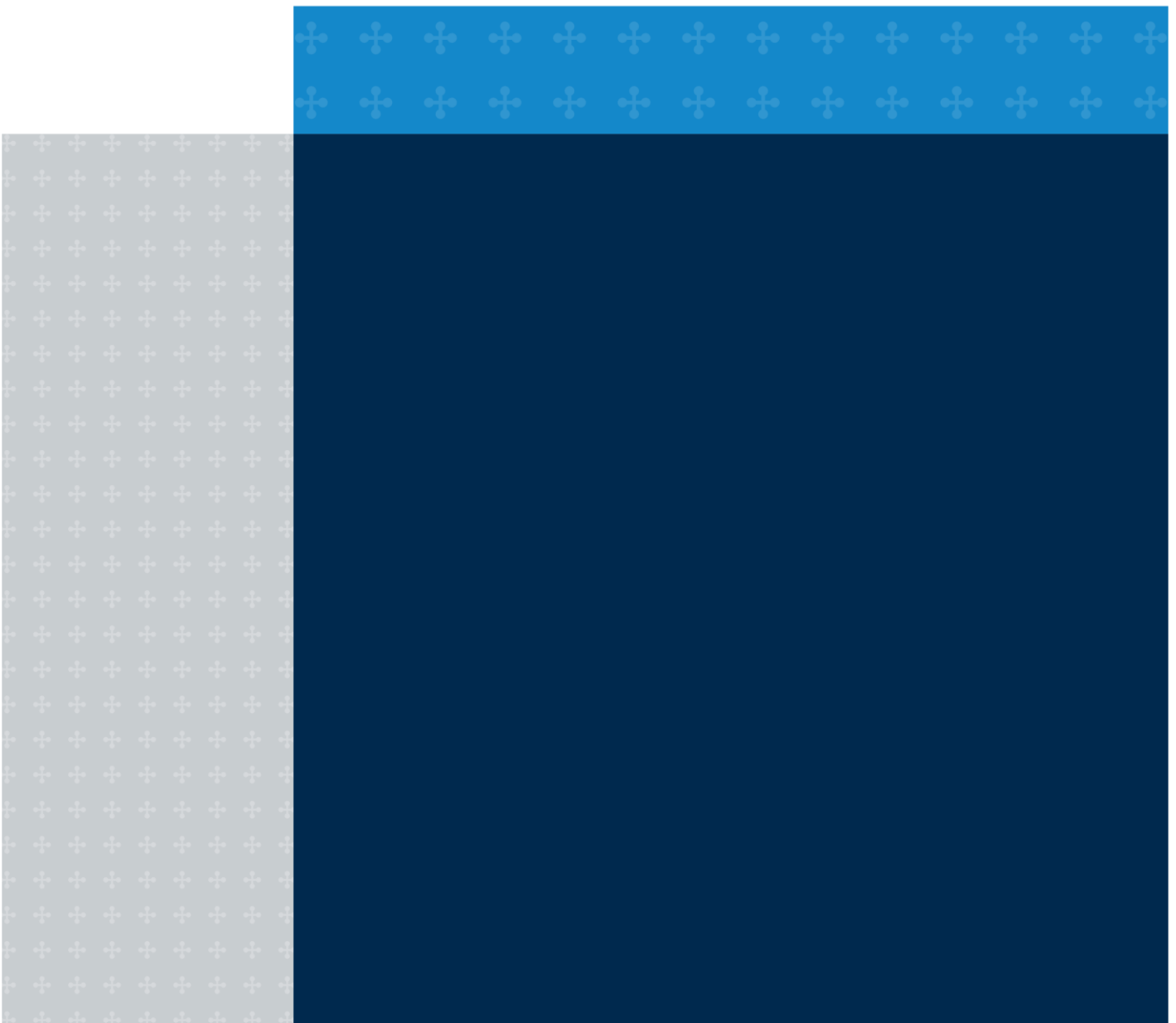




Policy Statement | PS25/20

# Simplified Obligations for recovery planning

December 2020





BANK OF ENGLAND  
PRUDENTIAL REGULATION  
AUTHORITY

Policy Statement | PS25/20

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## 1 Overview

1.1 This Prudential Regulation Authority (PRA) Policy Statement (PS) provides feedback to responses to the PRA's Consultation Paper (CP) 10/20 'Simplified Obligations for recovery planning'.<sup>2</sup> It also contains the PRA's final policy, in the form of the updated Supervisory Statement (SS) 9/17 'Recovery planning' (Appendix).

