BANK OF ENGLAND

Resolution

Statement of Policy

The Bank of England’s Statement of Policy on valuation capabilities to support resolvability

May 2021

(Updating June 2018)

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Bank of England | Threadneedle Street | London EC2R 8AH

Contents

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1 Background and statutory framework

1.1 This Statement of Policy is issued by the Bank of England (the Bank), as UK resolution authority, in accordance with section 3B(9) of the Banking Act 2009 as amended (the Banking Act). The Statement of Policy sets out how the Bank expects to use its power under section 3A(2) of the Banking Act to direct a 'relevant person' to take measure to address impediments to resolvability, specifically in relation to their capabilities to support timely and robust resolution valuations.

1.2 A 'relevant person' means:

(a) an institution[1] authorised for the purpose of the Financial Services and Markets Act 2000 (FSMA) by the Prudential Regulation Authority (PRA) or Financial Conduct Authority (FCA);[2]

(b) a parent of such an institution which (i) is a financial holding company or a mixed financial holding company; and (ii) is established in, or formed under the law of any part of, the United Kingdom; or

(c) a subsidiary of such an institution or of such a parent which (i) is a financial institution[3] authorised by the PRA or FCA; and (ii) is established in, or formed under the law of any part of, the United Kingdom.

1.3 The intended process around using this direction power is set out in the Bank's Statement of Policy on its power to direct institutions to address impediments to resolvability.[4] In short, this process involves the Bank:

(a) **Determining**, following a resolvability assessment, whether specific aspects of an institution's business constitute a substantive impediment to resolvability;

(b) Where a substantive impediment is identified, **notifying** the institution of the impediment and giving the institution four months to submit proposals for remediating measures; and

(c) If the Bank remained dissatisfied with the measures proposed by the institution, **directing** the institution to take specific action to remediate the impediment within a specified time period.

1.4 This Statement of Policy sets out principles that certain institutions are expected to meet in order to avoid a determination that insufficient valuation capabilities constitute an impediment to resolvability. Non-compliance with these principles may constitute a barrier to resolvability and may result in the Bank directing firms to improve their valuation capabilities to ensure resolvability.

2 Policy scope

2.1 This Statement of Policy applies to all institutions where the Bank expects to require resolution-specific valuations as a home or host resolution authority. This includes:

(a) **'MREL firms'**: institutions notified by the Bank that their preferred resolution strategy involves the use of statutory stabilisation powers in the UK, as determined in accordance with the factors set out in the Bank's Statement of Policy on its approach to setting minimum requirements for

(1) For the purposes of this Statement of Policy the term 'institution' means UK-incorporated banks, UK-incorporated building societies and those UK-incorporated investment firms that are required to hold initial capital of €730,000, in particular those that deal as principal. References to 'institution' shall be taken to also include 'relevant persons'.

(2) The PRA and FCA are the UK competent authorities. According to article 2 of the Bank Recovery and Resolution Directive and article 4 of the Capital Requirements Regulation (EU No. 575/2013), 'competent authority' means a public authority or body officially recognised by national law, which is empowered by national law to supervise institutions as part of the supervisory system in operation in the Member State concerned.

(3) The term 'financial institution' has the meaning given by article 4 (1) (26) of Regulation 575/2013/EU.

(4) The Bank of England's power to direct institutions to address impediments to resolvability, December 2015: www.bankofengland.co.uk/financialstability/Documents/resolution/barriersresolvabilitydec15.pdf

own funds and eligble liabilities (MREL Statement of Policy)[5]; or

(b) **'Internal MREL firms'**: institutions notified by the Bank that they are a 'material subsidiary' of an overseas-based banking group for the purposes of setting internal MREL in the UK, as determined in accordance with the criteria set out in the Bank's MREL Statement of Policy.

2.2 For the purposes of this Statement of Policy, references to 'firms' should only be taken to include those institutions that meet the criteria set out in paragraphs 2.1 (a) and (b). This Statement of Policy does not apply to any other institution, including those whose preferred resolution strategy in the UK is designated as modified insolvency, as well as non-material subsidiaries and branches of institutions incorporated outside the UK.

