

Evaluation of the Bank of England's resolution arrangements

Banks, building societies and major investment firms

June 2018



BANK OF ENGLAND





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Independent Evaluation Office, Bank of England

Foreword from the Chair of Court

The financial crisis highlighted the importance of having an effective framework that enables banks to fail in an orderly manner. The suite of powers and responsibilities the Bank of England ('Bank') has gained since 2009 is critical to assuring that failing institutions can be resolved without direct costs to taxpayers. For the Bank to be able to resolve firms effectively requires effort not only through its work as the UK's resolution authority, but also as a supervisor (through the Bank's Prudential Regulation Authority) and a central bank lender.

The evolution of the UK resolution framework and the implications across the institution led the Court of the Bank of England (the Bank's Board) to commission its Independent Evaluation Office (IEO) to review the effectiveness of the Bank's resolution arrangements. The IEO focused on the approach adopted for the resolution of banks, building societies and major investment firms — an area where the legal framework has changed substantially over the years. The IEO's findings and recommendations are contained in this report. The evaluation benefited from input from a range of external and internal stakeholders and I would particularly like to express my gratitude to Patrick Honohan (former Governor of the Central Bank of Ireland) — who acted as an embedded external advisor to the IEO team, providing support and challenge throughout the evaluation.

As the report sets out, significant progress has been made over the past decade, with Bank staff leading the way in international fora on developing the policy framework for resolution and taking steps to put policy into practice. As the IEO concludes, the Bank's work with the industry means that firms are more resolvable now than they were during the crisis, and costs of failure would increasingly be absorbed by investors, rather than taxpayers. However, much also remains to be done if the major UK banks are to be fully resolvable by 2022.

The recommendations in this report cover three themes. The first looks to support the Bank's work in delivering on its target to make firms fully resolvable by 2022. The second centres around the supporting infrastructure to reinforce cross-Bank working as it shifts further towards the implementation of the framework. The third levers off existing preparatory work for executing a resolution, bearing in mind it has been some time since a bank has been resolved in the United Kingdom.

I welcome the Bank's commitment in taking forward these recommendations, and Court will be monitoring their implementation as part of its wider follow-up framework for IEO reports.

A handwritten signature in black ink that reads 'Anthony Habgood'.

Anthony Habgood, Chair of Court
June 2018

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Executive summary

In February 2017, the Court of Directors (the Bank's Board) commissioned its Independent Evaluation Office (IEO) to conduct a broad-based evaluation of the effectiveness of the Bank's resolution arrangements. This report sets out our findings and recommendations.

The financial crisis highlighted the importance of having a framework to deal with failing banks, thereby preventing the need for future taxpayer bailouts. Much progress has been made over the past decade. A legal regime is now in place. And considerable headway has been made in developing and finalising a policy framework for resolution.

In recent years, the Bank has increasingly turned its attention to policy implementation. Against this backdrop, we evaluate the effectiveness of the Bank's approach in exercising its resolution responsibilities in relation to banks, building societies and major investment firms (the institutions in scope of this evaluation).⁽¹⁾ We identify three themes.

The Bank has stated to the Treasury Committee that 'major UK banks are on course to being fully resolvable by 2022'.⁽²⁾ Our first theme — **establishing a roadmap to 2022** — looks to support delivery of this ambitious public commitment. The Bank has been instrumental in spearheading international efforts on developing policy on resolvability, where it is widely acknowledged as an intellectual leader. It is also among the forefront of its international peers in terms of implementing the domestic resolution framework, and has been praised for the external communication of its approach. This foundation is critical and makes a central contribution to the credibility of the regime.

While the Bank's efforts have meant firms are substantially more resolvable now than they were during the crisis, there remains work to be done. We welcome the additional impetus provided by the Governors' recent decision to recognise the embedding of the resolvability framework as one of a small number of Bank-wide strategic priorities. And our view is that for this next phase of work, project discipline — through intermediate goals and milestones — is critical. A gradual rebalancing of the skillset within the Bank's Resolution Directorate would also help ensure it is sufficiently equipped to oversee firm-level resolvability and preparedness for resolution.

Our second theme — **working together in structural separation** — aims to enhance the Bank's internal infrastructure to support cross-institution working, while ensuring this adheres to the legal requirements. By law, the Bank is required to maintain 'structural separation' (ie operational independence) between its supervisory and resolution functions to avoid the risk of conflicts of interest (Box 1). In essence, this means that the Bank is supervising firms for two regimes: resilience against failure ('going-concern' supervision, led by the Prudential Regulation Authority (PRA)) and an orderly resolution ('gone-concern' supervision, led by the Resolution Directorate).

Our work finds that structural separation has been implemented effectively and appropriately. We also received very positive feedback on the effectiveness of the Bank's co-operation with other authorities on resolution matters — both in the United Kingdom and abroad. But as the resolution regime continues to mature, we believe there may be benefits in the Bank considering the scope for synergies between going and gone-concern supervision. We also see merit in reviewing and strengthening the existing governance and information sharing arrangements.

While it has been some time since the Bank has executed a resolution, it needs to maintain the capability to do so, potentially at short notice. This speaks to our third and final theme — **preparing for a resolution**. The organisation has made clear progress in developing its readiness to conduct a resolution. That includes comprehensive

(1) This set of institutions are in scope of the EU 'Bank Recovery and Resolution Directive', and jointly referred to as 'banks' or 'firms' in this report.

(2) See Bank of England (2017a).

walkthroughs and structured exercises with cross-border authorities to develop and embed co-operation. But we believe there is some further scope for refinement of the Bank's approach.

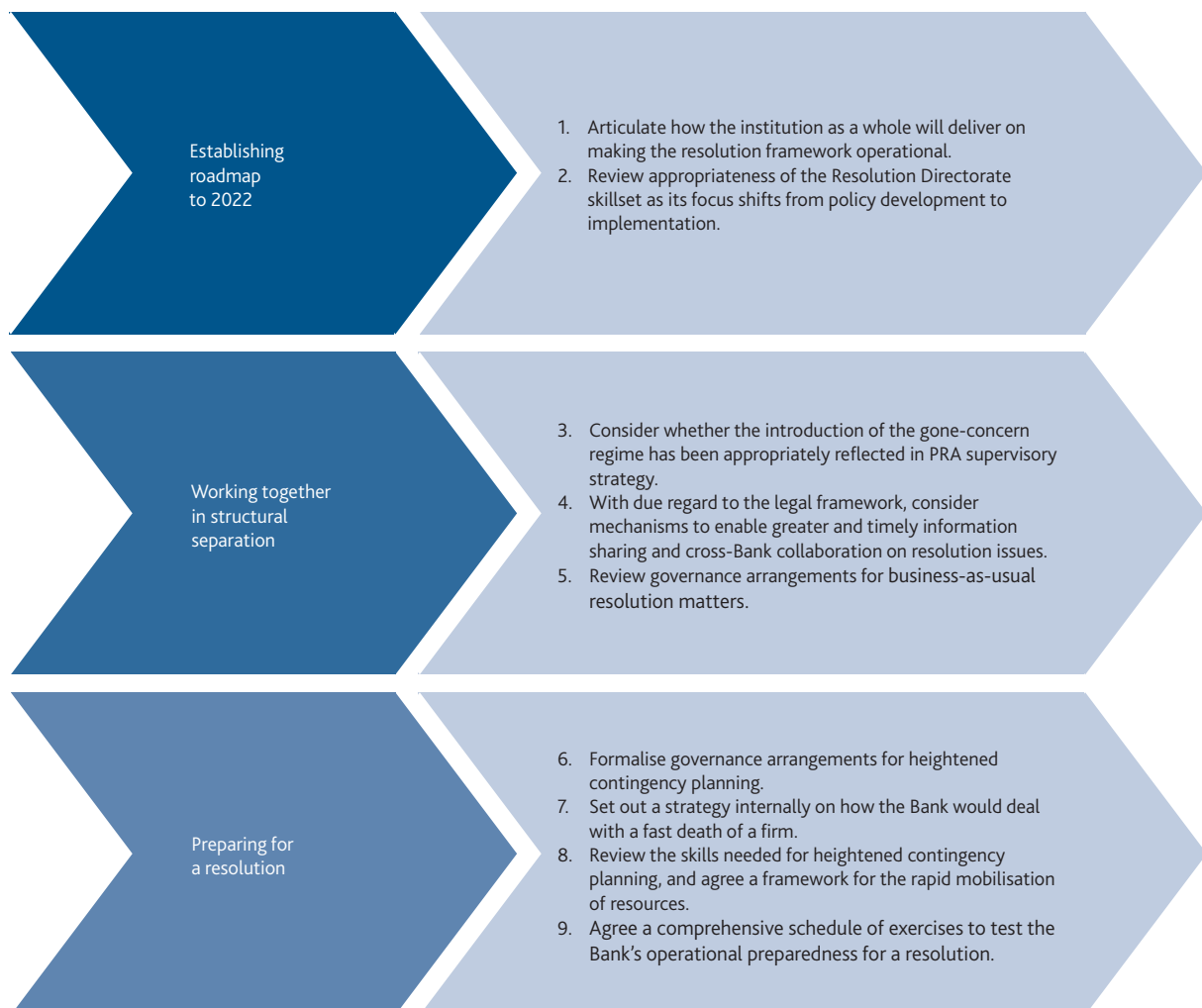
Our recommendations here centre around formalising current practices for heightened contingency planning — including preparing for a 'fast death' arising from operational events (eg cyber attack). While the Bank has carried out a number of valuable internal and external preparatory exercises, we believe these should be conducted on a more comprehensive schedule. We also recommend that the Bank continues to lever existing initiatives so that internal resources can be rapidly mobilised as needed.

