UK FINANCE

A response to the

Prudential Regulation Authority Consultation Paper 10/23
on
Solvent exit planning for non-systemic banks and building societies

October 2023

Introduction

UK Finance is the collective voice for the banking and finance industry. Representing more than 300 firms, we act to enhance competitiveness, support customers, and facilitate innovation.

We are pleased to respond to the PRA's CP10/23 which establishes requirements of firms in relation to planning for an orderly solvent exit as part of their business-as-usual activities, and if needed, to be able to execute one.

Our members are supportive of the PRA's clarification of its expectations in relation to solvent exit, an area in which they are already fully engaged. We support the aims of solvent exit planning which is to avoid the Bank Insolvency Procedure (BIP) and thereby achieve better outcomes for depositor including by avoiding a temporary loss of access to their funds which may happen in the BIP. We have only a few concerns regarding this consultation paper as described below.

Plan activation - a disclosable event?

Members are unclear whether the invocation of a solvent exit plan would qualify as a disclosable event. Our expectation is that no market disclosure should be required, in the same way that firms are not required to disclose their PRA buffer. Public notification would likely diminish the market value of any listed business and lead to second order effects that would result in lower achieved value-realisation for disposals, as the firm would be seen as a distressed seller.

More broadly notification could affect confidence in firms with a similar business model carrying out their business-as-usual activities. The recent collapse of Silicon Valley Bank (SVB) in the US impacted other mid-tier banks there, as depositor withdrawals accelerated from other banks which consumers perceived to be similar to SVB, despite them being well capitalised and holding sufficient liquidity.

We appreciate that the intention of this Consultation Paper (CP) is to make this sort of planning ubiquitous across all banks and building societies, which may improve investor and depositor attitudes towards exit planning. However, boards, and individual board members may have different risk appetites in relation to the 'disclosabilty' of plan activation. We would therefore welcome formal assurances from the PRA and the UK Listing Authority that solvent exit plan execution or a PRA

direction to prepare a detailed solvent exit execution plan will not be a disclosable event, recognising that, firms will nonetheless make their own individual judgments dependent on circumstances.

Solvent exit indicators

Solvent exit indicators will be business model specific and should re-use existing triggers where appropriate, for instance those used for recovery planning purposes. They should be a mix of qualitative and quantitative triggers with no automatic invocation trigger applied or expected by the PRA. Triggers will be set at a level that would reasonably allow a firm to instigate and successfully execute a 'slow burn' solvent exit, arising perhaps as a result of a change in circumstances that means its business plan is no longer realisable.

Members feel that it is unlikely that solvent exit planning would be applicable in the case of a more rapidly manifesting liquidity stress, where an 'over the weekend' resolution, probably based on the BIP, would be the mechanism of choice. It would be helpful if the PRA could confirm that it shares this view so that liquidity indicators are not set at such a level that prevents maturity transformation and impedes the flow of lending to the real economy.

Members have also expressed some concern as to whether the PRA envisages that quantitative capital and liquidity indicator triggers for solvent exit planning would be set more conservatively than those already adopted by banks in respect of capital and liquidity utilisation and headroom over the Total Capital Requirement and individual liquidity guidance. These already form a fundamental part of Internal Capital Adequacy Assessment Processes (ICAAP) and Internal Liquidity Adequacy Assessment Process (ILAAP), as well as strategic planning more generally. Our expectation is that they would not be higher, as particularly in the case of liquidity during the execution of a solvent exit, firms may have (limited) access to new deposit taking functions should that source of funding be vital to the execution of the plan.

Resources and costs

Controlling the cost of solvent exit planning

Members are concerned that the PRA may have underestimated the cost of preparing a first stage solvent exit plan. Costs will well exceed the £25K-£75K figure suggested in the consultation, as the amount of work needed to create this analysis is likely to significantly exceed that of completing a recovery plan and, for some firms, consume significant amounts of internal time. Additionally, members are increasingly expected to perform 2nd and 3rd line reviews for similar regulatory documents with many relying on external consultants (as recommended in the Supervisory Statement) the scarcity of which will be an additional cost to firms.

Our other concern is the potential for 'mission creep'. Since their first introduction ICAAP and ILAAP documents have expanded to become multi hundred-page documents that can take up to 3 months to produce and review. Their creation uses resources from a number of internal teams, and in some cases external consultants, as well as rigorous, exhaustive oversight by board members. Members worry that solvent exit analysis will see similar expansion in size over time with costs rising accordingly.