Application to MREL firms

2.3 MREL firms should have capabilities to support the valuations required under section 6E of the Banking Act and the associated regulatory technical standards (RTS) prepared by the European Banking Authority (EBA) and adopted by the European Commission.[6]

2.4 For MREL firms, this Statement of Policy applies to valuation capabilities in respect of a firm's assets and liabilities, as well as their equity. It also applies to capabilities to produce business forecasts and to support an estimate of outcomes in an insolvency counterfactual to assess risks under the no-creditor-worse-off (NCWO safeguard). MREL firms should also ensure that valuation capabilities are in place in respect of their significant subsidiaries as set out in paragraph 2.7 below.

Application to Internal MREL firms

2.5 Internal MREL firms should have capabilities to support group-wide valuations led by the home resolution authority of the relevant resolution entity in order to estimate the extent of losses and recapitalisation required. These capabilities may deliver valuations on a basis other than that specified in the EBA RTS, for example on a basis consistent with delivering the technical specifications of valuations required in the home jurisdiction.

2.6 For Internal MREL firms, this Statement of Policy applies to valuation capabilities in respect of a firm's assets and liabilities, as well as capabilities to produce business forecasts. Internal MREL firms should also ensure that valuation capabilities are in place in respect of their significant subsidiaries as set out in paragraph 2.7 below.

Application to subsidiaries of MREL and Internal MREL firms

2.7 Firms should ensure that capabilities compliant with this Statement of Policy are also in place for the assets and liabilities of their significant subsidiaries. A subsidiary would be considered significant to resolution valuations where timely and robust valuations of the subsidiary (or group of related subsidiaries) would be needed to adequately assess a firm's losses, recapitalisation needs, or post-resolution equity value. This may include subsidiaries incorporated outside of the UK and subsidiaries indirectly owned by the firm. At a minimum, a firm's significant subsidiaries include all subsidiaries that meet the criteria for 'material subsidiaries' set out in the Bank's MREL Statement of Policy. Firms should consider what other subsidiaries would be significant for this purpose.

3 Policy objectives

3.1 The overarching objective of this policy is to ensure that a valuer[7] could carry out the necessary resolution valuations on a sufficiently timely and robust basis not to impede the effectiveness of resolution. To achieve this overarching objective, a firm's valuation capabilities should, in the opinion of the Bank, meet the following objectives for timeliness and robustness.

3.2 The **timeliness objective** is that

(5) 'Statement of Policy on the Bank of England's approach to setting a minimum requirement for own funds and eligible liabilities (MREL)', June 2018: www.bankofengland.co.uk/-/media/boe/files/paper/2018/statement-of-policy-boes-approach-to-setting-mrel-2018.

(6) Commission Delegated Regulation (EU) 2018/345.

(7) For the purposes of this Statement of Policy the term 'valuer' should be taken to mean the person that is responsible for producing resolution valuations under the applicable resolution regime. For MREL firms, this should be interpreted as an independent valuer appointed under section 6E(2) of the Banking Act (noting that in some cases the Bank may consider it appropriate to carry out a provisional valuation itself).

(a) Subject to paragraph 3.2(c), valuations needed to inform decisions around the initial application of resolution tools could be carried out within two months[(8)] in the lead-up to resolution (assuming that this amount of time was in fact available). This includes those valuations needed to inform, where relevant,[(9)] the Bank's decisions around:

(i) whether the statutory conditions for using stabilisation powers or mandatory reduction powers in the UK have been met;

(ii) which stabilisation powers should be used;

(iii) the extent of application of stabilisation powers;[(10)] and

(iv) the write-down or conversion of internal MREL held by material subsidiaries and the adequacy of the resulting recapitalisation.

(b) For MREL firms whose preferred resolution strategy[(11)] is bail-in, valuations should support exit from resolution within three to six months of entry into resolution. This includes valuations to inform and describe the firm's restructuring plan,[(12)] and valuations to inform the final allocation of equity (or other compensation) to bailed-in creditors.

(c) Where the nature of a firm's business is such that the firm was particularly exposed to rapid changes to solvency or liquidity, valuations should be possible in quicker timeframes to the extent the Bank considered this necessary and proportionate. For example, this could include where a firm is primarily engaged in trading activities.