In terms of approach, our evaluation was primarily conducted between September 2017 and February 2018 by a dedicated project team reporting directly to the Chair of Court.⁽¹⁾ Any live cases in the run up and during this period were out of scope of the team's work.

During the course of the evaluation, the IEO team benefited from feedback and challenge from a Bank-wide senior-level advisory group (including external members of the Bank's Prudential Regulation Committee and PRA senior advisors). Patrick Honohan (former Governor of the Central Bank of Ireland) provided support and independent challenge to the team throughout the evaluation, and he has reviewed and endorsed the findings and recommendations in this report. The IEO team also worked alongside two other external advisors with practitioner and resolution experience — Jim Wigand (former Director of the FDIC's Office of Complex Financial Institutions (the US resolution authority)) and Richard Heis (former Global Head of Insolvency at KPMG in the UK).

This report was approved for publication by the Chair of Court at the May 2018 Court meeting.

Figure 1 Summary of recommendations



(1) The IEO team was: Lea Paterson (IEO Director), Andrew Georgiou, Céline Gondat-Larralde, Anna Jernova and John Power. Joseph Williams provided research assistance and analysis. The analysis and recommendations in this report, together with any errors herein, remain the full responsibility of the IEO, and not the IEO's advisors or members of Bank staff.

1 Context for the review

The Bank has had the responsibility for taking action to manage the failure of banks, building societies and certain investment firms since 2009.⁽¹⁾ This process, which is distinct from bankruptcy, is known as 'resolution'. Compared with other central bank and regulatory functions, it is a relatively new concept that has been evolving rapidly.

The creation and development of an effective resolution regime reflects a key lesson from the 2008 financial crisis. During that episode some failing banks had become too big, complex and interconnected to be put into normal corporate insolvency and needed to be bailed out by public funds. Resolution aims to change this so that losses are borne by investors and creditors in the event of a bank failure while ensuring critical operations can continue. It therefore contributes to the Bank's objective of protecting and enhancing financial stability.

Since the financial crisis, resolution arrangements both domestically and internationally have been reformed significantly. Internationally, standards have been agreed establishing the key attributes of effective resolution regimes.⁽²⁾ As part of this work, the policy and regulatory framework has been strengthened to make firms more resolvable. And structures have been established to manage the cross-border co-operation needed to plan the resolution of internationally active firms.

Domestically, new powers and tools have been given to the Bank to resolve firms through a suite of UK and EU legislation. In lockstep with the developing international framework, resolution policies have been introduced, and are being applied to UK firms. Internally, the Bank has created structures to help discharge and operationalise its wide range of resolution responsibilities — including completing the work to make firms resolvable and the framework fully operational. And in determining the appropriate capital requirements for the banking system, the Financial Policy Committee (FPC) has already taken into account the impact of effective resolution arrangements.⁽³⁾

This evaluation assesses how well the Bank is exercising its resolution responsibilities, as resolution authority principally, but also in its role as supervisor and central bank lender. It considers: progress to date in making firms resolvable by 2022 in light of its public commitments to the Treasury Committee (Section 2); how well the wider Bank works together to meet its resolution responsibilities (Section 3); and how well prepared the Bank is to conduct a resolution — mindful that it may need to do so while the framework is still being completed (Section 4).

The rest of this section sets out some salient features of the UK resolution framework (Section 1.1), the Bank's approach to deliver it (Section 1.2), and the approach to our evaluation (Section 1.3).

1.1 Key features of the UK resolution framework

The resolution regime — governed by legislation and a code of practice — is a critical part of the UK framework.⁽⁴⁾ It was introduced through the Banking Act in 2009 and, consistent with the international key attributes, it was further revised and strengthened through the implementation of the EU Bank Recovery and Resolution Directive (BRRD) in 2014. It identifies the ways in which the Bank (as resolution authority), the micro-prudential regulators (Prudential Regulation Authority (PRA), Financial Conduct Authority (FCA)), HM Treasury (HMT) and other

(1) The current set of powers and responsibilities were introduced through the EU Bank Recovery and Resolution Directive in 2014.

(2) In November 2011 the G20 endorsed the 'Key Attributes of Effective Resolution Regimes for Financial Institutions', part of the set of Financial Stability Board (FSB) policy measures to address the problems of firms that are 'too big to fail'. The attributes have been enhanced over time and the FSB has a significant work programme to promote their implementation. See Financial Stability Board (2014).

(3) See Bank of England (2015).

(4) The principal legislation is the UK's Banking Act 2009 and Bank Recovery and Resolution (No2) Order 2014. HMT is required under the Banking Act to publish a code of practice (HM Treasury (2017a)) on the resolution regime which, among other things, provides guidance as to how and in what circumstances the authorities will use their powers under the regime. Also relevant is the Memorandum of Understanding on resolution planning and financial crisis management between HMT and the Bank of England (HM Treasury (2017b)).

stakeholders (such as the Financial Services Compensation Scheme (FSCS) and foreign resolution authorities) interact with each other. The main features of the regime are set out in the Bank's flagship resolution publication (the 'Purple Book'),⁽¹⁾ and summarised below:

- As specified in law, the authorities (Bank, HMT, PRA and FCA) must consider seven objectives when selecting and using their resolution powers under the Banking Act. These include the continuity of banking services and critical functions in the United Kingdom; and protecting depositors and public funds.
- Four conditions must be met before a bank may be placed in resolution. The micro-prudential supervisor⁽²⁾ must assess that a firm is 'failing or likely to fail' (Condition 1). The Bank as resolution authority must then determine that there are no further actions that could be taken to prevent the firm from failing or being likely to fail (Condition 2). Further public interest tests are taken by the Bank before it can exercise its resolution powers (Conditions 3 and 4). See **Figure 3.2** for more detail.
- A range of tools is available to the Bank to resolve firms, including bail-in (or a write-down or conversion of creditor claims) and transfer to a private purchaser (or bridge bank). The Bank can also place firms into modified insolvency.⁽³⁾
- The resolution condition assessments, triggers and use of tools require formal co-ordination and consultation between the authorities. And because resolution powers allow the Bank to interfere with property rights of investors and creditors without their consent, further safeguards have been built into the regime.

A successful resolution framework, however, requires more than just a legal regime. Failing firms need sufficient capacity to absorb losses and to allow them to be recapitalised. They also need to be structured in such a way so that resolution allows for critical functions to continue. Cross-border co-operation is needed to handle the failure of an internationally active firm. And the framework needs to be credible, in particular providing clarity to market participants about resolution processes and the policy outcomes that those seek to achieve. As progress is made on each of these fronts, firms will become increasingly resolvable, thereby commensurably reducing potential disruption on critical services in the event of failure (in other words resolvability is not binary). Efforts to make banks more resolvable have been the primary focus of the Bank's business-as-usual work in recent years and are considered further in Section 2.

1.2 The Bank's approach to operationalising the framework

The Bank has taken a number of steps to operationalise the delivery of its resolution responsibilities — mindful that there are synergies and complementarities between those and the Bank's wider functions. One special feature of the legal regime is that it requires the Bank's resolution function to be structurally separate from its supervisory function.⁽⁴⁾ This is to ensure operational independence and the avoidance of conflicts of interest (Box 1) as the objective of the going-concern supervisory regime and the gone-concern resolution regime can pull in different directions.

Different set ups exist across jurisdictions — with some having the resolution and supervisory authority in different institutions to ensure there is no conflict of interest. The UK has chosen instead a model in which the Resolution Directorate is situated within the same institution as the Bank's supervisory authority, the PRA. This has resulted in the creation of a lean/nimble Resolution Directorate expected to lever off work and resources of the wider Bank and PRA. This key feature of the UK approach is aimed at avoiding the creation of a 'second supervisory function', and engaging with firms with a single voice (Sections 2 and 3).

(1) See Bank of England (2017b).

(2) The PRA is the UK prudential regulator of deposit-takers, insurers and major investment firms. The Financial Conduct Authority is the conduct regulator of financial services firms as well as the prudential regulator of financial services firms not supervised by the PRA.

(3) This applies to the smaller firms in the United Kingdom who do not supply transactional accounts or other critical functions to a scale likely to justify the use of resolution tools.

(4) Annex 2 sets out the relevant legal provisions. These include Article 4.7 of the Capital Requirements Directive and Article 3.3 of the Recovery and Resolution Directive. The Bank has also issued a public statement on how it meets the requirements of the legislation on structural separation. See Bank of England (2017c).

Box 1

Structural separation and the organisation of the resolution function

'Structural separation' between the work of the PRA and the Bank's resolution function has necessitated the Bank to make specific arrangements in relation to resolution decision-making structures, structural separation of resolution staff, and separate reporting lines for them.

