



Consultation Paper 10/23 on Solvent Exit Planning for Non-Systemic Banks and Building Societies

July 2023



Contents

Section 1: Introduction to Consultation Paper 10/23

Section 2: Planning for a Solvent Exit within Business-as-Usual (BAU) activities

Section 3: Producing a Solvent Exit Execution Plan and Executing a Solvent Exit

Section 4: How Reply Can Help



Section 1: Introduction to Consultation Paper 10/23



Overview

The Consultation Paper outlines the Prudential Regulation Authority's ("PRA") proposals for non-systemic banks and building societies in the UK to prepare, as part of their business-as-usual activities, for an orderly 'solvent exit' and if needed, to be able to execute one.

The PRA identified in 2021 and confirmed in its business plan for 2022-23 that it would do more in the coming years to increase confidence that firms can exit the market with minimal disruption, in an orderly way, and without having to rely on the backstop of an insolvency or resolution process. This is because:

“

Supervisors of smaller mid-sized firms generally spend a small fraction of their time on orderly exit planning in normal times. Perhaps partly as a result of this, the business of managing these exits often proves extraordinarily challenging and time-consuming when it comes to the crunch.

”

Sam Woods

Deputy Governor for Prudential Regulation and
Chief Executive Officer of the Prudential Regulation Authority

The proposals include:

- ✓ New rules and expectations stating that firms must prepare for a solvent exit as part of their BAU activities, and that firms must document those preparations in a solvent exit analysis;
- ✓ New expectations, which would apply only if solvent exit became a reasonable prospect for a firm, on how firms should: (i) prepare a detailed solvent exit execution plan, and (ii) monitor and manage a solvent exit; and,
- ✓ Consequential changes to SS3/21 'Non-systemic UK banks: The Prudential Regulation Authority's approach to new and growing banks' by amending the 'solvent wind down' section. This will be explored on the next page.



Amendments to SS3/21 Non-systemic UK banks: the Prudential Regulation Authority's approach to new and growing banks

	SS3/21	CP10/23
Overview of the PRA's supervisory approach for new and growing banks	The PRA's earlier approach for non-systemic banks focused largely on 'solvent wind downs.'	The proposed changes shift the focus from a solvent wind down to completing a 'solvent exit' of the business.
Orderly exit	<p><u>Recovery and resolvability</u></p> <p>SS3/21 referred to the overarching term 'orderly exit' for banks that no longer have a viable business model and which need to exit the market following unsuccessful attempts to recover. These exit options include going concern and resolution routes, where going concern routes refer to the actions the bank may be able to take to facilitate its own exit from the market. These firm-led actions include selling the firm as a whole or winding down the firm as a whole while maintaining solvency throughout to the point it can be liquidated safely, repaying all depositors and creditors in full. Resolution routes refer to the firm's entry into the resolution regime, which includes insolvency.</p>	<p><u>Recovery, solvent exit, and resolution</u></p> <p>CP10/23 revises the routes through which a bank may discontinue its businesses to:</p> <ul style="list-style-type: none"> • Recovery: a firm implements recovery options such as asset sales and disposal options to restore its financial position following a significant deterioration of its financial situation; • Solvent exit: a firm ceases its PRA-regulated activities while remaining solvent; • Resolution: a firm enters into the resolution regime.
Solvent wind down / Solvent exit planning	SS3/21 contains a subsection on solvent wind down, which is a way for firms to exit the market in an orderly way. For a new or growing bank experiencing stress, entering SWD may effectively be the final going concern option before resolution. The board is responsible for deciding whether to enter a wind down and for ensuring solvency during implementation. A board-approved SWD plan must be in place, which may be reviewed by the PRA. Additionally, as part of forward capital planning, banks should understand the constraints on the feasibility of SWD as an action.	CP10/23 removes the subsection on solvent wind down and replaces this with solvent exit planning, which requires that a firm should produce a 'solvent exit analysis' as part of its business-as-usual activities; and a 'solvent exit execution plan' when solvent exit becomes a reasonable prospect, both of which must be approved by the board and be proportionate to the nature, scale and complexity of the firm.