(8) This timeframe refers to the end-to-end valuation process, which would involve a number of interdependent steps. These steps could include collecting data and information, making data available to a valuer, reviewing data and models, calibrating models, running models, reviewing model outputs, applying overlays and adjustments, and presenting the analysis in a final valuation report.

(9) Specifically, points (ii) and (iii) are not relevant to Internal MREL firms, and point (iv) is not relevant to MREL firms that do not have material subsidiaries for internal MREL purposes.

(10) This includes: (i) the extent of any cancellation, dilution, transfer, write-down or conversion of shares, capital instruments or eligible liabilities; (ii) what assets, liabilities, or securities are to be transferred under a transfer tool; and (iii) the value of any consideration to be paid for assets, liabilities, or securities so transferred.

(11) As determined by the Bank and communicated to the firm on an individual basis

(12) This includes a business reorganisation plan required under S48H of the Banking Act to be drawn up following entry into resolution. In practice, some consideration of restructuring options is likely to take place prior to entry into resolution as well.

3.3 The **robustness objective** is that the valuations available within these timeframes support decisions by the Bank that achieve the Bank's resolution objectives in the given circumstances. This includes ensuring that the decisions taken would not have been meaningfully different[(13)] had more time been available to carry out the necessary resolution valuations. As such, the degree of robustness required will depend on the resolution tool(s) being considered, and on the nature of decisions that need to be made at a given stage in the resolution process.

3.4 These objectives together represent the degree of ex-ante preparedness the Bank is targeting for resolution valuations. The Bank expects firms to have valuation capabilities that meet both the timeliness and robustness objectives as stated above. However, the Bank recognises that robustness may be affected if less time is available to carry out valuations than contemplated under the timeliness objective.

4 Policy principles

Principle 1: Data and information

4.1 **Firms should ensure that their underlying data and information is complete and accurate, and that relevant data and information would be readily available to a valuer.**

4.2 Firms should hold all relevant data and information that would reasonably be considered necessary to enable timely and robust resolution valuations. This could include (but is not limited to) the data and information needed to:

(a) Produce robust valuations of a firm's **loan portfolios**. This includes detailed loan-by-loan data , as well as supporting information to inform material valuation assumptions. Supporting information could include, but is not limited to, historical payment data, information on collateral, forebearance information, as well as additional information needed to assess the value of more complex exposures (such as loan documentation, previous credit reviews,

(13) In this context, the meaningfulness of a difference in decision relates to whether or not it impacts the achievement of one or more of the Bank's statutory resolution objectives.

information on the borrower's financial condition, and information on the structure of lending and collateral for a group of related borrowers).

(b) Produce robust valuations of a firm's **trading positions**, including those in place for hedging and liquidity management. This includes information on investment securities, repo transactions, and derivatives, as well as the collateral, netting, and set-off arrangements applicable to these exposures.

(c) Assess the value of **other assets and liabilities**. This includes non-financial assets and liabilities, contingent assets and liabilities (such as material guarantees and litigation proceedings), and other off-balance-sheet exposures.

(d) Understand the **financial structure** of the firm's group.[14] For all entities within the group this includes unconsolidated balance sheets, as well as legal and financial information on creditor hierarchies, asset encumbrance, and intragroup exposures (including assets, liabilities, and guarantees). This also includes legal and financial information on the structure of special purpose vehicles (SPVs).

(e) Produce detailed **business forecasts**. This includes previous forecasts of the firm's financial statements, management information supporting the firm's strategic plan (such as management budgets and forecasts), and further information to forecast costs that may arise as a result of resolution or restructuring (such as information on leases, service contracts, and staff costs).

4.3 Firms should have arrangements in place to ensure the data and information they hold is complete, accurate, and reliable. This should include (but is not limited to) integrity checking, consistency checking, and access control. Data should be subject to regular verification, including reconciliation and testing, to ensure accuracy and completeness.

4.4 Data and information should be sufficiently up to date, taking into account the speed at which underlying positions could change in the lead up to resolution.