Staff and reporting lines: The work of the Bank as resolution authority is supported by a comparatively small dedicated Directorate led by the Executive Director for Resolution, comprising around 50 members of staff⁽¹⁾ and located within the Deputy Governorship for Financial Stability. In its business-as-usual work it is responsible for resolution policy development at the national and international levels and the implementation of policy by firms to ensure they are resolvable. This preparatory work also includes drawing up firm-level resolution plans and strategies, assessing resolvability (and requiring barrier removal), and the setting of firm-specific loss-absorbency requirements.⁽²⁾ The Resolution Directorate also needs to stand ready to implement a resolution if a firm experiences difficulties that cannot be recovered. This includes planning and providing advice to the Bank leadership as resolution authority on the range of decisions that need to be made, co-ordination with the other authorities and execution of the tasks required by the resolution regime.

Decision-making: Separate decision-making structures have been introduced to ensure that 'resolution authority' decisions are distinct from PRA and other Bankwide decision-making. This includes decision-making in business as usual — as well as in contingencies/resolution execution. The Governor is responsible for managing the day-to-day affairs of the Bank,⁽³⁾ and this includes its responsibilities as the UK's resolution authority. The Governor has constituted a Resolution Committee (ResCo) to provide advice on the discharge of the Bank's responsibilities. Within ResCo decision-making authority rests with the Deputy Governor for Financial Stability (DGFS) — certain matters are explicitly reserved to the Governor, and DGFS retains the ability to escalate matters to the Governor if they consider it appropriate to do so. The Executive Director for Resolution makes decisions (including following advice from the Resolution Advisory Committee) on most other resolution matters.

(1) On a full-time equivalent basis.

(2) Minimum requirements for own funds and eligible liabilities (MREL).

(3) See Bank of England (2017d).

Another feature of the UK implementation of structural separation is the advisory model adopted for the governance of resolution decisions. Resolution authority decisions are made by individuals and advised by supporting resolution committees (which include supervisors and other areas with an interest in resolution). That contrasts with other Bank responsibilities where committee decisions are often made through collective mechanisms. Governance is covered further in Sections 3 and 4.

A third implementation feature is that the Bank has simultaneously progressed the framework (including internationally) towards the desired end-state while maintaining and building its capability/readiness to execute a resolution during contingencies. The Bank has adopted a pragmatic approach here, progressing firm level planning in lockstep with barrier removal, generally prioritising those institutions that pose greatest risks to financial stability. During heightened contingencies for individual cases, the Bank reprioritises in order to work through how best to achieve a credible and feasible resolution for the firm in question given remaining barriers to resolvability. Operational readiness is considered further in Section 4.

1.3 Evaluation approach

In terms of scope, this evaluation covered banks, building societies and major investment firms — firms which are in scope of the BRRD, and are regulated by the PRA.⁽¹⁾

(1) With respect to investment firms, the resolution regime applies to those that deal as principal, hold client assets and are subject to a minimum capital requirement of €730,000. In the UK, most of these firms are solo-regulated by the FCA. Our evaluation focused principally on PRA-regulated firms (which includes major investment firms — see Prudential Regulation Authority (2013) for designation criteria), recognising, however, that the regime requires wider interaction between the Bank and FCA.

In line with previous IEO evaluations, we developed a set of criteria against which the effectiveness of the Bank's approach could be judged — namely:

- (i) a clearly articulated framework;
- (ii) effective implementation;
- (iii) progress towards resolvability;
- (iv) effective governance; and
- (v) an agile resourcing model.

We examined the Bank's approach in its business-as-usual work as well as in contingencies. For the latter, we avoided using case studies involving specific firms that had the potential to compromise live planning. Annex 1 provides further details of our approach.

In line with the IEO principle of not commenting on live policy, we have not evaluated the potential impact of the UK's withdrawal from the EU on the Bank's approach to resolution. As is noted in the report, the UK's resolution regime is based on the BRRD and wider international standards. The BRRD is itself currently the subject of some proposed changes although these are not yet finalised within the EU. More broadly, the UK's future relationship with the EU following its withdrawal will be shaped by the negotiation currently under way. It is not possible, therefore, to reach definitive conclusions about any implications for the resolution regime in the UK, however we would expect the UK regime to continue to adhere to international standards.

2 Evaluation — establishing a roadmap to 2022

The Bank has set itself challenging targets for making UK firms fully resolvable. Specifically, it has stated to the Treasury Committee that the major UK banks are on course to being fully resolvable by 2022, and had established a target of 2019 for public disclosure of summaries of firms' resolution plans and the Bank's assessment of their effectiveness.⁽¹⁾ In this section, we consider the progress the Bank has made.

Resolution is not a binary concept and firms are substantially more resolvable now than they were during the crisis. The Bank now has a strong set of resolution powers, policies for removing barriers to resolvability have largely been finalised (at least at a high level) and the banks are in the process of implementing them.

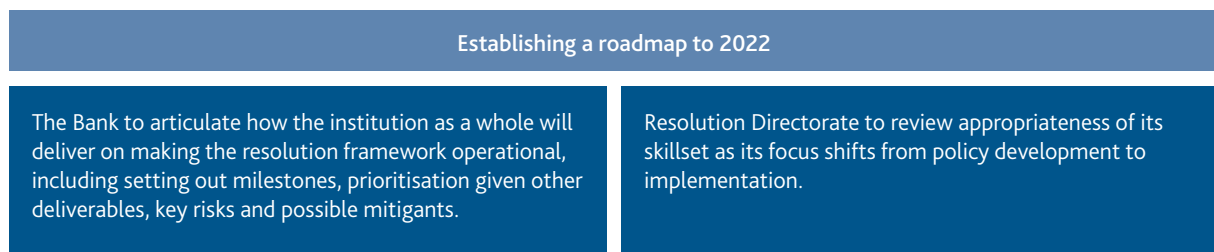
Particularly notable has been the leadership provided by the Bank internationally and in the EU to develop the resolution regime and policies that increase loss absorbency and tackle the barriers to resolvability. Feedback received from international and UK authorities, industry practitioners and a selection of regulated firms was universally positive about this aspect of the Bank's work (Box 2). Moreover Bank staff are regarded as having developed deep expertise in resolution.

While clear progress has been made, making firms fully resolvable will inevitably involve a long and complex process. In the recent past, the balance of the Bank's work has pivoted from policy development to policy implementation, and Section 2.1 assesses the Bank's progress in making the resolution framework operational. Our view is that the next phase of the work will require concerted efforts from across the institution — and from the banks themselves — to meet the commitments made to the Treasury Committee. We recommend that the Bank sets out a detailed road-map on how it will meet this challenge, including key risks to delivery and possible mitigants.

In our view, the continuing shift in the balance of the Bank's priorities from policy development to implementation may also require a gradual review of skills within the Resolution Directorate over the coming years. This is considered further in Section 2.2.

The evidence in this section is mainly relevant to our second and third evaluation criteria: effective implementation of the policy framework and progress towards resolvability. But it is also relevant to our first and fifth criteria: clearly articulated framework and agile resourcing model.

Figure 2.1 Recommendations — establishing a roadmap to 2022



(1) The Bank's response to the Treasury Committee's 2016 Capital Inquiry noted the Bank's intention of publishing summaries of major UK banks' resolution plans and its assessment of their effectiveness from 2019. The Bank will consult on its approach by the end of 2018 and work will begin in 2019. The consultation will propose that the first such assessments will take place in 2020. This will allow the assessments to reflect changes to banks' structures arising from the implementation of ring-fencing and EU withdrawal. See Bank of England (2017a).

2.1 Making the resolution framework operational

There are broadly four key components of work needed to make UK banks fully resolvable. These are: a statutory resolution regime; adequate loss-absorbing capacity; elimination of non-financial barriers to resolvability; and cross-border co-operation. The Bank has made significant progress on each of these components. For example:

- The United Kingdom now has in place a comprehensive and effective bank resolution regime, which gives the Bank a toolkit including powers to 'bail in' shareholders and creditors of failed banks.⁽¹⁾
- The UK banks subject to loss absorbency (in excess of minimum capital) requirements are well on their way towards meeting these by 2022, meaning that the costs of failure should be borne by the shareholders and creditors of failed firms, not taxpayers.
- The United Kingdom has led the way on the international framework for identifying the remaining barriers to resolvability, and the policy regime to address these barriers is now largely in place. The Bank is working with firms to implement these policies ahead of the deadlines set (**Figure 2.2**). Some, such as stays — which address the risk of the disorderly close out of financial contracts — have already been implemented.
- There has been a large investment in making co-operation work between the United Kingdom and home and host jurisdictions. As a result, the UK and other resolution authorities are better positioned to co-ordinate effectively in the event of a failure of a cross-border bank.

Achieving the 2022 target, however, will require further significant effort. Both domestically and internationally, progress has been varied across the barriers to resolvability (**Figure 2.2**) meaning some barriers are closer to being removed than others. That reflects the 'sequential triage' approach that has been taken. In other words, the Bank has focused first on those barriers considered the most important for effective resolution and with the longest lead time to implementation — as opposed to tackling all barriers simultaneously.

We did not find any evidence to suggest that the sequential approach has been problematic (ie later learnings have not undermined previous work). And feedback from firms suggested that they have found this approach more manageable — not least given the simultaneous implementation of ring-fencing requirements (see Box 2 on external feedback).

In evaluating progress towards resolvability to date, we had three key findings.

First, the Bank's commitments to the Treasury Committee are ambitious. Policies have not yet been set out for the removal of all the barriers at the international and domestic levels. And analysis of the Bank's firm-specific resolution plans highlights that major UK firms still have multiple impediments to resolvability to be removed by 2022.⁽²⁾ The Bank continues to work with firms to remove the barriers ahead of the deadlines set so far, some of which are a number of years in the future. The scale of the outstanding tasks was also confirmed by our external outreach. Industry practitioners noted, for example, that addressing valuations capability as a barrier to resolvability would be a particularly significant task.

