FINANCE, RISK AND COMPLIANCE

RESOLVABILITY

Resolvability: What does this mean for banks?

BACKGROUND

Banks are the first line of defense towards resolvability, and in 2014, the Bank Recovery and Resolution Directive (BRRD) 2014/59/EU introduced requirements on institutions to prepare and update recovery plans, setting out measures to be taken in the event of a significant deterioration to a bank's financial stability.

Measures must be taken by a bank in accordance with their Recovery and Resolution Plan (RRP) to ensure resilience and resolvability whilst safeguarding financial stability.

The directive provides regulatory authorities the power to ensure orderly resolution whilst establishing a framework for the recovery and resolution of failing credit institutions and investment firms.
The directive highlights the importance of an effective resolution regime. The process of resolution means that regulatory authorities will allow banks to fail, in an orderly way with minimal risk to the financial system.

Resolvability in the banking sector seeks to strengthen confidence in the capability of a bank during a significant economic downturn and goes a step to ensure taxpayers' money is not exposed to significant losses if banks deteriorate and exit the market. Instead, the cost of failure is placed on shareholders and investors when banks do fail and so encourages more responsible risk-taking.

RESOLUTION REPORTING

The Resolvability Assessment Framework (RAF) supports an institution's ability to demonstrate that they are resolvable and seeks to build transparency and accountability within the banking sector following the global financial crisis.

The RAF strengthens the resolution process by holding banks to account, a fundamental component of resolution planning being the assessment of resolvability. This is achieved through the provision of evidence through public disclosures made on resolvability; fostering confidence in a bank's capability to be resolved.

PROPOSAL

The Single Resolution Board (SRB) launched a public consultation on 23rd October 2019 outlining its expectation for banks, this consultation seeks to provide best practice and guidelines on key aspects of resolvability including a bank's capability to demonstrate resolvability and its preparations for crisis management.

The SRB launch of a resolution reporting Q&A platform on 6th November 2019 goes a step to support the challenges banks have with managing their resolution reporting requirements. Regulatory reform is ongoing, and banks continue to face heightened demands on reporting and data capability. The Single Resolution Mechanism (SRM) fosters a robust resolution framework. 2020 will see further development of regulatory standards and implementation in conjunction with the application of the revised legal framework (Credit Risk Regulation CRR II, BRRD II and SRMR II) and alignment with European Central Bank (ECB) Supervisory Review and Evaluation Process (SREP) and recovery planning.

The SRB view resolvability as an iterative process between them and banks. As banks continue to report on their resolvability, they must also ensure sufficient and effective implementation of their resolution strategy. Effective reporting must be underpinned by a robust governance framework, communication strategy and MI whilst banks must remain mindful of the financial market infrastructure and their capability to execute resolvability requirements.

The SRB publication of expectations for banks details 7 dimensions which banks must meet to be considered resolvable. These include:

- Governance
- Loss Absorption and recapitalisation capacity
- Liquidity and funding resolution
- Operational continuity and access to FMIs
- Information systems and data requirements
- Communication
- Separability and restructuring.

PRUDENTIAL COMPLIANCE

The Bank of England (BoE) Supervisory Statement (SS4/19) published in July 2019, outlines key outcomes for resolvability and sets out the expected approach to assess resolvability.

The Prudential Regulation Authority (PRA) has an expectation that firms will take an appropriately forward-looking view of its preparation for resolvability and how it would achieve these outcomes.

The PRA Policy Statement (PS15/19) on resolution assessment and public disclosure by firms outlines expectations in relation to external disclosure, and states the requirement for institutions to provide a summary disclosure of the report on the assessment of its preparations for resolution.

KEY REQUIREMENTS

The PRA has stated its minimum expectation from firms in relation to its assessment of preparation for resolution and the topics to be included in the biennial report:

- Information on the group structure and any aspects of the structure which could inhibit or enhance an orderly resolution
- Explanation of the firm's understanding of its resolution strategy and actions to support a timely resolution
- Outline of firm capabilities, resources and arrangements for resolution and a summary of how the firm would achieve resolvability of key outcomes to comply with the PRA approach to assessing resolvability Statement of Policy (SoP)
- Implementation plan to reduce or remove risks and key controls in place
- Testing summary
- Governance and oversight process for performing its resolvability assessment and producing its report.

