



# Resolution

**Pressures build on  
European banks**

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## 01 Executive summary

Resolution poses many challenges for banks. When designing a commercial banking model with operating structures that are capable of facilitating recovery and resolution, it is essential for banks to understand clearly how to navigate regulatory requirements and what to focus on to meet these challenges.

With the main components of a resolution regime for banks now in place across Europe and the regulatory requirements becoming clearer, banks should ensure that the various strands of their recovery and resolution planning work are fully joined-up; that they have identified and are tackling any remaining impediments to resolvability; and that they have implemented commercially viable solutions that meet the needs of customers, investors and regulators.

This paper discusses primarily these challenges facing larger banks in Europe, and updates KPMG International's earlier paper on Resolution – An evolving journey in Europe.



### Resolution – An evolving journey in Europe

#### Regulatory reform

The post-financial crisis regulatory reform agenda included not only a wide range of prudential and governance requirements intended to reduce the likelihood of failure of financial institutions, but also measures to enable failing Systemically Important Financial Institutions (SIFIs) to be 'resolved' in a more orderly manner and without cost to taxpayers (*see chapter 03*).

The main regulatory requirements for the resolution of failing SIFIs were set out in 2011 by the Financial Stability Board (FSB) in its Key Attributes for Effective Resolution. These Key Attributes formed the basis of the EU's Bank Recovery and Resolution Directive (BRRD) in 2014. Legislative and regulatory requirements have been developed further by the European Commission, the European Banking Authority (EBA) and by resolution authorities such as the Single Resolution Board (SRB) and the Bank of England (BoE).

In February 2019 the EU reached political agreement on the 'banking package', which included amendments to the BRRD, Single Resolution Mechanism Regulation (SRMR) and the Capital Requirements Regulation (CRR), in order to align more closely the EU and Financial Stability Board requirements on loss absorbency and to introduce greater clarity to the specification of bail-inable debt. Amendments to the hierarchy of unsecured creditors in insolvency, and to introduce a new class of non-preferred senior debt, were fast-tracked and finalised in December 2017.

Against this legislative and regulatory background, resolution authorities have been active in establishing prospective resolution strategies and drawing up resolution plans for systemically important banks; setting target levels (on a bank-by-bank basis) for the amount of loss absorbing capacity that these banks need to hold; and assessing whether resolution strategies and plans could in practice be implemented effectively if one of these banks was to fail.

Some resolution powers and tools have already been used to 'resolve' failing banks in Europe (most notably in Italy and Spain), either in combination with government support or to avoid entirely the use of public funds.

### Remaining challenges

However, substantial work remains in achieving effective resolution regimes. The FSB, BoE and SRB have identified eight main areas where actions need to be taken by systemically important banks to improve their resolvability. These cover the loss absorbing capacity of banks; the preparations that banks need to take to facilitate valuation,

funding, restructuring, the robustness of financial contracts and access to financial market infrastructures in resolution; robust operational continuity; and appropriate governance and management capabilities (*see chapters 04-11*).

These eight challenges are beginning to translate into requirements or expectations from resolution authorities that banks will address any remaining barriers to their resolvability (*see chapter 02*).

Meanwhile, for resolution authorities themselves the greatest remaining challenge of the post-crisis reform agenda may be posed by cross-border resolution. It may be difficult to reach agreement across jurisdictions on a resolution plan that is credible both for a cross-border banking group as a whole and for each of its subsidiaries across various jurisdictions. There may be inconsistent powers and different approaches to resolution planning across jurisdictions; a lack of mutual trust among the relevant resolution authorities; and when a cross-border bank is failing each resolution authority may act independently to preserve host country financial stability and to protect local creditor interests.

For banks, this cross-border challenge manifests itself in requirements on subsidiaries to hold loss absorbing capacity locally, either through raising external debt or equity, or through the down-streaming of debt or equity from a parent or group holding company. The requirement that major foreign banks operating in the EU should operate through an intermediate parent undertaking provides one mechanism for this.

## Resolution challenges for banks

### Sufficient loss absorbing capacity

Issuing sufficient eligible debt and positioning it across a banking group

### Funding arrangements

Planning for, and monitoring and mobilising, liquidity in a resolution

### Robust financial contracts

Ensuring that financial contracts could support the use of resolution tools

### Continued access to financial market infrastructure

Ensuring that critical services provided by financial market infrastructures could be preserved in a resolution



### Valuation preparedness

Enabling a third-party valuer to undertake timely and robust valuations ahead of and during resolution

### Robust operational continuity

Identifying the critical services on which a bank's critical functions depend, and demonstrating how these critical services could be maintained in a resolution

### Restructuring ability

Identifying and facilitating restructuring options that could be pursued in a resolution

### Adequate governance arrangements

Ensuring that governance arrangements, senior management skills, decision-making and communication would operate effectively in a resolution

# 02 Implications for banks

There are growing expectations on major banks to respond to the eight main challenges to resolution identified by the FSB, BoE and SRB. Banks need to be able to demonstrate that they have addressed these challenges.

## Addressing the eight challenges



### Loss absorbing capacity

- Issuing sufficient eligible debt (or converting existing ineligible debt) to meet external TLAC/ MREL requirements. Some banks may find it difficult and expensive to attract investors, pushing up significantly the cost of servicing eligible debt.
- Pre-positioning 'internal' MREL/TLAC to meet the requirements of both home and host resolution authorities.
- Focusing on the implications of these challenges for treasury management, and for the need to place even more emphasis on reducing remaining controllable costs to offset as far as possible the higher costs of servicing MREL-eligible debt.
- Providing sufficiently detailed liability data to their resolution authority, on both a regular and timely/ad hoc basis. This may require significant investment in IT and data architecture.
- Anticipating and responding to the various steadily changing regulatory requirements at EU and national authority level regarding the amounts of external and internal loss absorbing capacity that each bank needs to hold, and on the eligibility of different types of debt instrument.



### Valuations

- Assessing how well the bank meets the valuation preparedness principles set out by the BoE, SRB and EBA, and what this means for the bank's operational frameworks, systems, financial reporting processes, cash flow data and management assumptions for business as usual and resolution valuations of both banking and trading book assets.
- Focusing on the likely requirement for transparent governance arrangements to approve the programme of work required on valuation policies, procedures or methodologies.
- Taking a consistent approach across banking groups.
- Clarifying which functions are going to lead on the changes to valuation systems and controls, and communicating with the resolution authority.
- Ensuring that the approach can be consistently evaluated against other stressed valuations required of the bank (for example for solvent wind-down and for prudential valuation adjustments already reported).
- Engaging regularly with the bank's auditors who will need to be appraised of changes to the valuation framework (including increased transparency of accounting policy related to material drivers of valuation risk within the books and records of the bank).



## Funding in resolution

- Reviewing the adequacy and completeness of resolution funding plans. The FSB and BoE have emphasised that banks should be prepared for liquidity management in (and ahead of) resolution.
- Performing liquidity analysis on a timely basis at the level of material entities and for material currencies.
- Designing and documenting methodologies to estimate liquidity needs in resolution.
- Monitoring and mobilising liquidity sources in resolution, with a particular emphasis on estimating the liquidity resources available in resolution.
- Projecting access to, and usage of, third party facilities. Banks should consider their need and ability to monetise a wide range of collateral with third parties (including central banks).
- Embedding the outcome of funding plan analysis into the bank's internal governance frameworks.
- Establishing a framework to test funding capabilities and governance arrangements on a regular basis, and documenting the outcomes of these tests.