Second, feedback from firms suggested they were unclear on what 'good' looks like with respect to addressing some of the barriers to resolvability for which policies have been published. Some of the policies to address the barriers have clear quantitative targets for firms, for example the required levels of loss-absorbing capacity. As such, they are more straightforward for firms to implement. Other policies, for example the Bank's expectations on operational continuity in resolution, put a greater onus on firms to develop their own specific solutions. While this approach has the advantage of avoiding a 'one-size-fits-all' solution, it has required more iteration and has proved to be more difficult for firms to implement, especially where they may not have regular bilateral interactions with the Resolution Directorate (Box 2).

(1) In its Financial Sector Assessment Program review in 2016, the International Monetary Fund similarly noted that the framework for effective resolution in the United Kingdom was largely in place. See International Monetary Fund (2016).

(2) There is greater comfort in respect of smaller firms which would enter the modified insolvency procedure (and so fall outside of resolvability requirements).

Figure 2.2 Requirements on firms to remove the barriers to resolvability^(a)

Barriers to resolvability	Description	FSB policy issued	Policy issued domestically	UK policy implementation deadline
Loss-absorbing capacity — external	A firm needs to hold sufficient financial resources at the location where resolution powers will be applied to absorb losses and enable recapitalisation.	2015	2016	2019–22
Loss-absorbing capacity — internal	A group needs to have internal financial resources issued from material subsidiaries so the subsidiary can be recapitalised, thereby supporting the continuity of the critical functions it provides.	2017	2018 (expected)	
Firm resolution funding strategy ^(b)	A firm in resolution needs to continue to have sufficient liquidity to meet its obligations.	2018 (expected)		
Valuation capabilities	Timely and robust valuations of a firm's assets and liabilities are a key input into the Bank's decisions in resolutions.	2018 (expected)	2018 (expected)	
Operational continuity in resolution	Firms need to continue to provide their critical functions in stress and resolution.	2016	2016	2019
Stays on financial contracts	Early termination of financial contracts by counterparties of a firm in resolution poses a risk to orderly resolution and also risks wider contagion through financial markets.	2015	2015	2017
Continuity of access to FMIs	A firm in resolution needs to continue to have access to financial market infrastructure (for example, payment systems) to continue to meet its obligations.	2017		
Post-resolution restructuring	Where a firm has been stabilised through resolution tools, restructuring would be necessary to address the underlying causes of the firm's failure and to return the firm to viability.	To be determined		

(a) Shading indicates that the action has been completed.

(b) Where a firm's own resources are temporarily insufficient, and access to private sector funding is disrupted, the Bank has put in place a flexible approach for the provision of liquidity in order to support the group resolution strategy.

Third, we observed some lack of clarity at working level on the roles of other directorates within the Bank (beyond the Resolution Directorate) in progressing the resolvability agenda. The extent to which the Bank has been able to function as one organisation to deliver the resolvability agenda is discussed further in Section 3.

The Bank recognises the challenges ahead and has already initiated a cross-Bank workstream focused on progressing resolvability. And we welcome the impetus and focus provided by the Governors' decision to identify 'Making the Resolution Framework Operational' as one of a small number of the Bank's strategic priorities for 2018–20. But in the context of our three findings above, we believe that it is essential as part of this work that the Bank further develops its plans with respect to the journey to 2022. We therefore recommend that the Bank sets out a more detailed roadmap to delivery, including:

- (1) Introducing greater project discipline through the establishment of intermediate milestones and goals to 2022, and an assessment of potential risks to achieving these given other priorities and potential shocks (eg heightened contingency planning for a firm — see Section 4). As milestones are reached and barriers are removed, these should be reflected in firms' resolution plans.
- (2) Clearer expectations for firms of what 'good' looks like in the run up to 2022 as they progress towards full resolvability (ie what is needed for orderly resolution, and any intermediate goals).
- (3) Identifying and securing the right resources from across the institution to supervise the removal of the barriers. The consequence of the resourcing model the Bank has chosen for resolution (see Section 1) means, in our view, that other directorates will need to be responsible and accountable for leading their own contributions to the collective effort. **Figure 3.3** sets out the main other directorates involved in delivering the Bank's resolution responsibilities.

2.2 Directorate skillset

To date, the work of the Resolution Directorate has been governed by its ambition to develop and make the resolution framework operable, as well as being prepared to execute a complex resolution should the need arise. That has required it to be skilled at: international negotiation and policy development; implementation tasks such as the development of firm level resolution plans and supervising the removal of barriers to resolvability; as well as having specialist expertise in conducting resolution transactions. To meet those challenges Resolution Directorate has grown its 'in house' expertise and successfully drawn in skills from outside the institution such as accountants, lawyers and investment bankers to aid operational preparedness.

As the balance of the resolution function's business-as-usual activity shifts further to policy implementation, and in particular monitoring compliance with the resolvability policies set out by the Bank, a rebalancing of skills within the Directorate may be needed. For example, our examination of HR data suggested that the Directorate is relatively light on supervisory backgrounds (eg experience from the PRA and the Bank's Financial Market Infrastructure Directorate). The optimal skills mix will depend on a number of factors including: determining the respective roles of the Resolution Directorate and the rest of the Bank/PRA in progressing the resolvability agenda; the extent to which the Directorate is able to draw on the expertise of risk specialists within the Bank; as well as the extent of outstanding policy development work. Irrespective of the model adopted, the Directorate will also need to remain skilled at execution (Section 4).

We therefore recommend that there is a review of the Directorate-wide skillset and scale mix in light of the internal reprioritisation of policy implementation. More generally, the Bank should continue to ensure that it builds the right expertise to challenge firms' resolution plans. We expect there may need to be a gradual transition as the demands for different skills grows over the coming years.

Box 2

External stakeholder views on the Bank's approach to resolution

This Box summarises views from external stakeholders on the Bank's approach to resolution. We spoke with: 11 banks and building societies covering the spectrum of resolution strategies and varied headquarter locations; a number of industry practitioners and consultants; the relevant UK authorities and bodies (HMT, FCA and FSCS); and a selection of international authorities, some with similar institutional arrangements for resolution as the UK and some with different approaches.

We discussed a wide range of topics with each covering most of our evaluation criteria, though with a focus on gaining input for our evaluation on: how well the Bank has articulated its framework externally; how well the Bank works with external stakeholders; and what progress had been made towards making firms resolvable. Our key findings included:

- **The Bank and its staff were seen as world leaders in developing the resolution approach:** the Bank has provided thought leadership in global policy development. The Bank's staff were seen as having developed a deep expertise in resolution. The Bank's resolution publications (in particular the 'Purple Book' but also its annual resolution strategy letters to firms) were universally praised for their clarity and accessibility. The 'Purple Book' was seen by some as setting the benchmark internationally.
- **Relationships with firms varied by their size:** the larger, cross-border firms were mainly content with the pace of progress of the Bank's policy development and implementation, and appreciated the Bank's sequential and pragmatic approach to tackling barriers to resolvability. Bilateral contact and two-way engagement with the Resolution Directorate facilitated tailoring firm-specific approaches and dealing with uncertainties. Smaller firms — not subject to stabilisation tools — were also content with their level of interaction with the Bank on resolution, albeit this is low and largely mediated through their supervisors. The main concerns were raised by mid-sized firms who lacked the degree of tailored engagement experienced by the largest firms; they would appreciate more bilateral engagement to enable them to move more quickly towards resolvability.
- **Progress is being made towards resolvability by 2022, but a considerable amount of work remains:** in terms of the individual barriers to resolvability, many of the firms we spoke with would like the Bank to set out more detail on what is required. In particular, this applied to the need to maintain operational continuity in resolution. Even some of the largest firms noted some uncertainty in identifying their critical functions, which would need to be maintained in resolution. Firms tended to understand, though, that implementation of novel policies is inevitably uncertain and likely to require iteration with the authorities. Industry practitioners remarked on the scale of the work that lay ahead for firms to reduce valuation barriers in resolution. A few stakeholders questioned whether the Resolution Directorate had sufficient resources to progress the resolvability agenda.
- **Tangible progress had been made to improve co-ordination with both the domestic and international authorities:** domestically, processes have been developed to deal with institutional tensions inherent in the differing objectives of the authorities (see **Figure 3.2** for examples). The Conditions Assessment process for firms potentially entering resolution was seen as working well. The international authorities fed back positively on the Bank's constructive role in Crisis Management Groups and resolution colleges,⁽¹⁾ and in international exercises (see Section 4.3).

(1) Crisis Management Groups (CMGs) bring together resolution, supervisory and other authorities of home and key host jurisdictions of a global systemically important bank (G-SIB) and meet periodically to discuss the preferred resolution strategy and review resolution planning work carried out by the Bank and the PRA (in the case of the UK G-SIBs) and the firm. In addition to CMGs for G-SIBs, the BRRD requires resolution colleges to be established for all EU firms with at least one subsidiary or significant branch in another EU country. As part of the tasks carried out within resolution colleges, the home resolution authority and the host resolution authorities in other Member States are required to reach joint decisions annually on the: group resolution plan; resolvability assessment; identification of substantive impediments to resolvability and agreement of measures to address those impediments; and setting of MREL at consolidated and subsidiary levels.