4.5 Data and information should be in a format that is readily understandable by a valuer. Data and information should also be cross-referenced and reconciled in order to enable a valuer to understand the relationship between various sources of information. This should include clear linkages between the various exposures to a counterparty, the collateral available against these exposures, and any applicable netting or set-off arrangements.

4.6 Firms should have capabilities in place to ensure that all relevant data and information could rapidly and reliably be made available to a valuer for the purpose of carrying out resolution valuations. Firms may meet this principle through having robust and tested processes in place to ensure they could rapidly collate, and provide secure access to, relevant data and information as and when it was required for resolution. In line with Principle 6, firms should clearly document such processes, including the relevant data sources, procedures, and responsible personnel.

4.7 There may be cases where the Bank does not consider a firm's processes sufficient to ensure that relevant data and information would be readily available to a valuer. In these cases, the firm may be expected to maintain this data and information in a virtual data room[15] that is established and regularly refreshed in business-as-usual. In other cases, where the Bank considers that a firm's processes are sufficient, a firm would not be required to maintain a virtual data room in business-as-usual in order to comply with this Statement of Policy.

Principle 2: Models

4.8 As necessary to meet the timeliness and robustness objectives, firms should have models available to be tested and used by a valuer on a timely basis in carrying out the valuation analysis needed for resolution.

4.9 Valuation models[16] should be available in business-as-usual for all material classes of assets and

(14) In this context, 'group' should be taken to include the firm and subsidiaries that are directly or indirectly owned by the firm. It does not include the parent entities of the firm or subsidiaries thereof in which the firm does not have an ownership stake.

(15) A virtual data room is a secure online repository of information typically used to facilitate due diligence during a transaction.

(16) For the purposes of this Statement of Policy the term 'valuation models' should be taken to include any models and tools that could

liabilities where it is not reasonable to expect that a suitably robust valuation model could be developed and deployed on a timely basis in the lead up to resolution, taking into account the overall complexity of the valuation task. An asset or liability class would be considered material for this purpose where its misvaluation could plausibly impact the robustness of resolution valuations of the firm, taking in to account the associated level of valuation uncertainty, and its significance to the firm's balance sheet and business model.

4.10 Firms should identify those assets and liabilities for which valuation models would be required to comply with this principle. Where a firm does not consider that a valuation model for an asset or liability would needed in business-as-usual, the firm should be able to articulate why this would not compromise the timeliness and robustness of resolution valuations of the firm. Firms should document, and review over time, how the scope of their valuation models is compliant with this principle.

4.11 In a limited range of cases, a firm may identify that they would not need to have any valuation models in place ex-ante in order to comply with this Statement of Policy. In these cases, the Bank would need to be satisfied that the timeliness and robustness objectives would still be met on the basis that:

(a) Valuation models could be built, reviewed, and applied by a valuer as needed well within the timeframes required, taking into account the firm's size, corporate structure, product range, trading activities, and heterogeneity of exposures; and

(b) The firm has robust and tested capabilities in place to provide sufficiently rapid access to complete and accurate data and information to enable a valuer to produce timely and robust valuations of the firm.

4.12 All firms should also have forecasting capabilities[17] (such as models, tools, and processes) available in business-as-usual to produce updated forecasts of their financial statements and key regulatory metrics on a timely basis. At a minimum, forecasting capabilities should be in place for the purpose of assessing recapitalisation needs in resolution. For MREL firms whose preferred resolution strategy[18] is bail-in, forecasting capabilities should also support the development of the firm's restructuring plan and the valuation of the firm's equity post resolution. Firms should also have capabilities to produce forecast income and cash-flow statements for the purpose of assessing the market value of equity in any business lines that may reasonably be divested as part of resolution or post-resolution restructuring. In general, a firm's forecasting capabilities should enable forecasts to take into account potential resolution and restructuring actions and the opinions of a valuer on a timely basis.

4.13 Firms should also consider what further modelling capabilities they should have available in business-as-usual to meet the timeliness and robustness objectives, taking into account the valuation analysis that may be needed in the event of their resolution. This could include models to estimate outcomes under an insolvency counterfactual.