## Operational continuity in resolution

- Assessing the bank's ability to identify, map and document the critical operational and finance-related services on which its critical functions depend; and to demonstrate how these critical services could be maintained if the bank was put into resolution – especially where these services are provided by third parties, or by intra-group providers that are separate from the regulated bank itself.
- Pulling together the roles of operational continuity in both recovery planning (including the operational support for the prospective sale of entities or business units) and resolution planning (the financial and operational support to deliver the resolution strategy and to preserve the continuity of critical functions).
- Establishing fire-drill exercises and playbooks to test the extent to which operating structures support recovery and resolvability, including the ability to dispose of entities and business units, to wind-down certain activities and to preserve the operation of critical functions.
- Determining which staff (IT, operations, human resources and risk) should remain in the regulated entities and which can be transferred into service companies, and to meet the potentially conflicting expectations of different national regulators in this respect.
- Using the work on operational continuity not just to enhance resilience but also to improve the efficiency and transparency of the bank's operations and to improve the management of operational risk.



## Continuity of financial contracts

- Ensuring that controls are in place to enable the bank to identify in-scope existing contracts and determine whether they comply with the requirements on contractual stays.
- Including a contractual term in relevant financial contracts recognising that the contract may be subject to the exercise of powers by resolution authorities to suspend or restrict rights and obligations, and to be bound by these powers as if the financial contract was governed by the law of the relevant member state.
- Ensuring that where contracts are governed by third country law there are contractual terms that prevent a counterparty from terminating a contract or exercising rights over security or collateral on the basis that a bank entering resolution constitutes an act of default.
- Establishing a process to identify any out of scope financial contracts entered into by group entities.
- Ensuring that feasible plans are in place outlining how the bank would communicate effectively with counterparties in order to minimise the risk of early termination.
- Establishing Brexit preparation plans for UK banks to treat EU member states as third countries, and for EU banks to treat the UK as a third country.



## Restructuring

- Building upon the work done as part of recovery planning and solvent wind-down to identify and develop post-resolution restructuring options to ensure that following entry into resolution the bank could return to a viable and sustainable business model meeting relevant regulatory requirements.
- Documenting the bank's capabilities to execute the identified restructuring options in resolution, and setting out the types of firm failure for which each option would be appropriate.
- Periodically testing the bank's capabilities for executing restructuring options in resolution, building upon the playbook and dry runs used to test its ability to activate recovery options.



## Access to financial market infrastructures

- Periodically reconciling the bank's material exposures to FMIs, in particular where FMIs provide critical services to the bank.
- Formally documenting the bank's contingency plans when dealing with infrastructure providers. This should include how a bank would communicate with FMIs and regulators, assess its exposures in resolution, and ensure the continuity of operations such as cash and collateral transfers. The contingency plan should detail any anticipated liquidity requirements and how the bank would expect to meet them.
- Engaging with FMIs to understand how they might react in the event of resolution, anticipating cases where an FMI might not continue a relationship with a bank in the event of the bank entering resolution, and considering alternative arrangements.
- Taking all reasonable steps available to maintain continued access to clearing, payment, settlement and custody services in order to keep functioning in resolution.
- Assessing possible extended liquidity, margin and collateral requirements.



## Management, governance and communications

- Assessing the succession planning arrangements for critical roles to ensure they would be suitably staffed and incentivised in resolution.
- Reviewing governance arrangements in place to ensure that they are fit for purpose in the event of resolution, recognising the need for flexibility and the likely involvement of the resolution authority.
- Developing a communication plan to be executed in resolution.
- Ensuring appropriate documentation of the bank's capabilities to deliver governance, management and communications in resolution.
- Establishing a process to periodically test documentation to ensure that it is credible and would be effective in resolution.

# 03 Regulatory landscape

The post-financial crisis regulatory reforms included measures intended to enable failing systemically important banks to be resolved in a more orderly manner and without cost to taxpayers. We set out here the broad timeline of these reforms, including EU legislation, and the latest developments at the SRB and BoE.

## Key regulatory milestones





## Evolution of the BRRD

The 'banking package' – first proposed by the EU Commission in November 2016 and now agreed on a slightly revised basis by the European Parliament and the European Council – makes a series of important amendments to the BRRD.

The revised Capital Requirements Regulation (CRR2) applies the FSB's total loss absorbing requirement to EU G-SIBs. The transitional requirement (the higher of 16 percent of risk weighted assets or 6 percent of the leverage ratio exposure measure) will apply as soon as CRR2 enters into force, and the final requirement (18 and 6.75 percent respectively) from 1 January 2022. Resolution authorities also have the discretion to apply an add-on to the TLAC requirement if that is necessary to support the preferred resolution strategy.

90 percent of this TLAC requirement will apply to the material EU subsidiaries (that are not themselves resolution entities) of non-EU G-SIBs.

CRR2 also sets out the definition of eligible liabilities to be applied to all banks subject to a resolution strategy for the purposes of setting bank-specific MREL requirements under the BRRD2. This definition applies a corresponding deduction approach to holdings of other banks' MREL instruments (which is more generous than the Basel Committee version, where holdings of TLAC that do not count as regulatory capital are deducted from the Tier 2 capital of the holding bank).

Meanwhile, the revised BRRD (BRRD2):

- Requires MREL to be set as a percentage of both the total risk exposure amount and of the leverage ratio exposure measure.
- Provides resolution authorities with flexibility to remedy breaches of MREL requirements (including TLAC for G-SIBs), including prohibiting certain distributions and requiring banks to restore the level of eligible instruments. In the event of a breach of MREL requirements, the SRB (for the banks under its remit) and national resolution authorities (for all other institutions or groups) can impose administrative sanctions and, under certain conditions, prohibit distributions and bonus payments.
- Establishes the concepts of resolution entities and resolution groups under single and multiple point of entry resolution strategies. Banks that are failing or likely to fail, but not subject to resolution, should be wound up in an orderly manner in accordance with the applicable national law (using the fast-tracked harmonised insolvency hierarchy).
- Introduces the concept of top tier institutions as a cluster of non-G-SIB resolution groups with higher systemic importance that need to meet stricter requirements comparable to G-SIBs.
- Limits the scope for G-SIBs and top tier institutions to include structured notes and unsubordinated debt instruments within MREL.
- Allows a resolution authority to require eligible liabilities to be subordinated in order to facilitate the application of the bail-in tool, while recognising the scope for part of the MREL requirement to be met through non-subordinated debt instruments.
- Requires MREL-eligible instruments issued under third country law to be subject to the contractual recognition of bail in.
- Where there is no statutory cross-border recognition framework, requires banks to include a contractual term in relevant financial contracts recognising that the contract may be subject to the exercise of powers by resolution authorities to suspend or restrict rights and obligations.
- Sets a maximum period of two days for the suspension of contractual obligations, which cannot include obligations to central banks, central counterparties and payment and settlement systems.
- Requires banks to report to their supervisors and resolution authority, and to disclose regularly to the public, their MREL requirement, the levels of eligible and bail-inable liabilities and the composition of those liabilities, including their maturity profile and ranking in normal insolvency proceedings.
- Limits the purchase of MREL-eligible instruments by retail investors by requiring an issuing bank to perform and document a suitability test to satisfy itself that the instrument is suitable for a retail client. Where the financial instrument portfolio of a retail client does not exceed €500,000, the issuer also has to ensure that the retail client does not invest an aggregate amount exceeding 10 percent of the client's financial instrument portfolio, and that the minimum initial investment is at least €10,000.

The Commission's proposals to amend the hierarchy of unsecured creditors in insolvency, and to introduce a new class of non-preferred senior debt that would be bailed-in in resolution after capital and other subordinated instruments but before other senior liabilities, and would rank behind other senior liabilities under national insolvency, were fast-tracked and finalised in December 2017.

The Commission has also issued a series of Delegated Regulations to supplement the BRRD, including in May 2016 a Delegated Regulation setting out the broad parameters and criteria that resolution authorities should follow when setting MREL requirements to enable both loss absorbency and the recapitalisation of a failed or failing bank subject to a resolution strategy that includes the possible use of bail-in powers.

### Single Resolution Board

The SRB has moved forward in the last 18 months with strengthening resolvability for SRB entities and less significant institutions, and fostering a robust resolution framework.