3 Evaluation — working together in structural separation

The Bank is under legal obligations to maintain 'structural separation' between its resolution and supervisory functions. This is to ensure operational independence and the avoidance of conflicts of interest (actual, potential and perceived); see Box 1.

In this section we evaluate the broader effectiveness of cross-Bank working on resolution issues against the backdrop of structural separation, with a particular focus on business-as-usual work and the implementation of resolution policy. The Bank's preparedness to conduct a resolution is discussed in Section 4.

Overall, we observe that structural separation has been implemented effectively and appropriately within the Bank. We also received very positive feedback on the effectiveness of the Bank's co-operation with other authorities on resolution matters — both in the United Kingdom and abroad (see Box 2).

However, we also identified scope to improve the effectiveness of internal co-ordination on business-as-usual resolution work, as well as to improve the effectiveness of some aspects of internal governance arrangements. The ongoing shift of focus from policy development to implementation has brought these issues into sharper relief — for example, by increasing the importance of effective co-operation between the Bank's Resolution Directorate and PRA firm-facing supervisors on the removal of firm-level barriers to resolvability.

This section centres around our second, third and fourth evaluation criteria: effective implementation of the policy framework; progress towards resolvability; and effective governance.

Figure 3.1 Recommendations — working together in structural separation

Working together in structural separation		
Governors to consider whether the introduction of the gone-concern regime has been appropriately reflected in the PRA supervisory strategy.	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 to review the governance arrangements for business-as-usual resolution matters.

3.1 One Bank, two regimes

As set out in Section 2, the balance of the resolution framework is shifting from policy development towards implementation and monitoring firms' actions to remove their barriers to resolvability. As a result, the Bank — through its roles as a supervisor and a resolution authority — is now supervising firms for:

- (1) **Resilience against failure:** to reduce the probability of a firm failing by focusing on the key risks to firms' safety and soundness. This is led by the PRA through its supervisory strategy and is known as the 'going-concern regime'; and
- (2) **Orderly resolution:** to reduce the impact of a firm's failure by taking steps to lower firms' barriers to resolvability (including building loss-absorbing capacity) to ensure they can be resolved in an orderly manner. This is led by the Resolution Directorate, and is known as the 'gone-concern regime'.

In accordance with the Bank's chosen model of not creating a second supervisory function (Section 1), we evaluate the Bank's approach in exploiting synergies across the two regimes from the perspective of progressing the resolution agenda. Orderly resolution contributes to the PRA's objectives and its stated risk appetite of operating a 'non-zero failure' regime.⁽¹⁾ So as part of our work, we considered the extent to which resolvability is being taken forward within the PRA's supervisory strategy.

Our work suggests that the PRA considers resolvability when determining the key risks facing firms and the forward-looking supervisory strategy. However, the approach adopted does not appear to be consistent across firms. For example, for UK headquartered firms, our work suggests a relatively limited consideration of resolvability in PRA discussions of firm-level supervisory strategies and key firm risks. By contrast, for internationally headquartered firms, resolution issues tend to form a core part of PRA discussions on the forward-looking supervisory strategy, and typically feature among the key risks relayed back to the banks.⁽²⁾

To a certain extent, one would expect the consideration of resolvability to vary from firm to firm and across firm types. The PRA's supervisory approach focuses on risks that are judged to be the most material to a firm's safety and soundness, and therefore understandably resolvability and orderly resolution may not always feature among the top risks. More generally, supervisors can face a trade-off between addressing live, going-concern risks and preparing for a tail-end event (ie the need to resolve a firm).

However, given the commitments made to the Treasury Committee (see Section 2), and the increasing focus on operationalising the resolvability framework, there may be benefits in reviewing the extent to which the supervisory approach supports the progression of the resolution agenda. We therefore recommend the Governors consider whether the introduction of the gone-concern regime has been appropriately reflected in the going-concern supervisory strategy. As a starting point, this consideration should include an articulation of the relative prioritisation of resolution issues within business-as-usual supervision in order to assist with the aforementioned trade-offs. In the longer term — once the resolution framework is fully operational — there may be broader implications for how the PRA supervises firms — including, for example, resources devoted to and intensity of supervision for certain firms.

3.2 Governance in business-as-usual activities

Resolving a financial institution — in particular a globally active one — involves a wide range of stakeholders in the United Kingdom and abroad, as well as across different parts of the Bank. Legislation and international agreements set out co-ordination and decision-making processes to facilitate resolution planning and execution, resulting in new duties for the Bank — both as a resolution authority and a supervisor (see **Figure 3.2**). The external and internal governance arrangements — including the effectiveness of structural separation within the Bank — were therefore a core focus of this evaluation.

As set out in Box 2, we received very positive feedback on the Bank's approach to its external governance and co-ordination responsibilities, including from key UK authorities and a core set of international counterparts. In particular, the UK authorities noted that relationships have improved since the crisis. The Bank's thought leadership on resolution issues was highlighted by international counterparts as key not only in the policy development phase of the work, but also in policy implementation.

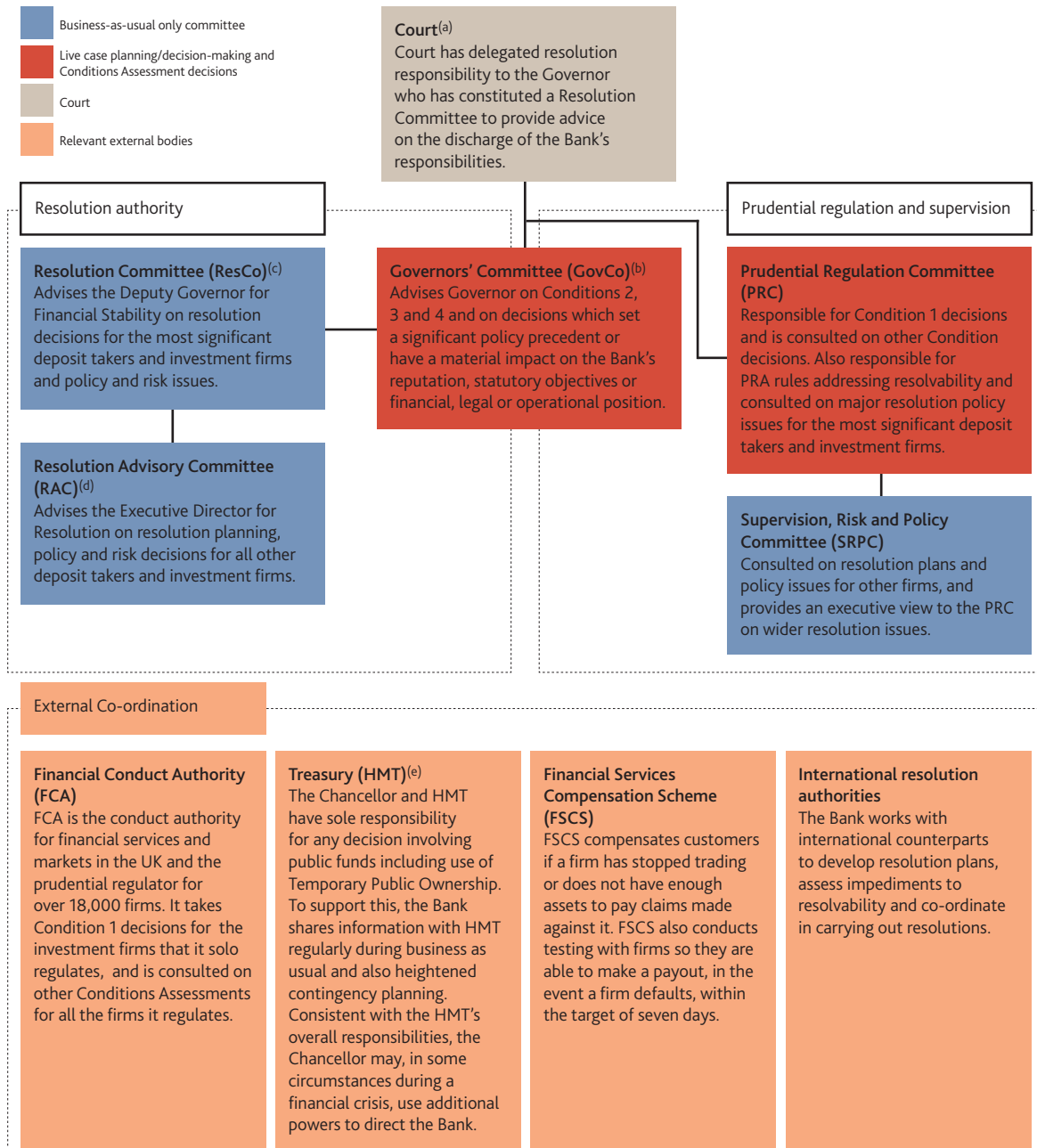
The picture internally, however, was more mixed.

We identified positive evidence on the implementation of structural separation for determining if the two conditions for resolution have been met, with clarity on the roles of the different parts of the Bank (see **Figure 3.2**). A number of stakeholders also noted this has improved over time.

(1) In addition, the PRA's Fundamental Rule 8 states 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.'

(2) This reflects the fact that the Bank expects to co-ordinate closely with the home authority in developing and implementing a resolution plan for these firms. See Prudential Regulation Authority (2018) for further detail.