1.2 This PS is relevant to PRA-authorised UK banks, building societies, PRA-designated UK investment firms, and their qualifying parent undertakings (firms), to which the Recovery Plans Part of the PRA Rulebook applies. The policy is likely to be of particular interest to smaller and non-systemic firms that do not perform critical functions.

### Background

1.3 Under Article 4 of the Bank Recovery and Resolution Directive (BRRD),<sup>3</sup> the PRA has discretion to apply Simplified Obligations for recovery planning (Simplified Obligations) for firms where their failure is not expected to have a 'significant negative effect on financial markets, on other institutions, on funding conditions, or on the wider economy', taking account of the other criteria set out in Article 4(1). Simplified Obligations enable the PRA, as UK competent authority, and the Bank of England as the UK resolution authority, to decide on the level of detail required in firms' recovery and resolution planning.

1.4 The PRA proposed to introduce Simplified Obligations by:

- setting out how it would perform an eligibility assessment to determine which firms are eligible for Simplified Obligations (eligible firms);
- for eligible firms, reducing the minimum number of scenarios considered in recovery planning to two; and
- clarifying that eligible firms are not expected to submit the information template referred to in SS9/17.

### Summary of responses

1.5 The PRA received two responses to the CP. The responses were supportive of the proposal to introduce Simplified Obligations. One response suggested that the criteria for assessing eligibility for Simplified Obligations take into consideration firms that are subject to both solvent wind down planning (SWDP) and recovery and resolution plans. The other response suggested additional measures to further reduce recovery planning expectations for eligible firms, and requested additional clarification on some of the proposals in CP10/20. The PRA's feedback to these responses, and final policy decision, are set out in Chapter 2.

1.6 Respondents also noted that the PRA's proposals would not result in substantial cost savings. The PRA recognises that the cost savings arising from the proposals may be limited. In particular, the PRA noted in PS29/17 'Recovery planning'<sup>4</sup> that the burden of recovery planning should naturally reflect the size and complexity of the firm in question. The final policy is intended to improve clarity by specifying certain measures that firms may take.

<sup>2</sup> PRA Consultation Paper 10/20 'Simplified Obligations for Recovery Planning', July 2020:

<https://www.bankofengland.co.uk/prudential-regulation/publication/2020/simplified-obligations-recovery-planning>.

<sup>3</sup> Article 4 of BRRD was transposed into UK law by Article 7 of the Bank Recovery and Resolution (No. 2) Order 2014 No. 3348.

<sup>4</sup> December 2017: <https://www.bankofengland.co.uk/prudential-regulation/publication/2017/recovery-planning>.

## Changes to draft policy

1.7 The PRA has considered the responses and has made additional changes to the draft amended SS9/17. It has updated:

- paragraph 2.3, to make minor amendments to improve drafting and to reference the updated paragraph 2.55 below;
- paragraph 2.4, to add further detail explaining how the PRA's recovery planning expectations vary according to the size of firms;
- paragraph 2.54, to make minor amendments to improve drafting; and
- paragraph 2.55, to explain that eligible firms are permitted to include a minimum of only two scenarios in their recovery plans, and that the two scenarios a firm includes should be sufficiently severe to test the recovery plan and are the most relevant to the firms' business model. The PRA expects firms to include a combined capital and liquidity stress, as these scenarios are the most challenging.

1.8 The PRA considers that the changes to the SS are not significant and will not materially alter the cost benefit analysis presented in CP10/20. The changes have been made to provide clarity.

## Implementation

1.9 The changes outlined in this PS will take effect on publication of this PS on Monday 7 December 2020.

1.10 The policy set out in this PS has been designed in the context of the UK's withdrawal from the European Union and entry into the transition period, during which time the UK remains subject to European law. The PRA will keep the policy under review to assess whether any changes would be required due to changes in the UK regulatory framework at the end of the transition period, including those arising once any new arrangements with the European Union take effect.

1.11 The PRA has assessed that the policy would not need to be amended under the EU (Withdrawal) Act 2018 (EUWA). Please see PS5/19 'The Bank of England's amendments to financial services legislation under the European Union (Withdrawal) Act 2018'<sup>5</sup> for further details.

1.12 The final SS attached to this PS should be read in conjunction with SS1/19 'Non-binding PRA materials: The PRA's approach after the UK's withdrawal from the EU'.<sup>6</sup>

<sup>5</sup> April 2019: <https://www.bankofengland.co.uk/paper/2019/the-boes-amendments-to-financial-services-legislation-under-the-eu-withdrawal-act-2018>.

