BANK OF ENGLAND

June 2018

The Bank of England's response to the Independent Evaluation Office's evaluation of its resolution arrangements

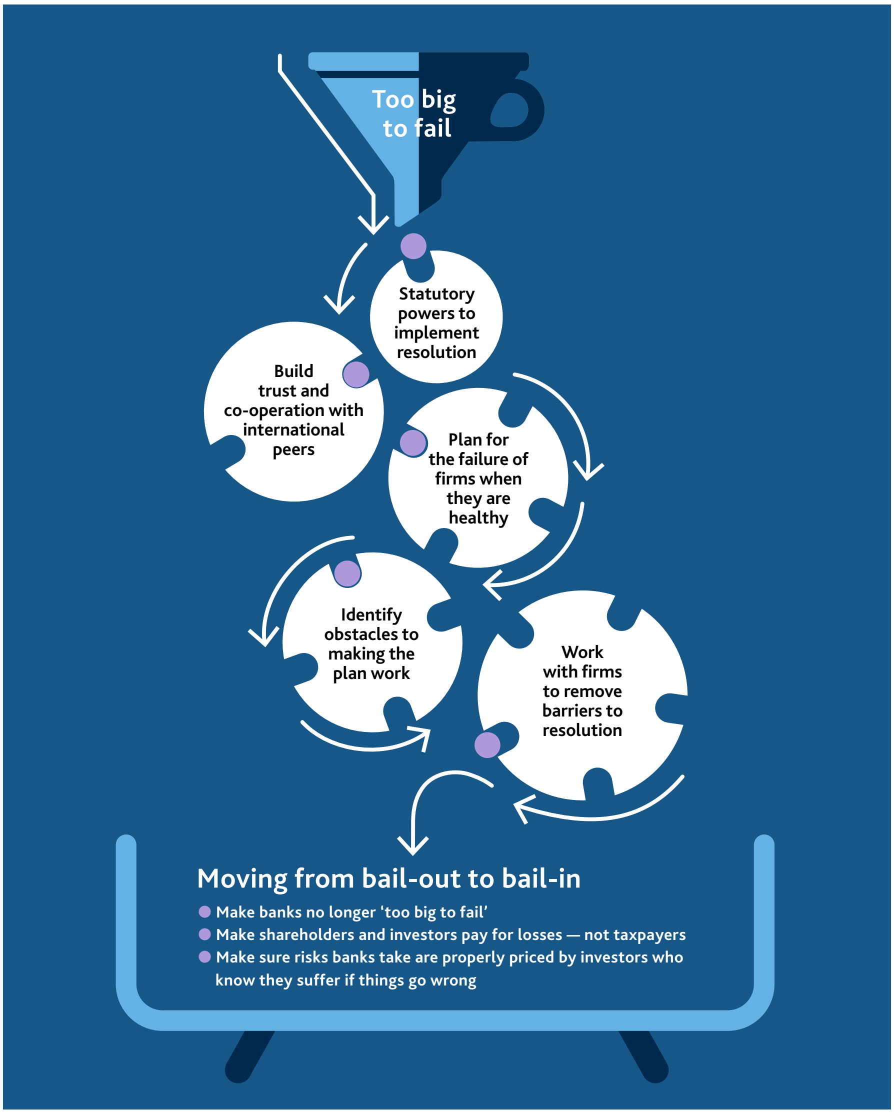
1 Introduction

The Bank of England (Bank) has been the resolution authority of the United Kingdom since 2009. In this role, the Bank is responsible for taking action to manage the failure of financial institutions — a process known as 'resolution'.

The regulatory system in the United Kingdom is not designed to ensure that firms will never fail. It is designed so that when firms fail, they can do so in an orderly fashion. This is a core feature of a stable and competitive financial system. The Bank's role as resolution authority is central to the delivery of the Bank's mission to maintain financial stability, and the Bank is strongly committed to developing a credible and effective resolution regime.