Figure 3.2 Stylistic diagram of the roles and responsibilities of the committees of the Bank and of the external authorities in resolution issues



Conditions assessments	Decision taken by:	After consultation with:
Condition 1 — Is the PRA/FCA satisfied that the bank is failing or likely to fail?	PRA or FCA	Resolution authority (Bank) ^(f)
Condition 2 — Is the Bank of England satisfied that it is reasonably likely that action will be taken that will result in the bank no longer failing or being likely to fail?	Resolution authority (Bank)	HMT, PRA and FCA
Condition 3 — Does the Bank consider it is necessary to exercise a resolution power, having regard to the public interest in the advancement of one or more of the objectives of the resolution regime?	Resolution authority (Bank)	HMT, PRA and FCA ^(g)
Condition 4 — Does the Bank consider that the resolution objectives would not be met to the same extent by use of the bank insolvency?	Resolution authority (Bank)	HMT, PRA and FCA ^(g)

(a) Bank of England (2017d) describes the full matters reserved to Court.
 (b) GovCo deals with issues of policy, strategy, and management that are not reserved for Court or the Bank’s three statutory policy committees. Decision-making power lies with the Governor.
 (c) ResCo’s function is to provide advice on the discharge of the Bank’s responsibilities: decision-making authority rests with the Deputy Governor for Financial Stability (DGFS) unless explicitly reserved to the Governor. The committee’s membership includes three Deputy Governors and 10 Executive Directors.
 (d) In advising Executive Director Resolution, the aim of RAC is to support the Bank in achieving its Financial Stability Objective to protect and enhance the stability of the financial systems of the United Kingdom. The committee’s membership includes Executive Director Resolution, 10 Directors from across the Bank and four Head of Divisions.
 (e) See HM Treasury (2017b).
 (f) If the PRA views Condition 1 is not met, it does not have to consult with other authorities.
 (g) If the Bank views Conditions 3/4 are not met, it does not have to consult with other authorities.

With respect to business-as-usual aspects of internal governance, the decision-making structure for resolution issues was created to facilitate cross-Bank co-operation and understanding of the evolving policy framework, while ensuring structural separation (see Annex 2 for legal backdrop). While the set-up has successfully delivered the key policy initiatives, practical experience demonstrated that some of the procedural aspects were not working well. For example:

- Membership of the resolution committees is broad and higher in number than other similar Bank committees. Despite this, while meetings were quorate, many of the members did not attend often.
- Our interviews with committee members suggested that some were unclear of their role at these committees, and would deprioritise attendance when faced with competing priorities.
- Some members also perceived low levels of challenge from many of the members.

While we found no evidence suggesting inappropriate decision-making, the feedback clearly suggests there is scope to improve the current set-up.

We therefore recommend the Bank reviews the governance arrangements for business-as-usual resolution matters. In particular, given many of the major policy issues have already been determined, preferred resolution strategies for firms set, and a separate forum set up to steer the resolvability work discussed in Section 2, we question whether the Bank-wide resolution committees are still needed in their current form with the existing (wide and senior) membership.

We believe it is for the Bank executive to determine the most appropriate governance structure for resolution given the work ahead. There are a number of approaches that could be effective, and irrespective of the model chosen, the Bank should ensure that:

- requirements for structural separation are respected;
- the framework is fit for purpose for the tasks at hand;
- challenge is provided to facilitate accountability and decision-making; and
- adequate opportunities for relevant areas to feed in their views are provided.

The decision on the appropriate governance structure for resolution issues should not be made in isolation, but should take due consideration of the subsequent impact on opportunities for information sharing — discussed next.

3.3 Cross-Bank working

A resolution — and the preparatory work for it — will affect multiple areas of the Bank (see **Figure 3.3**). It is therefore important that the relevant parts of the organisation understand their role with respect to resolution. They should also have adequate opportunity to feed in views, helping to ensure for example that any potential conflicts are identified and addressed in advance.

Numerous stakeholders (internally and externally) praised the Bank's ability to come together in a crisis, including in cases of heightened contingency planning. However in business as usual, despite efforts to improve knowledge and information sharing on resolution issues, we identified a number of internal frictions. In particular, we noted evidence of tensions in the policy development process. For example, frustrations were expressed by a number of internal stakeholders on having insufficient opportunity to feed into the policy debate ahead of committee discussions/decisions. Many have noted that this has been improving, although our evaluation suggested that issues still remain.

There appear to be a number of possible reasons for these tensions, including:

- Circumstances where different objectives of affected parts of the Bank pull in conflicting directions (an expected consequence for resolution and supervisory authorities — irrespective of the institutional set-up). An example of this related to the development of the domestic policy on loss-absorbing capacity — where tensions existed with respect to the in-scope mid-sized firms and the impact on the PRA's secondary competition objective.

- The fast pace with which the resolution framework has been developing, in line with the international agenda to make progress with ending 'too big to fail'.
- The competing priorities faced by different areas of the Bank — such as responding to live issues as part of many areas' business-as-usual work.
- Inherent difficulties of embedding a relatively new regime (ie resolution) into the more established/long standing central banking and supervisory functions.

Figure 3.3 Areas of the Bank of England with a role in the UK resolution framework

Financial Stability

- **Resolution Directorate** is responsible for planning and executing the orderly resolution of firms and for developing and implementing the policies that allow the objectives of resolution to be met. It also engages directly with firms on implementation of resolvability policies and to develop resolution plans/assess resolvability (see Box 1).
- **Financial Market Infrastructure Directorate** is responsible for the supervision and setting policy for financial market infrastructure. This includes providing technical expertise to support the development and implementation of resolution policy for central counterparties, for which the Bank is the resolution authority, and technical input on other financial market infrastructure related resolution issues.

Prudential Regulation

- **Supervisory Directorates** work to ensure the safety and soundness of firms and to avoid disorderly failure which would have systemic consequences. Supervisors work with the Resolution Directorate to progress firms' resolvability.
- **Supervisory Risk Specialist Directorate** provides technical expertise to identify, analyse and mitigate risks to the safety and soundness of firms to avoid disorderly failure which would have systemic consequences. It supports supervisors and assists with the development and implementation of resolution policies, including through direct engagement with firms.
- **Prudential Policy** is responsible for developing, issuing and implementing prudential regulation for firms, including supporting the implementation of certain resolution policies.

Markets & Banking

- **Markets & Banking Directorates** are responsible for the management of the Bank's balance sheet. In resolution, where a firm's resources are temporarily insufficient, and access to private sector funding is disrupted, the Bank has put in place a flexible approach for the provision of liquidity in order to support the group resolution strategy.

Legal

- **Legal Directorate** is the Bank's in-house legal function. This includes providing legal advice to Resolution Directorate across its policy and resolution responsibilities.

Some of these tensions are unavoidable and, to a certain extent, healthy. But we have nevertheless identified scope to improve the effectiveness of internal co-operation. Specifically, we suggest:

- Introducing more systematic and formalised mechanisms to improve information sharing. These should include opportunities to address tensions at an early juncture in cases where objectives can potentially conflict, as well as greater opportunities for joint discussions at different levels. These mechanisms are likely to be particularly relevant before and after key decision points for issues that are of relevance to multiple parts of the Bank.
- Seeking out greater opportunities to lever off existing analysis and expertise available across the organisation (eg PRA Risk Specialists). This could involve greater joint work on issues that affect multiple parts of the Bank, while respecting the legal framework (ie structural separation requirements).
- Giving further consideration on how best to continue keeping the PRC and FPC informed as the implementation process progresses, given that orderly resolution contributes to both committees' respective responsibilities.⁽¹⁾ For example, for firms that pose the greatest system-wide risks, decisions on the

(1) We note that both committees have been briefed on the resolution framework (including through tailored 'teach-in' sessions).

forward-looking supervisory strategy and the key risks facing the firm are made by the PRC. As part of these discussions, we would expect the PRC to be routinely kept up to date on firms' progress towards resolvability and how far away these institutions are from being able to fail in an orderly manner. Given these firms' relevance to the FPC's objective of financial stability, the FPC (without going into firm-specific issues) would also need to have comfort over progress in the resolution regime.⁽¹⁾

(1) Indeed, in December 2015 the FPC noted the benefits arising from credible and effective resolution arrangements as one of the key factors in its judgement on the appropriate level of capital for the UK banking system. See Bank of England (2015).

4 Evaluation — preparing for a resolution

Sections 1 and 2 reflect on the Bank's progress in making firms resolvable to achieve orderly resolution. This section considers the Bank's own levels of preparedness to conduct a resolution — mindful that it may need to do so while barriers to resolvability have not been fully removed.

Overall, the Bank's ability and readiness to execute a resolution appears appropriate given domestic and international progress on the policy regime and the strategic choices the Bank has made on internal organisation, structures and priorities (Section 1). Notably there are defined processes to identify the risk of bank failure and trigger more intensive planning. Procedures are in place to guide staff through the steps needed to conduct a resolution. During contingencies there are means to quickly scale/skill up the Resolution Directorate with external advisers. And the Bank has conducted extensive testing (including with other authorities) as well as internal contingency planning. Insofar as we can compare, the steps the Bank has taken to ensure operational preparedness appear among the forefront of international practice.