During 2019, the SRB is expected to continue to focus on:

- Drafting resolution plans;
- Setting MREL targets ([see chapter 04](#));
- MREL reporting (quarterly reporting and three-year forecasts);
- Identifying impediments to resolvability; and
- Overseeing responses by national authorities to the failure of less significant institutions.

The SRB published in February 2019 a Framework for valuation, setting out the SRB's expectations regarding the principles and methodologies for valuation reports ([see chapter 05](#)).

The SRB is expecting to put in place operational guidance for the on-site inspections of banks to be used not only for resolution actions but also for resolution planning purposes. This will enhance the current cooperation with the ECB (governed by a memorandum of understanding between the SRB and the ECB).

The SRB has also focused on:

- Brexit, publishing its expectations to ensure the resolvability of banks in the context of Brexit.
- Liability Data Reporting (LDR) and data quality, since the SRB experienced delays in the 2018 iteration of LDR with banks, which hindered the resolvability assessment.
- Initial assessments of available MREL, in terms of the amounts, quality and location within groups of loss absorbing capacity.
- Monitoring banks' compliance with internal controls, governance procedures and periodic reporting about MREL availability and targets.
- Enhancing resolution readiness through the further development of bank-specific resolution plans, preferred resolution strategies and potential post-resolution restructuring scenarios.
- Identifying critical functions, assessing their criticality, and considering their separability in resolution.
- The scope for funding and liquidity in resolution, in terms of access to central bank liquidity and the impact of asset encumbrance and margin requirements.
- Operational continuity.
- Cross-border recognition of resolution actions.
- Preparing the SRB's own crisis management manual, and undertaking dry run exercises based on the range of resolution tools.
- Implementing its first resolution of a bank (Banco Popular).
- Enhancing its oversight function over less significant institutions (including through the prior assessment by the SRB of the resolution decisions of national resolution authorities) to ensure consistency of actions within the banking union.
- Fostering cooperation and cross-border relationships, including with the ECB, BoE, Federal Reserve Board and the Federal Deposit Insurance Corporation.

## Bank of England

The BoE proposed in December 2018 a revised Resolvability Assessment Framework, focusing on actions that major banks should take to address the barriers to resolvability identified by the FSB, BoE and SRB. This framework brings together a series of issues that were previously addressed on a more stand-alone basis.

Alongside the BoE's proposed resolvability assessment framework, the UK Prudential Regulatory Authority (PRA) is consulting on rules that would require banks subject to a resolution strategy to submit their resolution plans to the PRA, and to publish a summary of their plans at the same time as the BoE publishes its assessment of the effectiveness of these banks' resolution plans.

	<b>MREL</b>	The BoE has set indicative MREL requirements for major UK banks, most recently in June 2018, so that these banks maintain a sufficient amount of resources that can credibly and feasibly be used to absorb losses and to recapitalise them to a level that enables them to continue to comply with the conditions for regulatory authorisation and sustains market confidence.
	<b>Valuations</b>	The BoE finalised in June 2018 its expectations for banks' valuation preparedness, to enable a valuer to carry out sufficiently timely and robust valuations to support effective resolution.
	<b>Funding in resolution</b>	The BoE proposes to supplement the FSB guidelines on funding in resolution by focusing on whether banks are able to estimate, anticipate and monitor their potential liquidity resources and needs and to mobilise liquidity resources in the approach to and during resolution.
	<b>Operational continuity in resolution (OCIR)</b>	Within the BoE's wider focus on operational resilience, banks should have in place OCIR arrangements to ensure operational continuity at the point of entry into resolution.
	<b>Continuity of financial contracts in resolution</b>	Banks should address the risk that financial contracts might be subject to early termination on entry into resolution, and to limit any adverse impact on their stability and the wider financial system.
	<b>Restructuring</b>	Although post-resolution restructuring would be undertaken by the resolution authority, the BoE proposes that banks should be positioned to identify, develop and execute post-stabilisation restructuring options on a timely basis to ensure that, following entry into resolution, they can return to fulfilling relevant regulatory requirements and to a viable and sustainable business model.
	<b>Continuity of access to Financial Market Infrastructure (FMIs)</b>	The BoE proposals would require banks to be able to take all reasonable steps available to maintain continued access to clearing, payment, settlement and custody services in order to keep functioning in resolution.
	<b>Management, governance and communications</b>	The BoE proposals focus on the ability of banks to ensure (during the execution of a resolution) that their key roles are adequately staffed and incentivised, that their governance arrangements provide effective oversight and decision making, and that they deliver timely and effective communications.

# 04 Minimum requirement for own funds and eligible liabilities (MREL)

BRRD and BRRD2, the Commission's Delegated Regulation and the implementation through the CRR2 of the FSB's TLAC requirements for EU G-SIBs provide the basis for resolution authorities to set MREL requirements on banks subject to resolution strategies. Resolution authorities across Europe are following slightly different paths in terms of the quantum and speed of implementation of the minimum loss absorbency requirements applied to banks under their jurisdiction.

## Single Resolution Board (SRB)

The SRB began in 2017 to set a general 'informative MREL target' for most banking groups under the SRB's remit, based on the default formula in the Commission's Delegated Regulation. This was not a binding requirement, but an orientation towards a future target intended to enable banks to prepare for their future MREL requirements. The informative target applies at the consolidated level of the EU parent resolution entity.

This informative target is the sum of three components:

1. A loss absorption amount (LAA), to meet the losses that the bank may incur in resolution, equal to a bank's Pillar 1, Pillar 2 and combined buffer requirements.
2. A recapitalisation amount (RCA), to enable the bank to meet prudential requirements in resolution, equal to a bank's Pillar 1 and Pillar 2 requirements.
3. A market confidence charge (MCC) set at 125 basis points less than a bank's combined buffer requirements.

As set out in its November 2018 and January 2019 MREL policy statements, the SRB is in the process of setting bank-specific MREL for major EU banks at the consolidated level and at the level of material subsidiaries (internal MREL), split into a 'first wave' for less complex banks and a 'second wave' for the most complex banks. As allowed for in the Commission's Delegated Regulation, bank-specific adjustments can be made to the recapitalisation amount and the market confidence charge.

The SRB intends to apply adjustments to reflect four possibilities:

- If the failure of a banking group might result in the group having a smaller balance sheet directly following resolution, for example as a result of credit risk losses, then risk weighted assets could be reduced in line with a maximum balance sheet depletion of up to 10 percent of total assets.
- If recovery options and other measures can be implemented credibly and immediately in resolution, then risk weighted assets can be reduced by up to 5 percent.
- Restructuring plan divestments and sales might also be taken into account in adjusting risk weighted assets.
- Where the resolution strategy for a banking group relies primarily on a transfer tool (sale of business, bridge institution and/or asset separation), the SRB will apply a scaling factor to reduce total assets by 20 percent, which will feed through to the risk weighted assets calculation for the RCA and MCC.

The SRB does not currently envisage any other adjustments to MREL targets, for example for liabilities that are likely to be excluded from bail-in in exceptional circumstances, or for deposit guarantee scheme contributions.

Anticipating the rules of the BRRD2, the SRB requires a minimum level of subordinated instruments, depending on the size and systemic importance of banks. In line with global TLAC standards, G-SIBs will initially be required to maintain a minimum amount of subordinated or non-preferred senior instruments equal to 16 percent of risk weighted assets plus the combined buffer requirement,



while D-SIBs and other resolution entities will be subject to a minimum of 14 percent (in BRRD2 this will be 13.5 percent). These subordination requirements can be subject to a downward adjustment by up to 2.2 percent and 2.5 percent respectively under strict conditions to ensure that this does not have a material adverse impact on resolvability.

The SRB does not see any legal basis for resolution authorities to exclude ex ante and uniformly eligible liabilities held by natural persons or small and medium-sized enterprises from MREL-eligible liabilities or from bail-in. However, holdings of subordinated or senior instruments by retail investors could prove to be an impediment to resolution. The SRB will therefore analyse a bank's exposure to retail bond-holders as part of the resolvability assessment.