As such, the Bank welcomes the Independent Evaluation Office's (IEO's) comprehensive and independent appraisal of the Bank's resolution arrangements. The IEO report follows a 2016 International Monetary Fund (IMF) report, which described the United Kingdom as having a 'robust' resolution framework, and being 'well advanced' in its implementation of reforms. In line with its drive for continuous improvement, the Bank accepts the IEO report's constructive recommendations for enhancing its work, and it is committed to implementing them.
The Bank's response is structured as follows: Section 2 outlines the Bank's responsibilities for, and approach to, resolution; Section 3 summarises the aims and scope of IEO's evaluation; Section 4 gives an overview of the IEO's main findings; and Sections 5 details the Bank's response to the recommendations made by the IEO.

Figure 1 Moving from bail-out to bail-in



2 The Bank of England's responsibilities for, and approach to, resolution

In the global financial crisis of 2008, the United Kingdom, like many other countries, did not have a framework for managing the failure of a bank in a way that would prevent significant financial instability. In order to avoid serious risks to financial stability, the government had to resort to bailouts.

As part of the post-crisis reforms, the Banking Act 2009 created a resolution regime for the United Kingdom. The principles of the UK regime have subsequently been reflected in international standards from the Financial Stability Board(1) and in the European Union's 2014 Bank Recovery and Resolution Directive (BRRD).(2) The UK regime was consequently updated to implement the BRRD. The resolution regime is intended to ensure that the losses from a failing bank are imposed on investors and shareholders of the bank, as with any other business, and not the taxpayer. The regime seeks to protect the public from loss and encourage prudent behaviour by financial institutions. In this context, the Financial Policy Committee (FPC) has noted that credible and effective resolution arrangements are expected to improve market discipline and thereby reduce the probability of a financial crisis by around a third.(3) This has informed the FPC's judgement about the appropriate Tier 1 capital requirements for the banking system, which the FPC keeps under review.(4)

Parliament has designated the Bank as resolution authority in the United Kingdom, conferring on it a set of tools and powers to manage the failure of a bank. Since 2009, the Bank has pioneered work to enhance the credibility and effectiveness of the resolution regime. A full account of the Bank's approach to resolution is provided in the Bank's so-called 'Purple Book' (updated in 2017), which the IEO report notes is 'seen by some as setting the benchmark internationally'.

To fulfil its responsibilities, the Bank sets a preferred resolution strategy for all banks, building societies and investment firms.(5) On the basis of their strategy, the Bank develops a resolution plan for each firm which sets out the arrangements that need to be in place inside the firm, including the removal of any barriers to resolvability. Many of these barriers are generic and so the Bank has worked with counterparts internationally to develop policies to address them, implementing the policies as UK requirements. Domestic policy provides firms with a period of time to implement and meet these requirements, but it is intended that the bulk of this work will be complete by 2022 (see **Figure 2** for deadlines for implementing resolvability policies). In the interests of transparency, the Bank has committed to publishing summaries of the major UK firms' resolution plans and its assessment of their effectiveness. The Bank will consult by the end of 2018 on the approach to assuring that banks have implemented policies which have been set to remove barriers to their resolvability, which is central to the Bank's strategic goal of making the resolution framework operational.(6)