4.14 Firms should ensure that a valuer would have the necessary access to the relevant models, and to the staff responsible for operating these models, such that model outputs could be used by the valuer in producing timely and robust valuations of the firm as a whole.

4.15 Models should be sufficiently flexible to enable a valuer to evaluate the impact of alternative resolution strategies, and to reflect the facts and circumstances of the situation at hand.

Principle 3: Valuation methodologies

4.16 **Valuation models should use methodologies that are consistent with the methodologies a valuer could reasonably be expected to apply in producing valuations that meet the robustness objective.**

be used in carrying out resolution valuations. This may include those that are not specifically designed for valuation purposes.

(17) For the purposes of this Statement of Policy the term 'forecasting capabilities' should be taken to include the models, tools, and processes which collectively support an analysis of future financial position, profitability, cash flows, or regulatory ratios.

(18) As determined by the Bank and communicated to the firm on an individual basis

4.17 Valuation models should use methodologies that:

(a) Produce valuations of assets, liabilities, instruments, or business units that enable a robust assessment of value given their nature and intended treatment in resolution;

(b) Produce valuations at a level of granularity that ensures the valuations meet the robustness objective; and

(c) Produce valuations that comply with applicable requirements for valuations, including under the resolution regime of the firm's home jurisdiction, where relevant.

4.18 Valuation models should use consistent methodologies across jurisdictions and subsidiaries wherever this is reasonable and practical.

Principle 4: Valuation assumptions

4.19 **Firms should have processes that support the use of realistic valuation assumptions, and should enable a valuer to review and revise, and demonstrate sensitivity to these assumptions if necessary.**

4.20 Firms should have processes in place for ensuring that the assumptions used in valuation models are realistic and up-to-date. This includes protocols for periodic and ad-hoc reviews, as well as clear escalation procedures and sign-off responsibilities for material assumptions. Where relevant, firms should seek to apply consistent underlying assumptions across their valuation models.

4.21 Firms should ensure that it would be possible to rapidly update and revise the key input assumptions of their valuation models. This includes all input assumptions that would reasonably need to be updated or revised to ensure valuations meet the robustness objective. Consistent with Principle 1, firms should have readily available data and information to inform the review of these input assumptions.

4.22 Firms should facilitate a valuer's access to relevant experts in order to review the firm's assumptions. Such parties could include, but are not limited to, management, counterparties, stakeholders, trustees, and local experts. The valuer should be able to consult with these experts without undue delay.

4.23 Firms should ensure that it would be possible to demonstrate, on a timely basis, the sensitivity of valuation outcomes to alternative assumptions in order to evaluate the extent of valuation uncertainty. Firms should evaluate the nature and extent of valuation uncertainty as part of model validation in business-as-usual.

Principle 5: Governance

4.24 **Firms should apply sound governance arrangements and processes to ensure that valuation capabilities compliant with these principles are maintained in business-as-usual and available prior to and during resolution.**

4.25 Firms should have clear and documented arrangements in place to ensure that valuation capabilities are compliant with the principles set out in this policy. This includes clear protocols around the design, maintenance, and operation of capabilities, including oversight arrangements and internal review processes. To the extent possible, these governance arrangements should be incorporated into existing governance arrangements for other aspects of firms' data and modelling capabilities. Resolution valuation capabilities should be treated as consistently as possible as business-as-usual valuation capabilities, having regard to the contingent nature of their use.

4.26 Firms should identify a suitably senior individual or committee to be responsible for compliance with these principles. This individual or committee should ensure that testing and review arrangements are in place in line with Principle 7 below, and that steps are taken to remedy any shortcomings in the firm's capabilities. This individual or committee should also ensure that the firm has documentation in place in line with Principle 6.

4.27 Firms should identify a suitably senior individual to be responsible for overseeing the firm's engagement with a valuer appointed for the purpose of carrying out resolution valuations. Firms should consider what governance arrangements would be needed to support this individual.

