed that firms nominate an executive director who will have responsibility for the firm's RRP
- recovery plans should be reviewed and resolution information updated at least annually.

Changes to the prudential reporting Regime (ICAAP & ILAA)

Upon the transition from the FSA to the PRA it is anticipated that the PRA will consolidate into a single framework the rules for RRPs, stress testing, capital planning buffers, and contingency funding plans. Provision will also be made to streamline the submission of documents (stress testing information, Individual Capital Adequacy Assessments, and Individual Liquidity Adequacy Assessments, etc.) associated with these rules.

Potential Skilled Person report

The CP indicates expectation of the use of skilled persons' reports to carry out testing over the feasibility of the RRP, the steps necessary to implement improvements to the firm's resolvability and the information needs in resolution.

Additional reporting requirements

There are further proposals to require certain firms to provide the UK authorities with additional exposure and trade data

Details of the firm's 20 largest interbank exposures over the previous six month period, with an update to be provided on a six monthly basis.

A full list of derivatives and securities financing positions, by both position and by counterparty. (This is to be submitted with the first RRP and firms will require the ability to produce the data going forward)

Action resulting from completed RRP submissions

Where findings from the resolution plan indicate that actions are required as a result of significant barriers to resolution, the UK authorities will expect certain preparative actions. These actions may be significant in nature, with the following examples being provided within the CP:

- simplification of intra-group relationships
- changes in contractual arrangements
- increased stand-alone capacity
- changes in corporate structures
- operational set-ups to facilitate separate of certain functions.

Response

Responses to the FSA CP are invited by 9th November 2011. A full copy of the proposal is available on:

http://www.fsa.gov.uk/pages/Library/Policy/CP/2011/11_16.shtml

Independent Commission on Banking

On 12 September 2011 the Independent Commission on Banking (ICB) released its final report setting out recommendations on reforms to improve stability and competition in UK banking.

As part of its remit, the ICB has recommended structural separation, including ring-fencing, within the banking sector as a way of insulating retail banking from exposure to wider potential market shocks and to aid improve the resolvability of these institutions.

There is a clear link between the FSA proposals and the ICB recommendations. Find out more on this at www.pwc.co.uk/banking.

Find out more

To discuss the potential impact of the proposals, please contact Duncan McNab (020 780 42516) or Ben Higgin (020 721 33901).

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