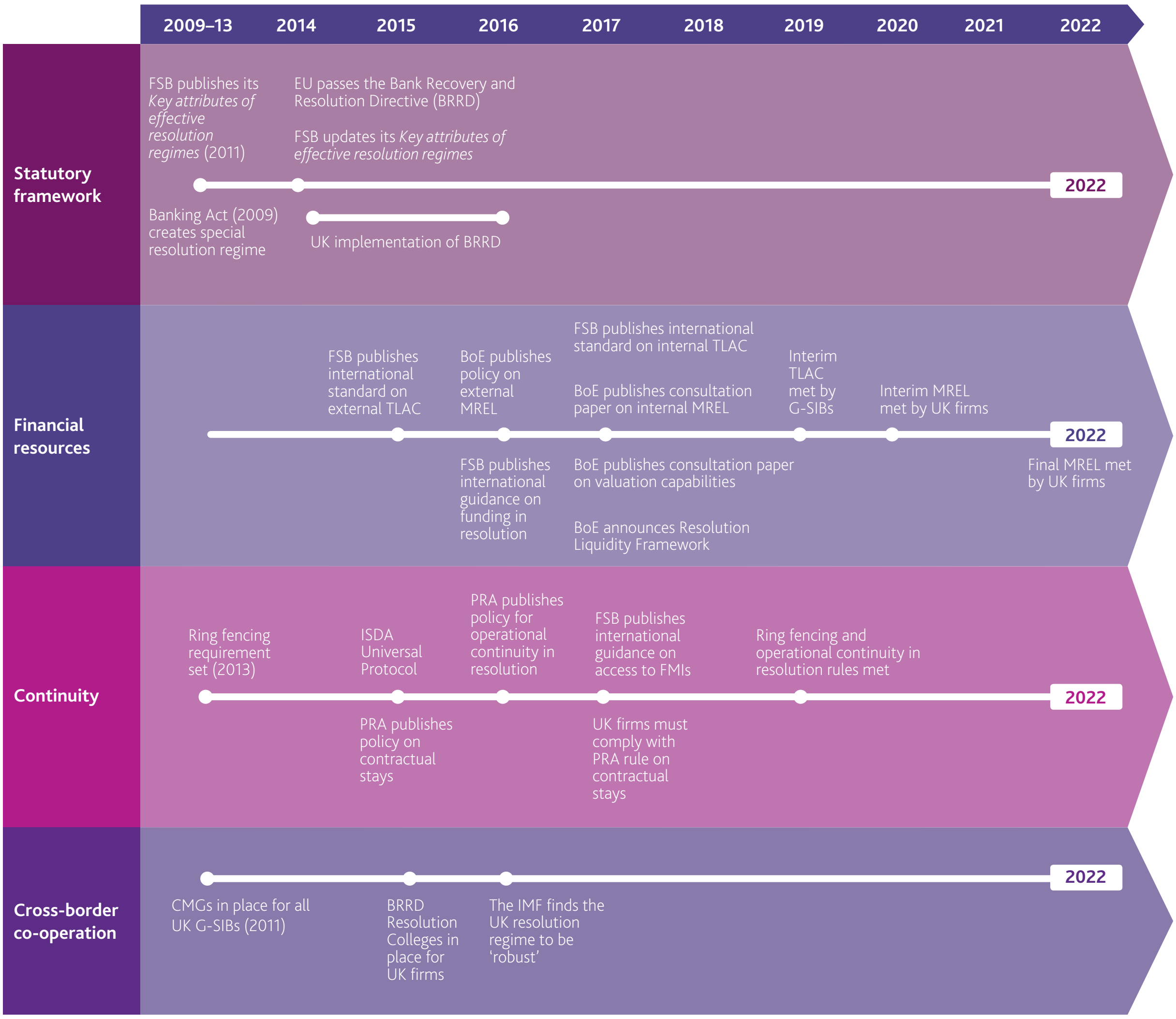
The Bank has also commenced work on improving the resolvability of other types of systemic financial institutions. It has made progress on developing the resolution framework for central counterparties, and the UK authorities are considering the need for the resolution regime to be extended to cover insurance companies.

Due to the cross-border nature of many of the most systemic financial institutions, international co-operation is crucial for delivering credible resolution plans. The Bank continues to work with authorities worldwide and hosts Crisis Management Groups for all the UK globally systemic banks and central counterparties, which represent an important forum for international engagement.

The IEO's evaluation follows the positive conclusions of the 2016 Financial Sector Assessment Program (FSAP) review conducted by the IMF. This described the UK bank resolution framework as 'robust', concluding that 'recovery and resolution planning is well developed' and that the 'implementation of reforms to ensure

(1) Financial Stability Board (2011), 'Key attributes of effective resolution regimes for financial institutions'; www.fsb.org/wp-content/uploads/r_111104cc.pdf.
(2) Directive 2014/59/EU of the European Parliament and of the Council; https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32014L0059.
(3) Bank of England (2015), 'Supplement to the December 2015 Financial Stability Report: The framework of capital requirements for UK banks'; www.bankofengland.co.uk/-/media/boe/files/financial-stability-report/2015/supplement-december-2015.pdf.
(4) *Ibid*.
(5) Referred to collectively as 'banks' or 'firms'.
(6) The Bank has defined seven strategic goals for the period 2018–2020 which are fundamental to the Bank's mission and cross-cutting in nature; one of these goals is 'making the resolution framework operational'.

Figure 2 Progress on resolvability



resolvability is well advanced in many areas'.(7) With regards to the international engagement of the United Kingdom, the IMF noted that the United Kingdom has been 'at the forefront of implementing the FSB agenda on cross-border co-operation'.