The SRB has also clarified that structured notes, liabilities issued by SPVs or entities established outside the EU, and notes governed by third country law can only be included as MREL-eligible instruments under certain conditions. Uninsured and non-preferred deposits with maturity over one year can only be included if sufficient evidence is provided that they effectively cannot be withdrawn at a notice period of less than one year.

Binding MREL targets are set with a bank-specific transition period. For banks that already meet the binding target, there will generally be no transition period.

The SRB will generally set individual transition periods of up to a maximum of four years for consolidated as well as individual MREL targets. The transition periods are defined based on quantity (target) and quality (subordination level) requirements to pave the way for building up banks' loss-absorbing and recapitalisation capacities. The transition periods take into account bank- and market-specific characteristics. For banks that already meet the binding target, there will generally be no transition period. In addition, the SRB will set non-binding interim targets to ensure the feasibility of reaching the target at the end of the transition period.

The SRB intends to make reference to the benchmark MREL of 8 percent of a bank's total liabilities including own funds, as set out in the BRRD, but not to make this a binding requirement until the leverage ratio becomes a binding requirement (once CRR2 is published in the Official Journal of the EU).

The SRB does not intend to publish individual decisions on MREL targets (but individual banks may choose to do so, or be required to do so under BRRD2). Where major EU banking groups have published their MREL targets this reveals that the SRB is setting MREL targets in the region of 25 – 30 percent.

## MREL requirements for selected banks in the European banking union

Bank	Country	MREL requirement as a percentage of risk weighted assets (as at December 2016)
BBVA	Spain	28.0%
BPCE	France	25.0%
Commerzbank	Germany	27.3%
Credit Agricole	France	24.8%
Deutsche Bank	Germany	29.3%
ING	Netherlands	29.0%
Santander	Spain	24.4%
Societe Generale	France	24.4%
Rabobank	Netherlands	31.0%
UniCredit	Italy	26.0%

Source: Published company information (as of February 2019)

## UK

The BoE updated in June 2018 its approach to setting MREL for major UK banks. This sets requirements for 2019, 2020-2021, and from 2022 onwards.

**From 1 January 2019:** UK resolution entities that are G-SIBs will be required to meet the minimum requirements set out in the FSB TLAC standard (higher of 16 percent of risk weighted assets, or 6 percent of leverage ratio exposures). Material subsidiaries of G-SIBs that are incorporated in the United Kingdom will need to meet these minimum requirements multiplied by a scalar of 75-90 percent.

**From 1 January 2020:** UK resolution entities that are G-SIBs or D-SIBs will be required to maintain MREL equal to the higher of (i) twice their Pillar 1 capital requirements and one times their Pillar 2A add-ons or (ii) twice their leverage ratio requirement (6.5 percent if their leverage ratio requirement is 3.25 percent). Material subsidiaries of G-SIBs or D-SIBs that are incorporated in the United Kingdom will need to meet these minimum requirements multiplied by a scalar of 75-90 percent.

UK resolution entities that are not G-SIBs or D-SIBs will be required to maintain MREL equal to 18 percent of risk weighted assets.

**From 1 January 2022:** G-SIBs will be required to meet an external MREL equivalent to the higher of (i) twice the sum of their Pillar 1 and Pillar 2A capital requirements, or (ii) twice their leverage ratio requirement (or the FSB's minimum TLAC leverage ratio requirement of 6.75 percent if this is higher).

D-SIBs and any other UK bail-in resolution entities will be required to meet an external MREL equivalent to the higher of twice the sum of their Pillar 1 and Pillar 2A capital requirements, or (ii) twice their leverage ratio requirement.

The BoE will review the calibration of MREL before the end of 2020, prior to finalising the end-state MRELs that will apply from 1 January 2022.

The various buffer requirements – including the capital conservation buffer of 2.5 percent, any counter cyclical capital buffer and any SIB surcharge – and any (undisclosed) Pillar 2B add-on are additional to these MREL requirements.

The BoE has published indicative MREL requirements for each of the seven systemically important banks in the UK, together with average requirements for a further nine UK banks subject to a resolution plan that involves the use of bail-in or transfer powers.

## Indicative MREL requirements for major UK banks

	From January 2020			From January 2022		
	Minimum going concern requirement	Interim MREL	Loss absorbing capacity in 2020 (MREL+buffers)	Minimum going concern requirement	Final MREL	Loss absorbing capacity in 2022 (MREL+buffers)
HSBC	11.5%	19.5%	22.7%	11.5%	23.1%	26.2%
Barclays	12.3%	6.5% of LREs	7.8% of LREs	12.3%	24.6%	29.1%
RBS	11.9%	19.9%	24.1%	11.9%	23.9%	28.0%
Standard Chartered	11.1%	19.1%	22.7%	11.1%	22.2%	25.7%
Lloyds	13.4%	21.4%	24.7%	13.4%	26.7%	30.1%
Santander UK	13.5%	6.5% of LREs	7.5% of LREs	13.5%	27.0%	30.4%
Nationwide	3.2% of LREs	6.5% of LREs	6.8% of LREs	3.2% of LREs	6.5% of LREs	6.8% of LREs
Average across other banks with a resolution plan that involves the use of bail-in or transfer powers	12.2%	18.0%	21.5%	12.2%	24.4%	27.9%

Percent of RWAs (except where stated as percent of leverage ratio exposures (LREs))

Source: Bank of England, June 2018.

The BoE has also issued a consultation paper (October 2017) on its approach to the setting of internal MREL for the material subsidiaries (representing at least 5 percent of a group's risk-weighted assets, operating income or leverage exposures) of major UK-headquartered banking groups and major UK subsidiaries of overseas banking groups. The BoE proposes that:

- Internal MREL eligible liabilities will need to meet the same criteria as apply to external MREL;
- In deciding where to set the internal MREL requirement within the 75-90 percent range, the BoE will take into account the credibility of the resolution plan, the availability of other resources in the group that could be readily deployed to support the material subsidiary, and the scaling of internal loss-absorbing resources applied by overseas authorities to material subsidiaries located in their jurisdiction;
- Where a ring-fenced retail bank is part of a material sub-group, internal MREL for the top entity of the material sub-group will be set at 90 percent as a starting point, unless the BoE is satisfied that the wider group has sufficient readily-deployable resources to justify moving to a lower calibration in the range; and
- Internal MREL requirements will apply from 1 January 2019 for material subsidiaries of G-SIBs, and from 1 January 2020 for other firms.



## Sweden

The Swedish resolution authority (Riksgalden) has set MREL requirements for the major banks based on a loss absorption amount and a recapitalisation amount both equal to a bank's total capital requirements (excluding the combined buffer requirement and the Pillar 2 systemic risk component), plus a market confidence amount equal to at least the combined buffer requirement.

For the largest banks in Sweden (with a Pillar 1 capital requirement of 8 percent, Pillar 2 of 2.5 – 5 percent, and combined buffer requirements of around 6.5 percent) this equates to an MREL requirement in the region of 30 percent. These requirements are being phased in by 2022.

## Denmark

The Danish financial services authority, in consultation with the financial stability authority, has established MREL (NEP in Danish) requirements for systemically important banks at twice the solvency requirement plus twice the combined capital buffer requirement (although the counter-cyclical capital buffer is included only once in the NEP requirement).

The NEP requirements for the three systemically important Danish banks are (as a percentage of risk weighted assets):

- Dansk Bank 35.9% (from September 2019)
- Jyske Bank 28.1% (July 2019)
- Sydbank 27.3% (July 2019).

For non-systemically important banks the NEP supplement will be in the range of 3.5 – 6 percent, with an average of 4.7 percent. These requirements will be phased in by 2022.