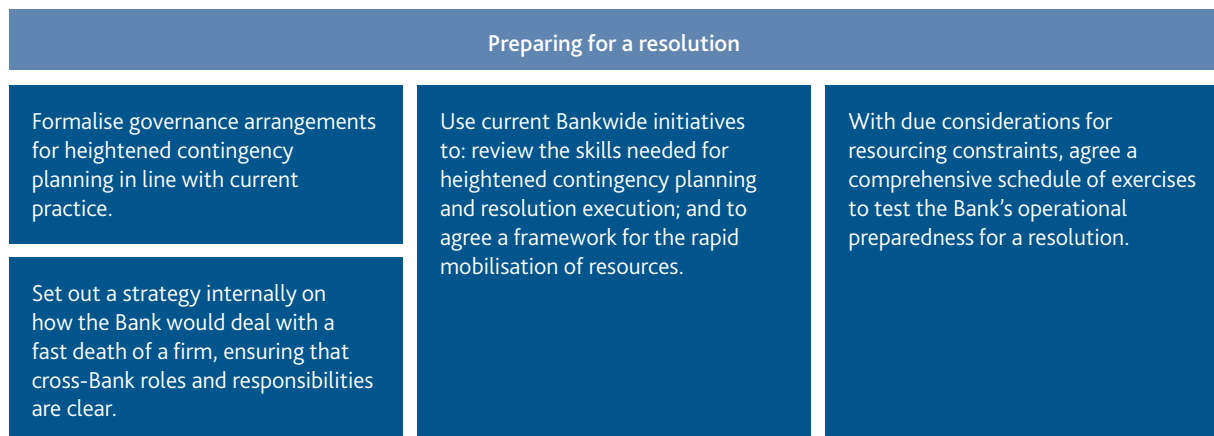
That means that although it has been sometime since the Bank has carried out a resolution of a PRA-regulated firm, the requisite expertise and know-how is available.⁽¹⁾

We believe, however, that there is further scope for the Bank to refine its approach. Some of our recommendations are designed to help improve near-term readiness to shocks in an environment where the desired framework is not yet fully in place. Others speak more to increasing resilience over the longer term, and in particular, consistent with the themes in Section 3, leveraging off the wider Bank to aid resolution planning.

The evidence in this section is mainly relevant to our second evaluation criterion: how effectively the approach is implemented. It also speaks to the fourth: the effectiveness of the governance framework in stress states of the world; and the fifth: the agility of the resourcing model.

We begin by considering the operational processes and governance arrangements in place to execute a resolution (Section 4.1); the resourcing arrangements in place in heightened contingency planning (Section 4.2); and then consider in more detail the steps the Bank has taken to embed the approach in its routine work (Section 4.3).

Figure 4.1 Recommendations — preparing for a resolution



(1) The Bank resolved Dunfermline Building Society in early 2009, where parts of the business were sold to Nationwide, some temporarily transferred into a bridge bank and subsequently auctioned off, and others placed into administration. The Bank Insolvency Procedure was used in 2011, when the Southsea Mortgage and Investment company failed.

4.1 Governance arrangements and processes to execute a resolution

Numerous decisions need to be taken in executing a resolution. And here the Bank has established distinct decision-making structures, which respect structural separation and statutory requirements (Section 1). Notably, as set out in **Figure 3.2** the assessment of conditions for resolution as well as use of stabilisation tools involves separate decision-makers. Those decisions are subject to formal co-ordination and consultation within the Bank/PRA as well as with the external authorities.

Feedback suggests that the process for co-ordination and consultation between the various authorities in times of contingency has bedded down well, with each familiar with their responsibilities. Internally we observe that in practice, the Bank's internal resolution committees (ResCo and RAC — see **Figure 3.2**) typically play only a minor role in supporting contingency planning and execution-type considerations. That may reflect the importance of the issues under consideration as well as the time critical nature of those decisions — requiring a more nimble forum than the internal resolution committees typically provide. In practice Bankwide contingency planning also typically considers wider central bank considerations — such as a decision to provide liquidity support and any request to HMT to seek an indemnity.

Beneath the internal governance, training and guidance materials exist to help guide staff through the resolution process. Those are supported by firm-specific resolution plans. As one might expect given the evolving status of resolution framework, many of these processes and accompanying documentation have not yet reached a settled state. For example:

- Individual resolution plans are based on the preferred resolution strategy, which for the systemically important firms, pending the delivery of the 2022 targets, are not yet fully operational.
- Some of the guidance represents work in progress, containing information to support business-as-usual planning (eg barrier removal), as well as contingency planning and execution issues. It can become easily out of date and time-consuming to update.
- Some expressed concern about the Bank's ability to progress a very 'fast death' scenario — for example if a firm failure was triggered by a cyber attack, or a misconduct event such as rogue trading, rather than a slower capital decline. This concern included, for example, whether the toolkit was appropriate or sufficient in such cases. And although work has been done in this area — including in contingency planning — we did not observe that to be embedded in the suite of practices and procedures.

As the resolvability agenda progresses, the Bank's ability to successfully implement a resolution according to the preferred strategy will continue to improve. Nevertheless at this juncture, we believe that the Bank could usefully take forward two specific actions both of which serve to help improve near-term readiness to shocks and help embed resolution planning into the wider Bank's DNA.

First, the Bank should update its governance arrangements in contingency/crisis planning. Consistent with the observed approach, that might formalise the primacy of GovCo⁽¹⁾ as a vehicle to help make decisions in a timely manner and oversee contingency planning. As part of operationalising this workstream we believe there is merit in setting out a more user-friendly guide for decision-makers governed by resolution strategy/chronology. That would be consistent with good practice from abroad. A 'layered' approach, demarcating high-level decision-making, and more detailed information for staff, could also usefully set out the roles of the rest of the Bank and how it is expected to contribute to the effort (bearing in mind accountability and legal obligations).

Second, we believe it would be helpful to document internally the strategy on how the Bank would deal with a 'fast death' and again specifically the expectations for different parts of the organisation in such an event. Here we are mindful that this may also require an assessment of whether the current toolkit is sufficient to meet policy-makers' needs.

(1) See **Figure 3.2**.

4.2 Resourcing in resolution

The Resolution Directorate leads on the implementation and execution of a resolution strategy. There are numerous tasks including:

- co-ordinating with the wider set of authorities (in both the run up to and execution phase) and providing policy advice to decision-makers; and
- detailed implementation tasks consistent with the resolution strategy, such as procuring an administrator/insolvency practitioner, drafting legal notices, overseeing valuation and developing the communications strategy.

Carrying out a resolution requires a mixture of technical know-how, firm level knowledge and expertise in navigating the wider Bank and UK authorities. As set out in Section 1 the Bank has chosen an operating model for its resolution function consisting of a small dedicated workforce for its wide range of resolution activities. That brings both benefits and challenges. The most notable challenge is access to sufficiently skilled staff during contingencies, which can be very resource intensive.

In order to address those challenges the Resolution Directorate has ensured that its staffing mix has expertise in transactional issues (Section 2). It has also put in place arrangements that allow it to appoint external advisers quickly and safely to provide advice on a range of technical issues associated with the resolution of individual firms.⁽¹⁾ Our evaluation nevertheless suggested that resources in Resolution Directorate are stretched — facing comparatively higher degrees of pressure than some other parts of the institution. And they tend to be put under further pressure during periods of contingency planning — making it harder for the Directorate to progress business-as-usual work.

Given budget constraints, we believe it is impractical for the Resolution Directorate to be resourced in peacetime to the level needed for a crisis. But in our view there is further scope to help alleviate pressure during pinch periods, and in particular by sourcing more internal support from the wider Bank for some resolution activities (for example, the briefing process).

The Bank has recently established new central functions to help prioritise and make difficult resourcing trade-offs explicit — particularly where the tasks at hand have a cross-Bank reach. It is also revitalising its skills register to help ensure it can keep track of where relevant expertise exists across the wider institution and to allow for better matching of short-term opportunities. In this context, we recommend that the Bank should consider how best it can mobilise resources across the institution during resolution type contingencies and that individuals with the appropriate skills are also rapidly made available for such events. That would need to ensure that all of the Bank's contingency planning tasks are adequately resourced — ie the Bank as resolution authority, supervisor and as a liquidity provider.

More generally, in a recent previous evaluation we observed the value of movement of key staff around the institution to strengthen collaboration and the exploitation of synergies, and to improve informal lines of communication/trust. That proved its worth especially during contingency planning.⁽²⁾ The development of effective reciprocal arrangements (such as structured secondments) between the Resolution Directorate and relevant touch points across the Bank could also prove a helpful longer-term strategy. That would need cross-Bank buy in and support from local management and be perceived to enhance career prospects.

4.3 Testing and learning lessons

The Bank has led — or been directly involved in — a substantive degree of resolution-related testing over our review period. Internally, that includes a Governors' Level Exercise, which walked through the decisions required in a resolution of a hypothetical domestic systemically important bank, as well as participation in other Bank testing regimes such as the provision of emergency liquidity. The Bank has also co-ordinated a table top exercise with the domestic authorities to replicate a hypothetical bank insolvency procedure. And internationally the

(1) For example: valuation analysis; restructuring and insolvency advice; administrator expertise and corporate financial advice (including the expertise needed to run a sales process).

(2) See Box 3 of Bank of England (2018).

United Kingdom has promoted and engaged in a series of exercises involving senior officials from a number of jurisdictions. Those have been designed to establish the co-ordinated decision-making processes necessary to execute a G-SIB resolution.

This testing has helped decision-makers understand their roles and the types of decisions they may face. It has exposed high-level gaps in the framework — particularly where a shared solution is needed. And it has aided co-operation between the authorities — by allowing participants to understand where key dependencies are.