Importance of PRA expectation management

Boards are unlikely to want to consider a document that they are accountable for to come to them lacking in detail and may look to increase the scope of the plan. In our view there is significant cross over from ICAAP/ILAAPs and recovery planning.

So, it would be helpful for the PRA to acknowledge publicly its expectations that first stage solvent exit analysis should be light touch and may draw on existing recovery planning and other documentation and that it does not expect firms to start from scratch. PRA messaging should indicate that the purpose of the solvent exit analysis process is to support preparedness by helping firms to understand and plan for the external capabilities - such as valuations by third parties - and other resources they may need were they to be required by the PRA at a future point, to produce a detailed solvent exit execution plan. This would provide a helpful indication to boards or advisors that first-stage solvent exit plans need not be extensive, overly detailed documents and help to avoid our feared 'mission creep'.

UK Finance will happily work with the PRA to organise workshops to communicate this and other messages to industry participants.

Solvent exit planning in the context of MREL preparation

We wonder if there is a lacuna in the PRA and Resolution Authority's thinking on solvent exit planning and preparing to become a bail-in bank?

As we understand it Solvent Exit Planning is only required by the PRA of firms expected by the Resolution Authority to enter the BIP. Firms must notify the Resolution Authority three years in advance of the point at which they expect to cross the Minimum Requirement for own funds and Eligible Liabilities (MREL) size threshold of £15-25 billion. The Resolution Authority will then at some point, but not necessarily when notified by the firm, (as we understand it) require the firm to commence planning to raise MREL in 3 years' time. The firm has a further 3 years to raise its full MREL requirement.

So, there may be a situation where a firm has been instructed, or can reasonably expect to be instructed, by the Resolution Authority that it is required plan to raise MREL and thus become a bail-in firm, although it has not yet crossed into the MREL zone. Would the PRA expect it to carry out (resource intensive) solvent exit planning during the 3 years whilst it is on the pathway to becoming a bail in firm, and engaging with investors to that effect, or does the PRA requirement to plan for solvent exit cease at the point the firm has notified the Resolution Authority that it expects to cross the MREL threshold 3 years in the future.

We would appreciate clarity from the PRA and Resolution Authority about how firms should approach solvent exit planning (or preferably not) in this interim period.

During the execution of a solvent exit plan

Continued deposit taking?

We would also appreciate clarity on what new deposit taking functions firms would be able to carry out whilst executing a solvent exit. During discussions on this topic, we were unable to come to a consensus on whether firms would be able to raise deposits on the open market or which deposit taking products they could continue to offer whilst carrying out a solvent exit. Apparently different consultancies have differing views on this, and firms have received various answers. We would therefore appreciate a clear set of functions firms may and may not carry out whilst executing a solvent exit. Some deposit taking will be necessary to cover firms' liquidity needs during the controlled sell off of assets to avoid them rapidly becoming distressed sellers. We understand that the PRA's appetite to allow firms to continue to raise deposits may differ on a case-by-case basis depending on a firm's business model.

Formal recognition of this by the PRA would be helpful to ensure that the invocation of a solvent exit plan does not result in automatic exclusion from all deposit markets. For instance, the PRA could vary a firm's permissions allowing it to raise deposits only up to the FSCS compensation limit.

Ongoing compliance with the Total Capital Requirement?

Members have also expressed a variety of understandings about which version of capital the PRA envisages that firms would be required meet over the course of a solvent exit. Our assumption is that at the point of invocation of the solvent exit plan the firm should meet its Total Capital Requirement but that it would not have to maintain the additional suite of buffers. Over the course of the solvent wind-down however, as assets are sold and tend to zero, we wonder if an increasingly scaled down capital requirement would be appropriate and would appreciate discussing this point with the PRA in more detail.

Impact of the Consumer Duty

In conversations with the PRA on the Resolution Assessment Framework, we have noted that there may be tension between the aims of resolution and the need for firms to carry on providing critical economic functions and good outcomes for customers through their obligations under the FCA's Consumer Duty requirements. We see that there may be a similar tension in relation to solvent exit planning - the FCA may expect firms to continue lending and providing critical economic functions during the execution of a solvent exit plan. These obligations may make it difficult as firms seek to wind down their PRA regulated activity and as such may interfere with executing a solvent exit. We would therefore like clarity on how firms should approach their Consumer Duty obligations during solvent exit.

Of course, we would be delighted to discuss with the PRA solvent exit team our views in more detail, if this would be helpful.

Responsible Executive

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