## Switzerland

The Swiss G-SIBs will be subject (by the end of 2019) to a TLAC requirement (including all buffers, except the counter cyclical capital buffer) of 28.6 percent of risk-weighted assets and 10 percent of the leverage ratio exposure measure, with at least half of each ratio in the form of bail-inable subordinated instruments. A reduction of up to 2 percentage points could be allowed depending on improvements to the resolvability of these G-SIBs, provided the resulting requirement remains above the FSB minimum TLAC requirements.



## Shortfalls and costs

The Basel Committee Basel 3 monitoring exercise now includes a report on the progress made (through new issuance and the conversion of debt into TLAC-eligible debt) by G-SIBs in meeting the FSB's TLAC requirements.

As at end-June 2018, and based on the Basel 3 standards currently in place, six of the 24 G-SIBs in the monitoring sample would fail to meet the minimum TLAC requirements that will apply from 2022, with a combined shortfall of €68 billion.

Based on the full implementation of the Basel 3 standards finalised in December 2017 (which will generally increase banks' measured risk weighted assets), the number of G-SIBs with a shortfall against 2022 TLAC requirements would increase from six to eight, with the combined shortfall increasing to €109 billion.

The EBA's December 2018 Risk Assessment Report noted that while large EU banks have already issued significant amounts of MREL-eligible instruments, many medium-sized banks, small banks required to hold MREL funding, and banks with weaker market perceptions still have to issue a significant amount of loss-absorbing instruments to meet their required levels of MREL.

It is clear from these monitoring exercises and from bank-specific calculations published by market analysts that:

- Shortfalls against minimum loss absorbing requirements are very unevenly distributed across banks;
- Some banks have made considerable progress in issuing eligible debt or converting existing debt into eligible form, but other banks are finding this difficult to achieve; and
- The Basel Committee data do not reflect the higher minimum requirements set by some national resolution authorities – these higher requirements would result in larger shortfalls.

The cost to banks of meeting minimum loss absorbing capacity requirements could be high. For example, if a bank's shortfall is equal to half of its common equity Tier 1 capital, and if eligible debt costs two percentage points more in annual interest than a bank's existing non-eligible liabilities, then making up this shortfall would reduce the bank's return on equity by one percentage point. This negative impact would be substantially higher if a bank has a larger shortfall (for example twice as high if a bank had not yet issued any eligible debt over and above its regulatory capital) or if the additional cost of eligible debt is more than two percentage points (for example, it may cost a bank at least an additional five percentage points to replace wholesale or corporate deposits with eligible subordinated debt).

# 05 Valuations

Valuations play a key role at various stages of resolution. First, a decision needs to be taken on whether to put a bank into resolution. Second, if a bank is put into resolution then decisions need to be taken on the choice of resolution tools and the extent and conversion terms of any bail-in of liabilities (both to absorb existing losses and to recapitalise the failing bank to guard against future losses). And third, if the bail-in tool is used then a (later) determination will be required of whether any creditors would have been better off had the bank gone into insolvency.

## **EBA and SRB valuation standards and guidance**

The EBA's Regulatory Technical Standards focus on these three types of valuation from a technical and methodological perspective, while its February 2019 Handbook on valuation for purposes of resolution focuses mostly on the second type of valuation and how the valuation practices should correspond with the choices that may need to be made on the use of resolution tools.

The EBA's Handbook is intended to foster the convergence and consistency of valuation practices and to form the basis for interaction with independent valuers.

The Handbook provides guidance on the practical steps of the valuation process, on the specific valuation criteria applicable to the various resolution tools and, with a view to facilitating the adoption of an informed decision by the resolution authority, on the content that is expected to be included in the valuation report.

In addition, the Handbook includes a short chapter on management information systems that highlights the importance of banks' valuation preparedness by stressing that banks should ensure the timely provision of high quality data and information so that the valuer can undertake a robust valuation.

Meanwhile, the SRB's Framework for valuation, also published in February 2019, provides guidance primarily on the principles and methodologies for the second and third types of valuation, and is aimed mostly at independent valuers. It focuses on valuation methodologies (discounted cash flow, market multiples, and adjusted book value) and on the valuation approach for determining the use of specific resolution tools (bail-in, bridge institution, asset separation, and sale of business).

The SRB Framework also covers the use of provisional valuations in circumstances where it is not possible to undertake a definitive valuation; the treatment of specific assets (such as non-performing loans, foreclosed assets, securities, derivatives, goodwill and deferred tax assets); and the treatment of specific liabilities (such as litigation costs, external services, restructuring costs, early termination costs, and contingent liabilities).



### Valuation 1:

#### To determine whether the conditions for triggering resolution are met.

This type of valuation should follow normal accounting and prudential rules relevant to an assessment of whether a bank meets the conditions for continuing authorisation (so the rules applying to the preparation of financial statements and the calculation of regulatory capital ratios). No account should be taken of any actions that the resolution authority might take if the bank is put into resolution.



### Valuation 2:

#### To inform the choice of resolution tools, including the extent of any bail-in of liabilities, and to determine (where relevant) the rate at which non-equity liabilities should be converted into new equity.

This valuation may depart from accounting and prudential rules, because potential losses should be assessed using economic values (the present value of future cash flows), in particular where the resolution strategy is based on the sale of businesses or assets within a defined disposal period.

In addition, this valuation should be based on prudent and realistic assumptions, in an attempt to avoid situations where the eventual losses are not covered by the initial bail-in amount. This may result in the inclusion of a conservative buffer to reflect probable losses that the valuer has not been able to estimate with sufficient accuracy as part of a provisional valuation.

In some cases Valuation 2 may be conducted on a preliminary basis ahead of a bank being put into resolution, but then repeated and finalised at some point after resolution. This will depend on the degree of uncertainty ahead of resolution and the extent to which there is scope to finalise bail-in amounts and conversion rates after resolution.



### Valuation 3:

#### To determine whether any creditor should be compensated under the 'no creditor worse off than under liquidation' principle.

This valuation should be undertaken on a gone concern basis, estimating the discounted value of cash flows that could reasonably have been expected to arise under the relevant national insolvency procedures for banks. This counterfactual outcome then needs to be compared with the treatment of creditors and shareholders in resolution.

### Bank of England valuation preparedness policy

The BoE has been concerned that systemically important banks may not have the data, systems and processes in place to enable them to be valued by a third party valuer in a timely and robust manner to determine both whether the bank should be put into resolution because it has failed or is likely to fail, and the choice of resolution tools – in particular the use of the bail-in tool to absorb losses and recapitalise the bank.

Following a consultation in 2017, the BoE finalised its policy on banks' preparedness for valuation to support resolution in June 2018. Banks should comply with this policy by 1 January 2021. Further guidance was provided to banks in November 2018, and the BoE is undertaking a survey of how banks are implementing its policy on valuation preparedness.

The BoE is adopting a principles-based approach to valuation preparedness, with a particular focus on a bank's data and information, valuation models and methodologies, valuation assumptions, governance, transparency and assurance.

The principles apply to UK-based banks subject to a resolution strategy that includes potential use of the bail-in power, and to material UK subsidiaries of overseas-based banking groups. These banks will need to demonstrate their compliance with the principles as part of the BoE's resolvability assessments. The principles are consistent with, and amplify, the sections on valuation preparedness in the FSB's June 2018 guidance on bail-in execution. They also provide good practice for other EU banks to follow, ahead of the EBA, SRB and/or ECB developing further the EBA's initial guidance on banks' valuation preparedness.

### Bank of England principles for valuation preparedness

1. **Data and information:** Banks should ensure that their underlying data and information are complete and accurate, and that relevant data and information would be readily available to a valuer. Banks should collect and hold all relevant data and information that would be reasonably considered necessary to enable timely and robust resolution valuations.
2. **Valuation models:** As necessary to meet the timeliness and robustness objectives, banks 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.
3. **Valuation methodologies:** 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.
4. **Valuation assumptions:** Banks 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.
5. **Governance:** Banks should apply sound governance arrangements and processes to ensure that valuation capabilities compliant with these principles are maintained in business-as-usual and are available prior to and during resolution.
6. **Transparency:** Banks should clearly and concisely document their valuations capabilities and how these could be relied upon to produce timely and robust resolution valuations.
7. **Assurance:** Banks should periodically review and evaluate their valuations capabilities with regard to these principles, and should facilitate reviews undertaken by the BoE or a third party to test compliance.