4.28 Firms should ensure that governance of valuation capabilities would remain intact throughout resolution.

Principle 6: Documentation

4.29 **Firms should clearly and concisely document their valuation capabilities and how these could be relied upon to produce timely and robust resolution valuations.**

4.30 Firms should produce operational documentation of how the firm would support a valuer in producing resolution valuations that meet the timeliness and robustness objectives set out above. Matters this documentation should explain include (but are not limited to):

(a) Timeframes and sequencing of the various aspects of the valuation process;

(b) Sources of the underlying data and information needed for resolution valuations;

(c) Procedures for collating this data and information and making it available to a valuer (alongside any additional documentation as requested);

(d) Models earmarked for use in valuing specific assets and liabilities, and in producing business forecasts for resolution valuation purposes;

(e) The key input assumptions for these models and the sources of data and information that would be used to inform these key assumptions;

(f) The relevant personnel a valuer would need access to for the purpose of assessing key assumptions; and

(g) Roles and responsibilities in the valuation process, including those for collating data, operating models, discussing assumptions and for being the primary point of contact for the valuer.

4.31 Firms should maintain supporting documentation as necessary to demonstrate that their capabilities could be relied upon for resolution valuation purposes. This should include, but is not limited to, the documentation of:

(a) Processes and responsibilities for verifying data and remediating data errors;

(b) Processes and responsibilities for the development, maintenance, and operations of relevant valuation models;

(c) The methodologies used in relevant valuation models;

(d) The key underlying assumptions used by the firm and the basis for these assumptions; and

(e) Escalation procedures and sign-off responsibilities for internal policies, model design, and key assumptions relevant to resolution valuation models; and

(f) Assurance measures that have been undertaken by the firm in line with Principle 7.

4.32 These documents should be readily available to the Bank for the purposes of assessing valuation capabilities. They should also be readily available to a valuer for the purposes of assessing the reliability of a firm's data, models, and assumptions when preparing to carry out resolution valuations. To assist these assessments, a firm's documentation should identify and explain any known limitations to their valuation capabilities.

4.33 These documents should be written in a clear and concise manner to enable the Bank or a valuer to familiarise themselves with a firm's valuation capabilities within a short timeframe.

Principle 7: Assurance

4.34 **Firms should periodically review and evaluate their valuation capabilities with regard to these principles, and should facilitate reviews undertaken by the Bank or a third party to test compliance.**

4.35 Valuation capabilities should be subject to review and testing to verify compliance with these principles and to support resolvability. Firms should incorporate review and testing of their valuation capabilities into the regular review and testing processes in place for other data and modelling capabilities. This may include review by internal experts independent of the individual responsible for the capability being reviewed. Firms should also consider having their capabilities reviewed by their internal audit functions or by experts who are independent from the firm.

4.36 Firms should facilitate tests and independent reviews initiated by the Bank to assess compliance with these principles as part of its ongoing assessments of resolvability or contingency planning for resolution.

4.37 Firms should provide information as requested by the Bank to support its resolvability assessments and ongoing resolution planning. This could include, but is not limited to:

(a) The firm's assessment of its compliance with the principles set out in this policy;

(b) A description of the testing and assurance procedures performed to support this assessment;

(c) An overview and status update on projects (both planned or in progress) that will improve or amend the firm's resolution valuation capabilities.

4.38 Firms should be up-front and open with the Bank and any independent reviewers about any limitations to their valuation capabilities that may compromise the feasibility of timely and robust resolution valuations.

4.39 Where deficiencies in capabilities are identified, firms should take the necessary steps to ensure that they are compliant with this policy, such that valuation capabilities are not an impediment to resolvability.

5 Timeframe for compliance

5.1 Firms should be compliant with this Statement of Policy by 1 April 2021.

5.2 The Bank may on a firm-specific basis set an earlier compliance date, for example where the Bank has concerns about the resolvability of a firm.

5.3 The Bank may also set a firm-specific compliance date where a firm that was not previously within scope becomes within scope of this Statement of Policy. This might occur if the resolution strategy applicable to the firm changes, or if the firm becomes 'material' for the purposes of setting internal MREL (excluding where this is a result of the initial setting of internal MREL). In these cases, the Bank will determine the appropriate compliance date on a firm-specific basis, and expects to allow firms at least 18 months for compliance.