The Bank has made significant progress towards a robust, credible and effective resolution regime since the financial crisis, but there remain barriers to overcome. Furthermore, the continuous evolution of the financial sector will present new challenges to resolution. The Bank is fully aware of the need to continue its work in this area, and takes its responsibility to do so seriously. In this light, it welcomes the IEO's report, and its recommendations to facilitate this aim.

3 Summary of aims and scope of the IEO's evaluation

In February 2017, the IEO was asked by the Bank of England's Court of Directors to assess the Bank's approach to resolution. The IEO evaluation was conducted primarily between September 2017 and February 2018 by a dedicated project team reporting directly to the Chair of Court. Any live cases in the run up and during this period were out of scope of the team's work.(8) The overall aim of the review was to give Court assurance about the Bank's approach to its statutory responsibilities as a resolution authority. The review examined resolution

(7) The International Monetary Fund (2016), 'United Kingdom financial sector assessment program — financial system stability assessment'; www.imf.org/external/pubs/ft/scr/2016/cr16167.pdf.
(8) Please see Annex 1 of the IEO report for full details of the background to the evaluation; www.bankofengland.co.uk/report/2018/independent-evaluation-office-report-evaluation-of-the-boes-resolution-arrangements.

planning and resolvability; resourcing and capabilities; interaction with the wider Bank and external co-ordination; and internal governance.

The evaluation criteria of the review were:

1. **Clearly articulated framework:** Are the Bank's objectives and the approach to achieve these clearly articulated and understood — both internally and externally?
2. **Effective implementation:** Is the policy framework effectively implemented in practice?
3. **Progress towards resolvability:** Is the Bank providing adequate oversight to ensure that firms are taking the necessary steps to increase their resolvability?
4. **Effective governance:** Is there an effective governance framework to support the delivery of the policy in both the business-as-usual and crisis state of the world?
5. **Agile resourcing model:** Is the resource model sufficiently flexible and forward looking?

The UK resolution regime is relatively new and has undergone significant development in recent years. The IEO review provides an opportunity to assess how effectively the Bank is discharging its responsibilities as a resolution authority, a supervisor and central bank in the context of this evolving framework, and consider whether there are elements of its approach that could be further enhanced.

4 Summary of the IEO's findings

The Bank welcomes the findings of the IEO assessment, which recognise the innovative nature of the work the Bank has undertaken in recent years, its efforts to communicate its approach effectively, and level of internal co-operation in a crisis.

Thought leadership in resolution policy: The IEO found repeated evidence of the Bank taking the lead globally on work to develop a pioneering resolution policy regime.

Communication and collaboration: The IEO noted the Bank's published approach to resolution — the 'Purple Book' — was universally praised for its clarity and accessibility. Moreover, the IEO found evidence of the Bank's collaborative relationship with cross-border firms, UK authorities and international regulators that it contacted during the evaluation.

Crisis work: The IEO noted the very effective way in which the Bank co-operates with other authorities on resolution matters.

These results confirm the positive strides that the Bank has made towards achieving a credible and effective resolution regime.

The IEO review also identified a series of constructive recommendations through which it considers the Bank could further improve the discharge of its responsibilities as resolution authority. These are set out in Section 5.

5 The IEO's recommendations and the Bank's response

The IEO has grouped its recommendations under three broad themes:

1. Establishing a roadmap to 2022;
2. Working together in structural separation; and
3. Preparing for a resolution.

The three themes and the nine recommendations which underpin these are set out below, followed by the Bank's response.

Theme 1: Establishing a roadmap to 2022

Recommendation 1. The Bank to articulate how the institution as a whole will deliver on making the resolution framework operational, including setting out milestones, prioritisation given other deliverables, key risks and possible mitigants.

The Bank welcomes this recommendation which is consistent with the Bank's strategic goal of making the resolution framework operational. To achieve this, the Bank will increasingly need to verify that firms are making the changes necessary to become resolvable. UK banks are much more resolvable today than in 2008 but they are not yet fully resolvable. As noted by the IEO, the Bank has communicated to the Treasury Committee that the major UK banks are on course to being fully resolvable by 2022. This is the date by which UK banks will be expected to comply with the policies the Bank has or will set to remove impediments to their resolution. Some of these policies apply already (eg requirements to stop close-out of financial contracts) whereas others will be implemented progressively over the coming years — for example, the Bank has set minimum loss-absorbing capacity requirements which apply progressively in 2019, 2020 and become fully effective in 2022 (subject to review).