# 06 Funding in resolution

When a bank enters resolution there is a significant risk that it will face a shortage of liquidity as funding is withdrawn. Resolution authorities have therefore been considering how a bank's funding needs could be met in resolution. There are four main elements of this – resolution funding planning by a resolution authority, a bank's own capabilities to monitor and estimate funding needs in resolution, private sector funding, and official sector funding.

## Financial Stability Board guidance on resolution funding

The FSB issued guidance in June 2018 on how a resolution authority should develop a funding plan for a bank entering resolution.

### Resolution authority

At a strategic level, the resolution authority should assess whether the overall strategy for ensuring adequate liquidity in resolution and the methodology to estimate funding needs in resolution are feasible and consistent with the overall resolution strategy for the bank.

At a more detailed level, the resolution authority should consider the role of liquidity in the assessment of whether the bank has met the conditions for entry into resolution; whether the measures that could be included in a resolution funding plan are consistent with the measures in the bank's own contingency funding and recovery plans; and the framework for estimating funding needs in resolution, in particular with respect to liquidity resources and funding needs at a material operating entity level and the transferability of liquidity resources between material operating entities.

Resolution authorities should also consider the adequacy of information sharing and coordination among resolution, supervisory and other relevant authorities. A resolution funding plan should establish a clear allocation of responsibilities and a communication plan among the relevant home and host authorities in relation to the provision of resolution funding; capture the implications of local regulatory requirements or other aspects specific to material operating entities in host jurisdictions and how funding will be distributed to the bank's material operating entities; and address any impediments to coordination and information sharing among the relevant authorities that might affect the timely provision of resolution funding.

## Banks' capabilities to monitor, report and estimate funding needs in resolution

A resolution funding plan should reflect the ability of a bank to measure sources and positioning of liquidity and to estimate funding needs in resolution; to take actions to remove impediments or improve the bank's capabilities; to report liquidity information at a material operating entity level on a timely basis, in particular with respect to the availability and location of unencumbered assets; and to identify and mobilise assets that could be used as collateral, and the operational, legal and regulatory feasibility of mobilising such assets, including on a cross-border intra-group basis.

### Private sector funding

A resolution funding plan also needs to consider the likely availability and value of a bank's assets in different failure scenarios; the likely availability and size of private sources of funding, and the key steps necessary to mobilise such sources of funding; and actions that could be taken by the authorities to increase the willingness of private counterparties to provide funding to a bank in resolution.

### Official sector funding

Resolution authorities should consider the potential availability of official sector funding, including central bank facilities, resolution funds, and temporary public sector backstop sources of funding. This should include analysis of the pre-conditions and operational procedures necessary to access any such funding.

### Bank of England approach to funding in resolution

The BoE's proposed resolvability assessment framework highlights the importance of banks being able to estimate, anticipate and monitor their potential liquidity resources and needs and to mobilise liquidity resources in the approach to, and during, resolution. This is consistent with the FSB guidance relating to banks' own capabilities.

The proposed framework recognises that some elements of funding in resolution are covered under existing requirements, including those relating to liquidity

management, contingency planning and stress testing in the context of a bank's Individual Liquidity Adequacy Assessment; the identification and testing of recovery planning options; and the criteria governing access to central bank liquidity facilities.

However, the proposed framework sets out six areas where in-scope banks would be expected to demonstrate that they are sufficiently prepared for funding in resolution. Again, this may also provide good practice for other EU banks to follow.

#### Bank of England expectations for banks' capabilities for funding in resolution

Banks should be able to:

1. Perform liquidity analysis on a timely basis at the level of material entities and for material currencies. This requires banks to assess materiality for liquidity management purposes, and to perform liquidity analysis on a timely basis at the level of material entities and for material currencies.
2. Develop estimates of, and assess, liquidity needs in resolution. This should be based on their current balance sheet, and on future estimated balance sheets, recognising that liquidity positions are likely to deteriorate in a period of stress. Banks should be able to estimate their liquidity needs in resolution, perform sensitivity analysis and identify the key drivers of liquidity needs at the level of the group and its material entities. Banks will also be expected to design and document methodologies to estimate liquidity needs in resolution; identify liquid assets required for operational reasons and likely intra-day liquidity needs in resolution; assess the quality and availability of collateral; take account of intra-group funding needs; and be able to obtain and report (to the BoE or the PRA) liquidity data on an enhanced basis during periods of stress.
3. Monitor and mobilise liquidity sources in resolution, with a particular emphasis on estimating the liquidity resources available to them in resolution, identifying unencumbered collateral and projecting collateral balances, and intra-group liquidity needs and the transferability of collateral across a group.
4. Project access to, and usage of, third-party facilities. Banks should consider their need, and ability, to monetise a wide range of collateral with third parties, including any potential need or ability to request liquidity from central banks. This should include an assessment of the timing of, and collateral suitable for, borrowing, and the availability of information a third party would require to risk manage their exposures.
5. Embed the outcome of their analysis into their internal governance frameworks. Banks' internal governance frameworks should facilitate effective and timely decision-making and reporting to senior management throughout resolution, and should also support firms' existing management of liquidity risk. In particular, banks should integrate their capabilities for managing liquidity risk in resolution into their existing liquidity management framework, alongside any existing legal entity-specific liquidity requirements, and internal stress tests; and should have the ability and processes to increase the frequency of reporting in a period of stress.
6. Participate in, and provide information for, tests of the above capabilities. Banks should test their capabilities and governance arrangements on a regular basis, and should document and review the outcomes of these tests.

# 07 Operational continuity in resolution (OCIR)

One key objective of resolution is to preserve the continuity of a failing bank's critical functions. These might include deposit-taking; lending to borrowers such as retail customers and SMEs where the reliance on bank-specific credit information may make it difficult for another provider to substitute for these services rapidly and effectively; clearing, payment and settlement services; and some forms of wholesale market and trading activities.

Much of the early emphasis of resolution planning focused on identifying the critical functions supplied by banks; identifying which banks supplied significant critical functions; and planning to use resolution tools in a way that would preserve the continuity of these banks' critical functions.

It also became clear from this resolution planning process that the continuing supply of critical functions – at the point of resolution, during any stabilisation period, and during the restructuring of a failing bank – depended on preserving the continuity of the various services on which this supply was based.

For example, as set out in a 2015 Guideline from the EBA, a core list of operational and finance-related services and facilities supporting banks' critical functions would include human resources, IT, transaction processing, real estate and facility provision or management, legal services and compliance functions, treasury related services, trading and asset management, risk management, valuation, accounting and cash handling.

As discussed in FSB guidance issued in August 2016, banks may rely (to varying extents and in different combinations) on three broad types of providers of critical services:

- 'in house' provision within the same regulated entity that provides the critical function;
- 'intra-group' provision (within a regulated or an unregulated entity) servicing more than one regulated entities that provide critical functions; and

- 'outsourced' third party service providers (including financial market infrastructures).

The discontinuation of any critical services could lead to an inability of a bank to perform its critical functions. The operational continuity of critical services has therefore become a key aspect of resolution planning, with a particular emphasis (in particular where critical services are provided on an intra-group or outsourced basis) on the 'resolution-proofing' of:

- the contractual provisions relating to rights of use and access, pricing structures, operational resilience and resourcing of the provision of critical services;
- the financial resources of the providers of critical services; and
- the governance of, and management information systems relating to, critical services by banks and banking groups.

The SRB, BoE and FSB have all emphasised the importance of operational continuity. The SRB has focused in particular on the management information systems required to ensure operational continuity; the effectiveness of service level agreements (intra-group and third party); and on the continuity of critical outsourced or shared services, such as IT infrastructure and software related services.