Scope of the Consultation Paper

This Consultation Paper is applicable to the followings firms:



Applicable

- UK Banks*
- UK Building Societies*



Not Applicable

- Credit Unions
- Branches of third-country groups

Timeline



*In particular, UK-incorporated banks and building societies which are:
(i) NOT subject to the Operational Continuity Part of the PRA Rulebook; or
(ii) NOT members of a group which is a global systemically important institution (G-SII); or an other systemically important institution (O-SII).



How It Will Affect Firms?

Successful solvent exit



Less costly and more efficient



Benefits

Increase the chance of a successful solvent exit

Having a solvent exit plan as part of BAU will allow firms to make a timely decision guided by clear and forward-looking indicators and overseen by appropriate governance that would increase a probability of a successful solvent exit. This, therefore, will help firms to reduce the risk of losses.

Less costly exits and more efficient

Preparing for a solvent exit plan in advance would facilitate a firm for a more efficient and less costly for an exit when it occurs since the firm would already have created their governance procedures, understood the timeline and relevant actions, as well as any potential risks that may occur during the execution.

Additional time

Firms will need to spend additional time to familiarise themselves with the proposals, conduct a gap analysis, set up their internal governance and produce their first solvent exit analysis. This would be amounted to one full-time equivalent (FTE) staff, depending on the complexity of their business models and to the extent where firms can leverage and adapt their existing infrastructure from their recovery planning.

Costs of compliance

There would be an extra operational compliance costs to firms arising from the requirement to implement a solvent exit framework, including costs from producing and maintaining a solvent exit analysis, embedding the plan into BAU, reviewing their analysis and monitoring relevant indicators.

It is estimated that the present value of total costs would be around £ 325,000 to £ 775,000 per firm

Disadvantages



Costs of compliance



Additional time



Section 2: Planning for a Solvent Exit within BAU Activities



Planning for a Solvent Exit as Part of BAU Activities

- The PRA introduces new expectations to help firms prepare for an orderly 'solvent exit' as part of their BAU activities.
- Firms should prepare for a solvent exit by producing a 'solvent exit analysis' regardless of whether the firm can foresee the prospect of the solvent exit.
- However, if the firm can foresee a reasonable prospect of the execution of a solvent exit, a 'solvent exit execution plan' should be produced. See Section 3 for more details.



- Firms should take into consideration of any plausible circumstances that could lead to the need of executing a solvent exit.
- Examples of situations where execution of a solvent exit may be required:
 - Facing financial issues, such as economic, market, or significant financial loss;
 - Facing non-financial issues, such as a major governance failure, or loss of critical IT infrastructure ;
 - No longer meeting threshold conditions for authorisation as a deposit-taker AND having no viable strategy for returning to achieve required criteria within a reasonable timeframe; and/or
 - Deciding to change business strategy or priorities and not engaging in a deposit-taking activity.

Definitions



Solvent Exit

the process through which a firm ceases to operate its PRA-regulated activities, e.g., deposit-taking, while remaining solvent.



Solvent Exit Analysis

a document outlining preparations for solvent exit of a firm.

The PRA expects firms to base their preparations for an execution of a solvent exit either in:



Stressed Circumstances

- For instance, a firm has difficulty accessing to its capital, funding or liquidity.
- It is worth noting that the preparations of the solvent exit under this expectation may NOT be sufficient for a 'fast failure'.



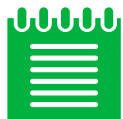
Non-Stressed Circumstances

- For example, a firm decides to change its business strategy to cease its deposit-taking activities in order to pursue business opportunities in other sectors.



Solvent Exit Analysis

A firm should produce a solvent exit analysis, including the following topics as a minimum:



Solvent Exit Actions

- Outline any **actions that a firm needs to cease its regulated activities** while remaining solvent.
 - E.g., augmenting and amending its recovery options (e.g., selling businesses/assets, transferring liabilities), and transferring and/or repaying deposits.
- Set out the **timeline for the solvent exit actions to be executed**, taking into account any internal or external factors.



Solvent Exit Indicators

- Set out indicators to help a firm identify and monitor insights on **when a solvent exit should be initiated** and assess the potential success of executing such a solvent exit.
- The indicators should (i) be calibrated in a **forward-looking** manner; and (ii) include **financial and non-financial metrics**, both quantitative and/or qualitative.