The Bank believes greater transparency over the progress being made towards removing barriers to resolvability will incentivise banks to take those actions. As such, the Bank has already committed to publishing summaries of major UK banks' resolution plans and summary assessments of their effectiveness. The Bank will set out its planned approach to delivering this work in a consultation paper by the end of the year.

The Bank has formed a new Executive Director level Steering Group which will co-ordinate the cross-Bank work necessary to deliver the strategic goal of making the resolution framework operational. The Steering Group includes Executive Directors from all relevant areas of the Bank.

The Steering Group is responsible for:

- overseeing and directing work required to deliver the project;
- ensuring quality control and efficient allocation of resources;
- providing guidance required for analysis and policy development to be undertaken;
- overseeing policy development to ensure that the priority outcomes are identified and decisions are escalated to the appropriate decision-making committee;
- reviewing outputs of cross-Bank working groups that will report to the Steering Group;
- sharing information across the areas of the Bank represented; and
- forwarding proposals to decision making committees as required in accordance with statutory objectives.

Recommendation 2. Resolution Directorate to review appropriateness of its skillset as its focus shifts from policy development to implementation.

The nature of the Resolution Directorate's work necessitates a broad range of skills. The current skillset includes policy and supervisory expertise as well as a mix of legal, accounting and other transactional skills which are necessary for designing and executing resolution actions such as bail-in.

The Bank agrees the proposed review will enable the Resolution Directorate to ensure it has the appropriate skills needed to continue to support resolution work and the delivery of the Bank's strategic goal of ensuring the resolution framework is operational and banks have taken the necessary actions to remove barriers to their resolvability by 2022, consistent with the commitment made to the Treasury Committee. The review will be undertaken by end-2018 and will draw upon the Bank's newly developed resources for organisational design.

Theme 2: Working together in structural separation

Recommendation 3. Governors to consider whether the introduction of the gone-concern regime has been appropriately reflected in the PRA supervisory strategy.

The Bank accepts this recommendation and Governors will assess the interaction between the going and gone-concern regimes in delivering the strategic goal of making the resolution framework operational. In particular, the FPC, as part of its medium-term priority of finalising post-crisis reforms, will be reviewing the judgements underlying its overall calibration of the risk-weighted capital framework for UK banks. This review will focus on progress towards ensuring banks are resolvable.(9)

The Prudential Regulation Authority (PRA) will also consider how operationalisation of the resolution framework will be reflected in its approach to supervision and identification of supervisory priorities. Implementation will be finalised by the end of 2020, in order to accommodate any changes to supervision that are required once the ring-fence regime (which comes into effect on 1 January 2019) has been in operation for a year.

Recommendation 4. With due regard to the legal framework, the Bank to consider mechanisms to enable greater and timely information sharing and cross-Bank collaboration on resolution issues, including through more opportunities for joint discussions at different levels.

The Bank accepts this recommendation and sees it as an opportunity to continue to improve the One Bank model for delivering its obligations as resolution authority. For example, the Bank maintains a 'watchlist', drawing on PRA and Financial Conduct Authority (FCA) supervisory assessments under the 'Proactive Intervention Framework',(10) to inform its contingency planning as resolution authority. Furthermore, the Bank has implemented a programme of annual 'peer reviews' which draw upon cross-Bank expertise, to inform the annual assessment of the resolvability of firms. This working relationship reflects the way the requirement for structural separation between the Bank's functions as resolution authority and supervisor has been implemented. The model ensures operational independence and separate decision-making processes but a close working relationship between the Resolution Directorate and PRA. The Bank maintains a public statement on its arrangements for structural separation(11) and has internal frameworks for co-operation and co-ordination.

Delivery of the strategic goal of making the resolution regime operational will increase the need for cross-Bank collaboration, including policy expertise on prudential policy, firm and financial market infrastructure specific knowledge from supervisors, and operational market and banking expertise given the Bank's role as a central bank. To facilitate this, the Resolution Directorate has established a 'hub' to co-ordinate and plan cross-Bank work. As noted in response to recommendation 1, this is supported by a new Executive Director level steering group to oversee delivery of this project, including representatives from all the relevant areas, which will be used to ensure ongoing collaboration within the framework of structural separation.