<sup>6</sup> February 2019: <https://www.bankofengland.co.uk/prudential-regulation/publication/2019/non-binding-pra-materials-the-pras-approach-after-the-uks-withdrawal-from-the-eu-ss>.

## 2 Feedback to responses

2.1 The PRA must consider representations that are made to it in accordance with its duty to consult on its general policies and practice, and must publish, in such manner as it considers fit, responses to the representations.

2.2 This chapter sets out the PRA's feedback to those responses, and its final decisions. The sections below have been structured in line with the sub-headings in Chapter 2 of the CP.

### Eligibility assessment process

2.3 The PRA proposed an eligibility assessment process to determine which firms would be eligible for Simplified Obligations, for both credit institutions<sup>7</sup> and investment firms. The PRA also proposed to use its discretion to determine that globally systemically important institutions (G-SIIs) and other systemically important institutions (O-SIIs) are not eligible for Simplified Obligations, and that it would therefore not carry out a quantitative assessment on these firms where the credit institution or investment firm has been identified as a G-SII or O-SII.<sup>8</sup>

2.4 For investment firms, the PRA did not propose a quantitative threshold, as there is only one PRA-designated UK investment firm that is not a G-SII or an O-SII. The PRA proposed that the decision for this firm would be taken in line with the qualitative assessment process for investment firms set out in Commission Delegated Regulation (EU) 2019/348, published with regard to regulatory technical standards (RTS).

2.5 For credit institutions, the assessment process to determine eligibility for Simplified Obligations comprises a quantitative and qualitative assessment.

### Quantitative thresholds

2.6 One respondent highlighted that it was not clear precisely where the PRA's proposed 60 basis point cut-off sits for credit institutions.

2.7 There is no precise cut-off available due to the number and nature of the metrics the PRA is required to calculate in order to determine the total quantitative score. The PRA is required to calculate a quantitative score based on regulatory reporting data, using the indicators listed in the RTS. This methodology relies on market-size information across the indicators listed in the RTS, and therefore any one metric will change from year to year. It is therefore not possible to provide a more precise quantitative threshold.

2.8 Until the PRA has performed the assessment, firms cannot be informed of whether they will be eligible for Simplified Obligations. Firms will be informed if they are eligible for Simplified Obligations following the PRA's assessment.

### Link with solvent wind down planning (SWDP)

2.9 One respondent queried the relationship between recovery planning and SWDP. The respondent requested that the PRA's eligibility assessment process specifically take into account firms that are subject to both SWDP and recovery and resolution plans (RRP), and noted that further simplifications to RRP would be welcome for firms that produce and maintain both a SWDP and RRP until such firms are no longer subject to SWDP.

<sup>7</sup> A credit institution is an undertaking the business of which is to take deposits or other repayable funds from the public and to grant credits for its own account.

<sup>8</sup> For credit institutions on the basis set out in Article 1(7), and for investment firms on the basis set out in Article 3(5) of the RTS.

2.10 Under Article 4 of the BRRD, the PRA can apply Simplified Obligations to firms when their failure is not expected to have a ‘significant negative effect on financial markets, on other institutions, on funding conditions, or on the wider economy’. The PRA expects that firms that do not provide critical functions would likely be eligible for Simplified Obligations. The PRA has decided that considering a firm’s status as a new and growing firm under the proposals in CP9/20 ‘Non-systemic UK banks: The Prudential Regulation Authority’s approach to new and growing banks’<sup>9</sup> is not required when deciding whether a firm is eligible for Simplified Obligations, as the key determinant is whether the firm performs a critical function.

2.11 The PRA is publishing the final policy as proposed, and considers it appropriate that firms that provide critical functions should be subject to full recovery planning obligations. This may be subject to further consideration as the PRA works on building its ‘strong and simple’ regime.<sup>10</sup>

2.12 SS9/17 states that the degree of detail and analysis in recovery plans should reflect the complexity and size of firms, and recognises that recovery options may be limited for small and simple firms. Firms in scope of SWDP should follow this principle of proportionality in relation to recovery planning. See the proportionality section below for more detail.

2.13 The PRA is considering responses to CP9/20 and will be finalising its policy in due course.

### **Recovery planning expectations for Simplified Obligations firms**

2.14 The PRA proposed to amend its recovery planning expectations so that eligible firms would be expected to include at least two scenarios in their plan. It also proposed that eligible firms would not be expected to submit the information template referred to in SS9/17.