Potential Barriers and Risks

- Define any potential barriers and risks, and **anticipated impacts**, including those that are market-wide and firm-specific, to the execution of the exit.
 - E.g., the existence of uncontactable customers, a complex legal and corporate structure, a change in market conditions that decrease the sale value of assets.
- Evaluate the potential impact of the identified barriers and risks on the outcome and **efficacy of its solvent exit actions** and take reasonable steps to mitigate or remove material barriers or risks.
- Set out **possible dependencies** that may be necessary for executing a solvent exit decision.



Resources and Costs

- Set out **financial and non-financial resources** needed to execute a solvent exit, including any additional costs, e.g., costs to cover haircuts, specialist services fees, redundancy and retention payments and pension fund deficits.
- Identify the **absolute minimum** level of financial resources required, below which there would be no reasonable prospect of successfully executing a solvent exit.



Communication

- Outline any **internal and external stakeholders** who could be affected by such an exit, including, regulators, depositors, creditors, shareholders, staff and other market participants.
- Specify the **methods and timing** of communication, both before and during the execution.
- Assess how a firm would handle and **mitigate any adverse impacts** of a stakeholder's reaction, such as potential depositors runs, key staff resignations.



Governance and Decision-Making

- Set up clear governance arrangements with a named executive accountable for:
 - BAU preparations for a solvent exit;
 - Escalation and decision-making regarding a solvent exit; and
 - Monitoring the execution of a solvent exit.
- Has the capacity to provide **timely, adequate and appropriate information**, conduct analysis and make realistic projections of the firm's financial resources to inform decisions regarding a solvent exit.
- Make timely decisions with **necessary approvals**, taking into consideration of relevant information and solvent exit indicators.



Assurance

- Carry out appropriate **assurance measures** for its solvent exit preparations. This can be done internally or externally.
- Review and **update the solvent exit analysis at least once every three years** and whenever there is a material change affecting solvent exit preparation.
- The solvent exit analysis should be **approved** in accordance with the firm's governance arrangements.

- The level of detail of the analysis should be **proportionate** to the nature, scale and complexity of each firm.
- The solvent exit analysis may be included as a **discrete section in its recovery plan** or **prepared separately**.
- It is recommended for a firm to take into account **plausible circumstances** that could lead to the necessity of executing a solvent exit.



Section 3: Producing a Solvent Exit Execution Plan & Executing a Solvent Exit



Solvent Exit Execution Plan

- The PRA expects a firm to produce a solvent exit execution plan when there is a reasonable prospect that the firm may need to execute a solvent exit (i.e. solvent exit indicators have been triggered) or the firm is requested by the PRA to produce a solvent exit execution plan.
- The solvent exit execution plan must be reviewed, sufficiently challenged and approved by the firm's Board of Directors or senior governance committee.
- The solvent exit analysis prepared as part of business-as-usual activities (see Section 2) should be the starting point for its solvent exit execution plan.
- A non-exhaustive list of contents that the PRA would expect a firm to set out in its solvent exit execution plan is outlined below.



Actions and Timelines

From the point of **initiation to the removal** of the firm's Part 4A permission – including actions that the firm will take to identify, and transfer or repay, deposits; sell assets; and transfer or repay other liabilities (if applicable).



Barriers and Risks

The firm should **update the barriers and risks identified** in its solvent exit analysis prepared during BAU, to reflect the circumstances leading to the initiation of a solvent exit. The execution plan should also include how the firm will **identify, monitor and respond to emerging barriers and risks throughout the execution** of the solvent exit.



Detailed Action Plan

The **action plan** for the execution of the solvent exit should cover:

- The identification, and transfer or repayment of **deposits**;
- Dealing with customer **complaints**;
- Dealing with existing contractual **commitments**;
- The sale or transfer of all or part of the **business, assets and liabilities**;
- The vacation of **premises** and disposal of **fixed assets**;
- **Communication** with stakeholders; and,
- Any **formalities** to comply with applicable legal and regulatory requirements, such as directors' duties and shareholders' rights under company law, data protection law, employment law and insolvency procedures.