Recommendation 5. The Bank to review the governance arrangements for business-as-usual resolution matters.

The governance arrangements for resolution were developed when Parliament designated the Bank as resolution authority. These arrangements were designed to support the implementation of the statutory framework and the development of detailed regulatory and supervisory requirements to implement the regime.

The Bank agrees that it is appropriate to review the existing arrangements to ensure they are appropriate for the next stage of work on resolvability and the cross-Bank approach to delivering this strategic goal with the PRA. Governors, supported by the Resolution Directorate, will therefore undertake a broad review of the governance arrangements for resolution in 2018 Q3.

The Bank agrees with the IEO that separate internal governance arrangements are appropriate for business as usual and heightened contingency and will reflect this when undertaking the review. Indeed, as the IEO notes, this will be an opportunity to formalise previous experience where special arrangements have been put into place to oversee heightened contingency planning. As suggested by the IEO, the governance review will consider the mandates and membership of the existing resolution committees and ways of maintaining information flows and ensuring relevant areas can influence proposals effectively. This will include reviewing the mandates and operation

(9) Bank of England (2017), *Financial Stability Report*; www.bankofengland.co.uk/-/media/boe/files/financial-stability-report/2017/june-2017.pdf.
(10) Prudential Regulation Authority (2016), 'The Prudential Regulation Authority's approach to banking supervision'; www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/approach/banking-approach-2016.pdf.
(11) Bank of England (2017), 'Statement on structural separation between the resolution and supervision functions of the Bank of England'; www.bankofengland.co.uk/-/media/boe/files/about/legislation/statement-structural-separation.pdf.

of existing arrangements for co-ordination between the Resolution Directorate and PRA. The Bank's existing statement on its arrangements for structural separation (see recommendation 4) will be assessed to establish whether any consequential amendments are required.

Theme 3: Preparing for a resolution

Recommendation 6. Formalise governance arrangements for heightened contingency planning in line with current practice.

The Bank agrees with this recommendation and will implement it through the review to be commenced in 2018 Q3 described above.

Recommendation 7. Set out a strategy internally on how the Bank would deal with a fast death of a firm, ensuring that cross-Bank roles and responsibilities are clear.

Resolution provides a framework for the authorities to act to address financial failure. In essence, the resolution regime enables financial restructuring in support of public policy objectives which are not reflected in general corporate insolvency arrangements. As such, the resolution toolkit can be used to enable restructuring in the event of all types of failure but the process may be more challenging and the options more limited if the failure results from non-financial reasons, such as criminal sanctions which destroy franchise value. The Bank nevertheless assesses the risk of failure under a wide range of scenarios. In light of the IEO's recommendation, the Bank and PRA will give particular emphasis to the risks of a 'fast death' and will also consider the roles and responsibilities of different parts of the Bank and PRA in such scenarios. This will be supported by a Bank simulation exercise to test current arrangements.

Recommendation 8. Use current Bankwide initiatives to review the skills needed for heightened contingency planning and resolution execution; and to agree a framework for the rapid mobilisation of resources.

The Bank accepts these recommendations and will conduct a review of the internal and external skills required for heightened contingency planning by end-2018. In particular, this will include a review of the utilisation of external advisers to provide the specific technical expertise necessary to undertake heightened contingency planning or execute a resolution.(12) The review will consider the mitigants against the risk that advisers are appointed too late in light of the Bank's framework for the procurement of advisers and the statutory powers for requiring firms to appoint skilled persons.(13)

The Resolution Directorate will also identify relevant skills and individuals with these from other directorates who can be used to relieve and support resolution subject matter experts, for short periods of time, in heightened contingency planning. For example, previous heightened contingency planning cases have identified a particular need for individuals with project management, procurement and financial planning skills. The rapid mobilisation of additional resource for this work will be facilitated by the Director of Priority and Resourcing and the Bank's newly established 'People Committee'.

Recommendation 9. With due considerations for resourcing constraints, agree a comprehensive schedule of exercises to test the Bank's operational preparedness for a resolution.