Meanwhile, the BoE's July 2016 Supervisory Statement on operational continuity set out expectations on banks to ensure the operational continuity of critical services to facilitate recovery actions, orderly resolution and post-resolution restructuring. The BoE's key expectations are that a bank should:

- Undertake a comprehensive mapping and documentation (including a description of service, jurisdiction, service delivery model, ownership, infrastructure, pricing and contractual arrangements) of critical services to critical functions, to provide clarity on which critical services need to be maintained in resolution. This may involve identifying legal entities, business lines or divisions that perform critical functions and the critical services they receive and / or provide.
- Be able to demonstrate how its operational arrangements supporting critical services facilitate resolution, within a reasonable time.
- Describe what would happen to critical services if resolution tools were applied, including how the bank's operational arrangements would facilitate separability and restructuring within a reasonable time, while preserving the continuity of critical functions.

The PRA's supervisory requirements on outsourcing (for services provided intra-group and from third parties) and similar approaches taken by the EBA (as in the EBA's February 2019 revised Guidelines on outsourcing arrangements) and the ECB require banks to:

- Maintain responsibility for critical services and not outsource any functions that require senior management judgement or decision-making that could affect the prudential soundness or risk appetite of the bank.
- Ensure that critical services providers have sufficient financial resources to allow the continuity of provision of critical services during and after resolution.
- Ensure that intra-group critical services providers will remain operational despite the failure of any group entities, as a result of their change capabilities and operational contingency arrangements, operational resilience and staff and expertise.
- Ensure that a critical services provider, whether intra-group or third party, cannot change the arrangements of service provision as a result of a bank (or part of a banking group) entering resolution.

- Demonstrate that the bank has identified and documented the critical services it receives.
- Enter into service level agreements between business units of a bank, intra-group entities or third party providers that are objective and on third party terms.
- Articulate clearly how access to operational assets (such as data, intellectual property, premises, licences and leases supporting critical services) will be maintained in a resolution.
- Ensure that a critical services provider located within a banking group has its own governance and management structure in place.

In its July 2017 progress report on resolution, the FSB reported that it had found inadequacies in arrangements for operational continuity in many G-SIBs. Most G-SIBs were found to have identified their critical services and had mapped these services to critical functions, business lines and legal entities. A number of G-SIBs had also amended, or were in the process of amending, service level agreements to include specific resolution clauses, including in some cases through the development of a single global master services agreement. However, work remains to make operational continuity arrangements fully operational in resolution and to ensure that providers of operational services have sufficient financial resources to continue in resolution.

The BoE's proposed resolvability assessment framework indicates the BoE expectation to use the bail-in power in resolution initially to stabilise a failing or failed bank, and that post-resolution restructuring might best be achieved by initially preserving the continuity of all of a bank's business lines, not just its critical functions. This in turn may mean that the scope of a bank's operational continuity arrangements would need to support the continuity of most or all functions in order both to ensure the continuity of critical functions and to support restructuring.

This may require a bank to have in place arrangements to ensure the continuity of a broader set of functions than solely those identified as critical. This would represent an extension of the PRA's current OCIR policy. The BoE will not apply this wider approach to its assessments of banks' resolution plans until beyond 2020.

# 08 Continuity of financial contracts in resolution

The revised BRRD2 allows resolution authorities to suspend certain obligations for up to a maximum of two days. This includes the possibility of exercising this power to avoid the further deterioration of the financial conditions of a bank before the bank is put into resolution, from the point in time when the determination is made that the bank is failing or likely to fail, and that there is no private sector measure immediately available which, in the view of the resolution authority, would prevent the failure of the bank within a reasonable timeframe.

While BRRD2 provides a statutory basis under which a resolution authority can enforce a suspension of contractual rights, some national resolution authorities such as the BoE already had this power under previously enacted national legislation (the Banking Act 2009).

BRRD2 also clarifies the cross-border application of the suspension power. Within the EU there is an automatic cross-border read-across, so that a suspension of obligations imposed by the resolution in one member state would be automatically recognised by other EU member states and as such would be effective across the EU. However, these requirements do not apply directly to contracts under third country law. BRRD2 therefore requires banks subject to resolution strategies to include a contractual term in relevant financial contracts recognising that the contract may be subject to the exercise of powers by resolution authorities to suspend or restrict rights and obligations, and to be bound by these powers as if the financial contract was governed by the law of the relevant member state.

Similarly, banks should ensure that where contracts are governed by third country law there are contractual terms that prevent a counterparty from terminating a contract or exercising rights over security or collateral on the basis that a bank entering resolution constitutes an act of default.

In the UK, the PRA Stay in Resolution rules – that apply to all relevant third country law financial contracts entered into since 2017 – already impose an obligation on UK banks to agree with relevant counterparties in a legally enforceable way that termination rights or rights to enforce a related security interest may only operate to the extent that they would be permitted as if the BRRD2 applied to them. Banks are also required to be able to demonstrate - through documentation and the ready availability of information on relevant contracts – that they comply with these requirements.

The BoE's proposed resolution assessment framework takes this one step further by requiring banks to have in place:

- Feasible plans outlining how they would communicate effectively with counterparties both during pre-resolution contingency planning period (if necessary) and during resolution, in order to minimise the risk of early termination. Pre-resolution, such communication might include an assurance to counterparties that the bank will continue to meet its financial obligations towards them during the stress. During resolution, such communication might include informing counterparties that a stay on early termination and security enforcement rights has been imposed and explaining that the consequence of resolution is that the operating company to which they are a counterparty will be stabilised and continue to operate, while the terms of the resolution are finalised at the level of the resolution entity.
- The ability to identify any 'out of scope' financial contracts entered into by group entities, not governed by BRRD2 or subject to the PRA Stay rules.
- The ability to explain to the BoE how their internal governance, assurance and testing ensures that they satisfy BRRD2 and the PRA Stay rules.

Meanwhile, as part of the preparations for the UK's withdrawal from the EU, and depending on the terms of any agreement governing that withdrawal, UK banks will need to prepare to treat EU member states as third countries, and EU banks will similarly need to treat the UK as a third country.

# 09 Restructuring

Once a failing, or failed, bank is put into resolution it is important that the authorities have the tools to restructure the bank. The main tools here are the powers to sell or transfer assets and liabilities to other firms, and to transfer assets to an asset management company. Meanwhile, the bail-in and bridge institution powers are intended primarily to provide the authorities with the time and flexibility necessary to achieve an orderly, effective and efficient restructuring.

An important contributor to a successful restructuring is that a bank entering resolution has itself put the necessary measures in place to facilitate and support a restructuring in resolution. The BoE's proposed resolvability assessment framework includes expectations on banks – in advance of resolution – to identify, develop and execute post-stabilisation restructuring options on a timely basis to ensure that, following entry into resolution, the bank could return to fulfilling relevant regulatory requirements and to a viable and sustainable business model.

To meet these expectations, banks subject to a resolution strategy should build on relevant work done on recovery planning and solvent wind-down. A broad range of restructuring options and a wide and comprehensive set of capabilities to execute them will be needed, because the exact restructuring needs for a bank in resolution will not be known beforehand. Banks should identify options for restructuring in resolution, based on a consideration of the circumstances in which recovery options might or might not be available and suitable for resolution, including solvent wind-down.

Some recovery options developed to meet recovery planning requirements should also be available as restructuring options for a bank in resolution. Indeed, some options that could not be used in recovery – because the expected benefits would not be realised in a sufficiently short period of time – may be available as

restructuring options for a bank in resolution. However, other recovery options may no longer be available in resolution (for example because they have already been used in an attempt to avoid resolution).

To support resolvability, the BoE is proposing that banks subject to a resolution strategy should be able to describe their capabilities for executing the identified restructuring options in resolution, and to set out the types of firm failure for which these options would be appropriate. Banks should consider how capabilities developed for other purposes (such as recovery planning, valuations and operational continuity in resolution) would be used for this purpose. In addition, banks should test their capabilities for executing restructuring options in resolution using the same criteria as for their assessment of capabilities for executing recovery options.