As we have progressed the evaluation we have also observed that:

- There is a wide range of resolution issues that could potentially be tested/walked through ranging from high-level decision-making to more practical detail (such as testing through the effectiveness of individual resolution policies, as well as the logistical issues associated with the Bank needing to host an auction).
- Effective testing requires a substantial investment of time and resources and is at risk of being deprioritised — in particular, because of contingency planning. Such planning can also inform the goals of testing. That however, by definition, is not pre-determined or necessarily targeted at where the gaps in the framework might be.
- There is merit in structured follow up to testing exercises — reviewing how far gaps are being remediated and ensuring the internal documentation is updated appropriately.
- The Bank plays a role in helping other authorities meet their testing requirements with respect to resolution activities (eg the FSCS).

Looking ahead we see value in the Bank applying further structure and regularity to its testing schedule. From our perspective we suggest that a future set of exercises could usefully cover:

- High-level walkthroughs to familiarise decision-making processes, how resolution objectives are met, as well as expose gaps in the framework in its entirety. That should continue to make use, where possible, of synergies with existing Bank-wide testing.
- How cross-Bank resources would be mobilised to handle a large-scale resolution.
- More detailed internal simulations to help ensure that resolvability policies, once implemented, are fit for purpose (eg triggering MREL, valuations, etc).

In our view it is not essential — or wise — to commit to testing the framework in its entirety on a highly frequent (eg annual) basis. However, an agreed schedule of exercises might better expose the prioritisation calls the Bank may need to make when subject to shocks such as planning for live cases. And by setting expectations upfront it might also help the other authorities in their own planning efforts.

Annex 1 Background to the evaluation: remit, scope and methods

In February 2017, the Bank's Court of Directors agreed that the IEO would conduct an evaluation into the effectiveness of the resolution arrangements put in place by the Bank in pursuit of its statutory responsibilities. The review would consider how well the Bank is placed to ensure that a firm's failure can be dealt with in an orderly manner, as well as look at the continuing work to progress the resolvability of firms.

In terms of scope, this evaluation covered banks, building societies and major investment firms. These are the PRA-regulated firms in scope of the key EU Legislation on resolution — the Bank Recovery and Resolution Directive — which was established in 2014.

In line with the approach taken in previous reports, we developed a set of criteria based upon key research questions describing what 'good' should look like and against which the effectiveness of the Bank's approach could be judged. Specifically these were:

Evaluation criteria	Research question
Clearly articulated framework	Are the Bank's objectives and the approach to achieve these clearly articulated and understood – both internally and externally?
Effective implementation	Is the policy framework effectively implemented in practice?
Progress towards resolvability	Is the Bank providing adequate oversight to ensure that firms are taking the necessary steps to increase their resolvability?
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?
Agile resourcing model	Is the resource model sufficiently flexible and forward looking?

The evaluation was primarily conducted between September 2017 and February 2018. In line with the IEO principle of not commenting on live policy (to avoid inadvertently compromising the independence of policy formulation by the Bank), we used a cut-off date of December 2016 for the evaluation — marking the implementation of the final part of the UK statutory framework for resolution. Case studies for specific firms were reviewed for the period up to end-2015, to avoid any inference to live planning.

To inform our findings, the team received full and unrestricted access to internal documents, committee papers and relevant staff for interview. A survey was also completed by staff in the Resolution Directorate and selected individuals in other directorates with a role in resolution policy and/or execution. A full description of the IEO's methods is set out in the table below.

Input	Details
Desk-based review	Analysis of internal and external documents (eg the Bank's published approach to Resolution; the Resolution Directorate's internal policies and procedures; committee papers; Bank Management Information).
Interviews and survey	Approximately 115 interviews with Resolution Directorate staff and their key internal stakeholders, and 146 responses to an IEO survey. ^(a) Over 20 external interviews covering firms, industry practitioners, UK authorities/institutions (HMT, FCA and FSCS) and international counterparts.
Case studies	Some contingency planning cases (eg Greek and Cypriot banks) and lessons learnt from past failures (Dunfermline Building Society, Southsea Mortgage and Investment Company Ltd.).
Peer comparisons	Basic international comparisons, including conversations with staff from international resolution authorities.

(a) The IEO surveys received a combined response rate of 66%.

The evaluation further benefited from input and challenge from three external advisers who between them brought a combination of regulatory and practitioner perspectives.⁽¹⁾ Patrick Honohan (former Governor of the Central Bank of Ireland and a Senior Fellow at the Peterson Institute) acted as an 'embedded adviser' for the team, working alongside the IEO and providing challenge and support throughout the evaluation. Mr Honohan has reviewed and endorsed the findings and recommendations in this report. Two further advisers — Richard Heis (former Global Head of Restructuring at KPMG) and Jim Wigand (former Director of the Federal Deposit Insurance Corporation (FDIC) Office of Complex Financial Institutions) — worked at an arm's length from the project team, providing feedback and an external perspective as the work progressed.

The IEO team was also aided by a Bank-wide Senior Advisory Group which included internal senior representation from the Resolution Directorate, Legal Directorate and PRA as well as a PRA Senior Advisor and an external member of the Prudential Regulation Committee.⁽²⁾ The group met on a monthly basis and provided input and challenge throughout the project.

Consistent with previous IEO evaluations, the team's work was run at arm's length from the business areas and reported directly into the independent Chair of the Bank's Court of Directors. As such, recommendations and analysis contained in this report are the sole responsibility of the IEO.

(1) As with all IEO evaluations, external advisers were offered remuneration at the Bank's standard daily rate for senior external advisers.

(2) Full membership consisted of: Jon Cunliffe (Deputy Governor Financial Stability), Charles Randell (former external member of the Prudential Regulation Committee), Lyndon Nelson (Deputy CEO of the PRA & Executive Director, Regulatory Operations and Supervisory Risk Specialists), David Rule (Executive Director, Insurance Supervision), Sarah Breeden (Executive Director, International Banks Supervision), Andrew Gracie (Executive Director, Resolution), Michael D'Souza (PRA Senior Advisor), Rebecca Jackson (Director, Priorities and Resourcing), Mike Mitchell (Director, International Banks Supervision), David Bailey (Executive Director, Financial Market Infrastructure), Lauren Anderson (Head of Department, EU Withdrawal Unit), Geoff Davies (Head of Division, Resolution), Andrew Lodge (Head of Division, Resolution) and George Johnston (Acting Head of Legal, Financial Stability).

Annex 2 Legal provisions around structural separation⁽¹⁾

Bank of England 1998 Act — Section 30C

- (1) The Bank must make arrangements to ensure compliance with
 - (a) article 4.7 of the capital requirements directive, and
 - (b) article 3.3 of the recovery and resolution directive,
 (which require resolution functions and supervisory functions to be operationally independent of one another).
- (2) The Bank must prepare and issue a statement of its arrangements under subsection (1).
- (3) If there are material changes to the arrangements, it must prepare and issue a revised statement.
- (4) The Bank must consult the Treasury before issuing a statement under subsection (2) or a revised statement under subsection (3).
- (5) If it appears to the Treasury that any action proposed to be taken by the Bank would be incompatible with obligations of the United Kingdom under the provisions mentioned in subsection (1)(a) or (b), the Treasury may direct the Bank not to take that action.
- (6) If it appears to the Treasury that any action which the Bank has power to take is required for the purpose of implementing those obligations, the Treasury may direct the Bank to take that action.
- (7) In this section —

'the capital requirements directive' means Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms;

'the recovery and resolution directive' means Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms.

Bank Recovery and Resolution Directive (BRRD) — Article 3 (3): designation of authorities responsible for resolution

Resolution authorities may be national central banks, competent ministries or other public administrative authorities or authorities entrusted with public administrative powers. Member States may exceptionally provide for the resolution authority to be the competent authorities for supervision for the purposes of Regulation (EU) No 575/2013 and Directive 2013/36/EU. Adequate structural arrangements shall be in place to ensure operational independence and avoid conflicts of interest between the functions of supervision pursuant to Regulation (EU) No 575/2013 and Directive 2013/36/EU or the other functions of the relevant authority and the functions of resolution authorities pursuant to this Directive, without prejudice to the exchange of information and co-operation obligations as required by paragraph 4. In particular, Member States shall ensure that, within the competent authorities, national central banks, competent ministries or other authorities there is operational independence between the resolution function and the supervisory or other functions of the relevant authority.

(1) See Bank of England (2017c) for further detail on how the Bank meets the requirements of the legislation on structural separation.

The staff involved in carrying out the functions of the resolution authority pursuant to this Directive shall be structurally separated from, and subject to, separate reporting lines from the staff involved in carrying out the tasks pursuant to Regulation (EU) No 575/2013 and Directive 2013/36/EU or with regard to the other functions of the relevant authority.

For the purposes of this paragraph, the Member States or the resolution authority shall adopt and make public any necessary relevant internal rules including rules regarding professional secrecy and information exchanges between the different functional areas.

Directive 2013/36/EU of the European Parliament and of the Council (Capital Requirements Directive) — Article 4.7

Member States shall ensure that the functions of supervision pursuant to this Directive and to Regulation (EU) No 575/2013 and any other functions of the competent authorities are separate and independent from the functions relating to resolution. Member States shall inform the Commission and EBA thereof, indicating any division of duties.

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