### **Scenario testing**

2.15 One respondent requested further clarification regarding which of the three scenarios eligible firms would no longer be expected to include, and questioned whether the proposal to reduce the number of recovery scenarios would lead to cost savings for firms.

2.16 Recovery planning is designed so that firms are ready for periods of financial stress, can stabilise their financial position, and can recover from financial losses. The PRA considers that eligible firms should ensure that the tests they undertake are sufficiently severe and relevant to their business model, and eligible firms should therefore determine which scenarios they provide. The PRA expects firms to follow the European Banking Authority’s ‘Guidelines on the range of scenarios to be used in recovery plans’.<sup>11</sup> It also expects firms, including those eligible for Simplified Obligations, to include a combined capital and liquidity stress, as these scenarios are the most challenging. SS9/17 has been updated to reflect the PRA’s expectations for eligible firms regarding the minimum number of scenarios that eligible firms are expected to include in their plan.

2.17 The PRA recognises that the cost savings arising from the proposals may be limited. CP10/20 highlighted that some smaller firms have difficulties in designing more than two scenarios that are plausible and severe enough to test their recovery plan, and the PRA considers that the benefit of a third scenario would not justify the additional burden on eligible firms. This ensures the policy is proportionate and meets the purpose for which it is intended.

<sup>9</sup> June 2020: <https://www.bankofengland.co.uk/prudential-regulation/publication/2020/new-and-growing-banks>.

<sup>10</sup> Strong and simple - speech by Sam Woods: <https://www.bankofengland.co.uk/speech/2020/sam-woods-city-banquet>.

<sup>11</sup> Available at [www.eba.europa.eu/documents/10180/760136/EBA-GL-2014-06+Guidelines+on+Recovery+Plan+Scenarios.pdf](http://www.eba.europa.eu/documents/10180/760136/EBA-GL-2014-06+Guidelines+on+Recovery+Plan+Scenarios.pdf).

### Template submission

2.18 One respondent commented that the PRA's proposed clarification that eligible firms would not be expected to submit a template would have no benefit, as most smaller firms do not currently submit this.

2.19 The PRA recognises that the cost savings arising from the proposals may be limited. The final policy removes ambiguity by clarifying the PRA's expectations in relation to template submission for firms with shorter and less complex recovery plans.

### Proportionality

2.20 One respondent requested further clarity on the statement in the draft amended SS9/17 that 'for all firms, the degree of detail and analysis should reflect the complexity and size of the firms'. They questioned whether this means that eligible firms will need to provide a less complex, model-driven recovery plan, and requested that the PRA host events to clarify these changes.

2.21 The PRA expects that smaller firms have fewer legal entities, less recovery indicators, a more limited range of recovery options, and simpler governance arrangements, and are therefore able to justify submitting shorter recovery plans than large complex firms.

2.22 The PRA has updated paragraph 2.4 of SS9/17 to add further clarity to how the PRA's recovery planning expectations vary according to the size of firms. Occasionally, the PRA provides guidance or workshops for firms on particular policies, and the PRA will consider whether it would be beneficial to provide further detail on proportionate recovery planning.

### Frequency of recovery planning

2.23 One respondent requested that the PRA further reduce recovery planning requirements by explicitly permitting eligible firms to carry out their recovery planning every two years, unless there are changes in key prudential metrics or recovery options.

2.24 The PRA does not agree that smaller firms only need to update their recovery plans every two years. Under the Recovery Plans Part of the PRA Rulebook, firms are required to keep their recovery plans up to date. This ensures that recovery plans will be based on current information and executable as required. Firms are responsible for their own recovery plans, and should ensure that their recovery plans remain relevant, credible, and executable in a severe stress. If circumstances change in a manner that merits updating the recovery plan, then the plan should be updated, and firms should not wait for a two year cycle. The PRA does not intend to change this requirement for eligible firms.

2.25 The PRA notes in SS9/17: 'For small firms with very simple business models, whose key prudential metrics have not changed materially year on year, the firm's governing body may decide at its annual review that the information, plans and triggers from the previous year continue to be appropriate'. The PRA encourages firms to bear in mind this option when appropriate.



## Appendices

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- 1 SS9/17 'Recovery planning', available at: <https://www.bankofengland.co.uk/prudential-regulation/publication/2017/recovery-planning-ss>.
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