Banks could build here on the playbooks and dry runs advocated by the ECB and the BoE as part of the testing of their ability to activate recovery options effectively. Playbooks should set out escalation and decision-making procedure within a bank, the available recovery options, key external contacts, and appropriate communication measures. Dry runs can be used to test key parts of a bank's recovery plan in live exercises, to verify that recovery planning is credible and executable. These techniques could also be useful in the context of restructuring options during a resolution.

# 10 Continuity of access to financial market infrastructures (FMIs)

The FSB has been paying particular attention to the continuity of access to FMIs during resolution and ensuring banks are able to identify their reliance on different FMIs and to put in place appropriate contingency plans.

The FSB's July 2017 guidance on the continuity of access to FMIs (defining FMIs to include payment systems, central securities depositories, securities settlement systems and central counterparties) focused on both banks that might ultimately be subject to resolution and the FMIs themselves.

The guidance set out the importance of resolution authorities requiring banks to:

- Have a contingency plan in place for dealing with FMIs during resolution. This should include how a bank would communicate with FMIs and regulators, assess their exposures in resolution, and ensure the continuity of operations such as cash and collateral transfers. A contingency plan should detail any anticipated liquidity requirements and how the bank would expect to meet them.
- Identify their reliance on different FMIs (including mapping this to the key service and product offerings of the bank).
- Engage with FMIs to understand how they might react in the event of resolution and their own planning activities.
- Share regular information on their communications with FMIs with resolution authorities.

Within this overall approach, the SRB has focused on understanding the conditions for the continued participation of a bank in resolution in FMI services, and preparing fast track procedures to transfer participation to a bridge bank.

Meanwhile, the inclusion in the BoE's proposed resolvability assessment framework of a requirement on banks to consider continuity of access to FMIs is a relatively new approach for the BoE. Banks will be required to identify and record all their relationships with FMIs, in particular where FMIs provide critical services to the bank; to anticipate cases where an FMI might not continue a relationship with a bank in the event of the bank entering resolution, and to consider putting in place alternative arrangements; to take all reasonable steps available to maintain continued access to clearing, payment, settlement and custody services in order to keep functioning in resolution; and to assess possible extended liquidity, margin and collateral requirements.



# 11 Management, governance and communications

The various resolution challenges discussed previously in many respects generate natural counterparts in terms of a bank's management, governance and communication processes. Moreover, many of these processes have already been required to support recovery planning and OCIR.

There is an increasing emphasis on the effectiveness of a banks' governance and management, both ahead of resolution and in preparing for what might be required once a bank enters resolution.

The BoE's proposed resolvability assessment framework sets this out clearly through its focus on:

## Management

Banks should ensure that critical roles would be suitably staffed and incentivised in resolution. This may seem slightly surreal when a resolution authority has the powers to remove the directors and senior management of a bank in resolution and to appoint replacements, but the proposed BoE framework would require banks to identify the roles that would be critical in a resolution and to consider the availability of staff, recruitment and retention arrangements, and succession plans accordingly.

## Governance

Banks should ensure that governance arrangements are in place and fit-for-purpose during resolution, recognising the need for flexibility and the likely involvement of the BoE (as resolution authority) and any appointed administrator in the decision-making process during resolution. This should extend potentially to the terms of reference of existing committees and to the possible appointment of new committees and the introduction of amended decision-making procedures during resolution.

## Communications

Banks should ensure that a communication plan is in place ahead of and during resolution. External and internal stakeholders need to be identified, potential key messages and disclosures should be identified, and the resources should be in place to deliver these communications and disclosures in resolution.

## Documentation

Banks should document their capabilities to deliver effective governance, management and communications in resolution, and should review and test this documentation to ensure that it is credible and would be effective in resolution.

# 12 How KPMG member firms can help



## Strategic advice

- Acting as a strategic adviser for the recovery and resolution journey, helping banks to bring together the various related elements of recovery and resolution planning – recovery planning, resolution strategy, operational continuity, loss absorbing capacity, valuation, and resolution assessment.
- Challenging banks' thinking around proposed solutions – review and challenge of key inputs, assumptions and outputs.
- Assessing the impact of these elements on banks' commercial viability, and exploring ways of maintaining and enhancing this viability.
- Integrating these elements into banks' governance, risk appetite and risk tolerance, management, internal controls and reporting procedures and processes.
- Bringing together experienced consultants who are familiar with the commercial drivers in banking and the regulatory requirements associated with resolution planning and experienced restructuring professionals who can help to design and implement solutions that remove impediments to resolvability.



## Loss absorbing capacity

- Helping banks to issue MREL-eligible securities, including senior non-preferred debt, using a private placement approach.
- Providing advice on banks' preparedness to provide detailed liability data to their resolution authority.
- Proposing solutions in IT and data architecture to support data requirements.
- Preparing information and data for a bank to send to its resolution authority so that the authority can develop a resolvability assessment and resolution plan for that bank.

- Taking a structured approach to collecting and analysing information about the bank, quality assurance over this information, and identifying gaps against the target state of a comprehensive and credible resolution plan.
- For banks regulated by the SRB, this includes the enhancement of their IT architecture and the definition of processes to enable automated Liability Data Reporting (regularly and ad hoc).
- MREL and other Pillar 3 disclosures.



## Valuations

- Providing advice on, and quality assurance of, banks' valuation preparedness.
- Acting as a valuer of banks facing difficulties.
- Support banks in setting up adequate governance, documentation and internal and external review procedures to support resolvability preparedness, including communications with the resolution authorities.



## Funding

- Challenging banks' thinking on resolution funding plans – review and challenge of key inputs, assumptions and outputs.
- Incorporating the outcome of the funding plan into banks' governance documentation.
- Helping banks to run fire drills and test funding capabilities and governance arrangements.



## Operational continuity in resolution

- Identifying and benchmarking critical functions and critical services through performing operational due diligence.
- Developing standalone target operating models consistent with regulatory operational continuity requirements.

- Implementing changes to legal entity and operating structures (including the ring-fencing of retail banks in the UK).
- Helping banks to run fire drills to test the extent to which they have delivered operational continuity outcomes around facilitating recovery options and resolution strategy, financial and operational resilience, identifying any gaps, and establishing a remediation plan.
- Resolution-proofing critical services and helping banks to demonstrate the required outcomes to their resolution authority.
- Maximising the commercial benefits of steps taken to enhance financial and operational resilience.



### Continuity of financial contracts

- Helping banks to establish a process to identify in scope and out of scope financial contracts.
- Supporting banks in their review of, and changes to, existing contracts.
- Challenging governance documentation and communication plans with counterparties to minimise the risk of early termination.



### Access to financial market infrastructure

- Helping banks to undertake a mapping exercise of key services that depend on FMIs, providing challenges of key inputs, assumptions and outputs.
- Supporting banks in formally documenting contingency plans.
- Challenging banks' thinking on reasonable steps to maintain continued access to key processes – providing challenge to key inputs, assumptions and outputs.



### Restructuring

- Supporting documentation of banks' restructuring options in resolution.
- Challenging banks' thinking around proposed restructuring options – review and challenge of key inputs, assumptions and outputs.
- Helping banks to run fire drills and test their restructuring options in resolution.



### Management, governance and communications

- Helping banks to develop and assess succession planning arrangements for critical roles.
- Challenging banks' thinking on governance arrangements currently in place to ensure that they are fit for purpose in the event of resolution.
- Helping banks to develop a communication plan to be executed in resolution.
- Supporting documentation of banks' governance, management and communication arrangements in resolution.



### Responding to regulators

- Helping banks to respond to issues raised by their resolution authority and supervisor in feedback letters and benchmarking reviews, including reviews of the solvent winding down of trading books and connectivity with financial market infrastructures.

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