TIMELINE

2019

July 2019
- RAF final publication

23rd October 2019
- SRB launch public consultation on expectation from banks

28th October 2019
- SRB launch 2020 work program

6th November 2019
- SRB launch resolution reporting Q&A

2020

First Friday in October 2020
- First cycle of RAF reporting

2021

Second Friday in June 2021 and biennially thereafter
- External disclosure

2022

First Friday in October 2022
- Deadline for compliance and second cycle of RAF reporting

IMPACT

Firms must demonstrate their ability to continue with financial and operational activities whilst competent authorities begin the restructuring process, ensuring adequate resolution-ready financial resources are available to absorb further losses.

Reasonable measures should be taken to facilitate continued access to custody services, clearing, payment and settlement services in the event of resolution.

The banks' resolvability strategy is only feasible when it can be effectively applied in the appropriate time frame and if potential impediments to the business reorganisation have been considered as outlined in Article 52 of BRRD. These expectations are underpinned by three layers which the SRB have determined as objectives, principles and expectations.

RESOLUTION REPORTING AND DISCLOSURE CHALLENGES

The PRA acknowledge barriers to resolvability and seek to address this by mandating firms assess internal capabilities, resources and arrangements to achieve key resolvability objectives.

Challenges for in scope firms include:

Reporting
- Size and scale of the reporting; PRA expects the report to typically be 250 pages long
- Sufficient level of detail in the report to allow competent authorities understanding of firm's preparations for resolution based on size, complexity and structure of its business operating model.

RAF Compliance

- Minimum Own Funds and Eligible Liabilities (MREL) reporting compliance
- Liquidity monitoring; funding in resolution
- Judgement and interpretation of requirements
- Sufficient level of transparency detailing firms understanding of its resolution strategy in their public disclosure
- Governance and attestation
- Disclosure (regulatory and public)
- Assurance and oversight (Evidence)
- Alignment of Recovery Plan with firm Risk Management Framework
- Consider compliance with PRA Operational continuity in resolution (OCIR) policy.

Firm Capability

- Address risks of early termination of contracts following resolution and impact assessment on stability to the bank and wider financial system
- Assess valuation capability to support resolution
- Ability to execute restructuring plan in the event of resolution.

Firms should consider any risks identified and manage these through adequate risk mitigation planning whilst ensuring minimal disruption to financial and operational services during the resolution and restructuring process.

The SRB expectations guidance seeks to support a commonality between firms' approach to reporting. This emphasises the enormity of the reporting requirements and fundamental need to harmonise the approach to resolvability in the long term.

CAPCO FINANCE, RISK AND COMPLIANCE (FRC)

For financial institutions, new regulations increase complexity and cost. Through guiding and implementing FRC strategies operationally and harnessing new and emerging technologies for Regtech, Capco has built a reputation of empowering clients to turn finance, risk and compliance into a competitive advantage.

To support in your understanding and implementation of Resolution and Resolvability requirements, Capco FRC is a team of experts in regulatory change execution. Our FRC team has a wealth of experience in supporting clients to meet regulatory reporting and disclosure requirements in an efficient and compliant way.

CAPCO SOLUTION DELIVERY FOR CLIENTS

The continuous reform of the regulatory landscape following the global financial crisis has led to greater robustness and resilience within the banking sector but at a cost of significant time, money and effort to manage the technical implications of compliant regulatory change implementation for reporting institutions.

Here's how Capco FRC can support with these challenges:

- Review of operating model and internal control framework
- Regulatory rulebook compliance
- Assess the alignment of the RAF with the risk management framework and RRP
- GAP analysis of the current reporting framework and data sources
- Validation and assurance; reporting governance
- Peer benchmarking
- Regulatory training
- Seminars on market developments and thought leadership.

TO UNDERSTAND THE IMPLICATIONS OF RECOVERY AND RESOLUTION FOR YOUR BUSINESS, PLEASE CONTACT ONE OF THE FOLLOWING TEAM MEMBERS.

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