The Bank supports the principle of this recommendation and recognises the value of regular, targeted simulations. This is demonstrated by the regular exercises conducted with counterparts in the euro area and United States to establish and test co-ordination and decision-making processes for resolution and the use of internal walkthroughs and table top exercises. Building on this, the Bank will implement a programme of regular internal simulations incrementally as resource allocation allows. The Bank will also seek ways to make such exercises more efficient, reducing future resource intensity. As is currently the case, the lessons from these exercises will be reflected in updates to internal processes.

(12) The Banking Act 2009 requires the Bank to appoint external advisers to conduct the independent valuation of the assets and liabilities of the firm.
(13) The Banking Act 2009 permits the Bank, as resolution authority, to appoint skilled persons to provide reports in support of the exercise of its functions at the expense of the firm.

6 Conclusion

The Bank welcomes the IEO's evaluation, which recognises the Bank has led the way internationally in developing the resolution policy framework and that the decision to prioritise policy development and communication have yielded clear benefits. The Bank also welcomes the IEO's endorsement of the Bank's decision to make the operationalisation of the resolution framework one of a small number of strategic goals. The implementation of the IEO's recommendations will support the Bank to deliver this demanding goal.

Summary of the Bank's response to the IEO's recommendations

Theme	Recommendation	Response		
Theme 1: Establishing a roadmap to 2022	Articulate how the institution as a whole will deliver on making the resolution framework operational.	The Bank has a strategic goal of making the resolution framework operational and has committed to publishing assessments of the effectiveness of major UK banks' resolution plans.	The Bank has formed an Executive Director level Steering Group to co-ordinate the cross-Bank delivery of this project.	The Bank will set out its planned approach in a consultation paper by end-2018.
	Review appropriateness of the Resolution Directorate skillset as its focus shifts from policy development to implementation.	The Directorate's current skillset includes policy and supervisory expertise, and a mix of other skills necessary for designing and executing resolution transactions.	The Bank will undertake the proposed review by end-2018, drawing upon the Bank's newly developed resources for organisational design.	
Theme 2: Working together in structural separation	Consider whether the introduction of the gone-concern regime has been appropriately reflected in PRA supervisory strategy.	Governors will assess the interaction between the going and gone-concern regimes.	The FPC will review the judgements underlying its calibration of the risk-weighted capital framework for UK banks.	The PRA will consider how operationalisation of the resolution framework will be reflected in its approach to supervision, and priorities, implementing this by end-2020.
	With due regard to the legal framework, consider mechanisms to enable greater and timely information sharing and cross-Bank collaboration on resolution issues.	The Bank already employs a 'One Bank' model of working, eg drawing on PRA and FCA Supervisory Assessments to maintain its 'Watchlist', and annual Peer Reviews.	The Resolution Directorate has established a 'hub' to co-ordinate and plan cross-Bank work to deliver the strategic goal of making the resolution framework operational. This is supported by a new Executive Director level Steering Group .	
	Review governance arrangements for business-as-usual resolution matters.	Governors will undertake a review of the governance arrangements for resolution in 2018 Q3.		
Theme 3: Preparing for a resolution	Formalise governance arrangements for heightened contingency planning.	Governors will undertake a review of the governance arrangements for resolution in 2018 Q3.		
	Set out a strategy internally on how the Bank would deal with a fast death of a firm.	The Bank assesses the risk of failure under a wide range of scenarios	The Bank and PRA will emphasise assessment of 'fast death' risk, and will consider the roles and responsibilities of different parts of the Bank and PRA in such scenarios.	The Bank will conduct a simulation exercise to test current arrangements.
	Review the skills needed for heightened contingency planning, and agree a framework for the rapid mobilisation of resources.	The Bank will conduct a review of the internal and external skills required for heightened contingency planning by end-2018.	The Bank will identify relevant skills, and individuals with these, who can be used for short periods of time in heightened contingency planning.	
	Agree a comprehensive schedule of exercises to test the Bank's operational preparedness for a resolution.	The Bank conducts regular exercises with European and US counterparts, internal walkthroughs and tabletop exercises.	The Bank will implement a programme of regular internal simulations as resource allocation allows.	Lessons from these exercises will be reflected in updates to internal processes.