Assessment of Resources



The execution plan must detail the **financial and non-financial resources** needed to execute a solvent exit and how the firm will maintain access to and monitor the adequacy of resources needed.

Governance Arrangements



The execution plan should include **roles and responsibilities** in making the formal decision to initiate the solvent exit, as well as in managing and monitoring the execution of the solvent exit.

Communication Plan



The execution plan should include a **clear and detailed communication plan for stakeholders** impacted by the solvent exit. For example, these include regulators, depositors, creditors, shareholders, staff, and other market participants. The communication plan should cover:

- anticipated reactions from different stakeholders;
- how such reactions could affect the solvent exit; and,
- how the firm will respond to stakeholder reactions.

Organisational Structure, Operating Model and Internal Processes



The execution plan must be sufficiently detailed to inform itself and the PRA of how it will complete the cessation of its regulated activities and must be appropriate for its **business model, structure, operations, risk strategy and the circumstances** leading to the initiation of a solvent exit.



Executing a Solvent Exit

During the execution of a solvent exit, there are actions that a firm must take, which include:

Continual Assessment

The firm must continually assess whether its solvent exit actions are likely to succeed and whether they remain feasible and appropriate or whether it would need to take further actions to facilitate completion.



Regulatory Communications

The PRA must be made aware and kept informed, together with other stakeholders, as appropriate, throughout the execution of a solvent exit. Any risks or concerns about the successful completion of a solvent exit must be raised to the firm's PRA supervisor.



Comply with PRA Requirements

The firm must submit an application to the PRA to have its Part 4A PRA permission removed. The firm must comply with the PRA's threshold conditions, rules and other regulatory requirements proactively and determining whether it may fall short of any obligations during the execution of a solvent exit.



Efficient Decision-Making

The firm should monitor the projected and actual levels and trends of solvent exit indicators and implementation of the execution plan to inform decision-making and determine whether and when insolvency procedures should be invoked.



Section 4: How Reply Can Help



Next Steps

Avantage Reply, part of the Reply Group, specialises in Financial Services consulting, specifically Regulatory Advisory, Risk Transformations, Treasury and Capital, and Quantitative Modelling.

We support clients in implementing and complying with regulatory landscapes and bring extensive experience from collaborating with to–level executives in globally leading financial institutions.

If you would like to share your views before the consultation closes on **27 October 2023** or for any questions and support on how any of these changes may affect your firm, please get in touch.



Our Team



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Vishwas has international FS consulting and risk management experience across Europe, the US, the Middle East and SE Asia, leading a multitude of risk transformations and change programmes. Vishwas is a trusted advisor to the C-Suite across a number of financial institutions with strong working relationships with industry associations and academia and is a speaker at industry events and forums.



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Blendi is an experienced Manager with a sound knowledge of risk management, Recovery Plans, Wind-Down Plans, operational risk and project management. He has worked on various projects in the UK and mainland Europe. Blendi has an understanding of Recovery Planning and extensive experience working On Wind-Down Plans, where he has developed several plans for different clients. He has also worked in process mapping of different sections of the Single Resolution Board (SRB) regulation.

Blendi's experience has involved working independently within different teams at large banks for extended periods of time, reporting directly to senior management. He has previously led the delivery of other regulatory driven projects.



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Kasimaporn is a Consultant who has a solid legal background in Corporate, Mergers and Acquisitions (M&A), and Banking industry, with extensive experience over three years in a law firm in assisting domestic and cross-border clients in controlling their legal risks by interpreting laws and regulations, defining policies, advising in regulatory reporting, conducting analysis to identify complex issues, needs, and risks and suggesting business-driven solutions.

Kasimaporn has well-developed analytical thinking, creative problem-solving, organisational, presentation and communication skills. She has good commercial awareness and attention to detail. Kasimaporn also performs well under pressure and in a fast-paced environment. She can work independently and efficiently on the projects. Kasimaporn is passionate about her clients and takes an interest in helping them achieve their business goals.



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Kavisha is a financial regulatory consultant with a specialist legal background. Her regulatory experience covers financial advisory, asset management, payments, financial crime and cryptocurrency work in the UK and Singapore. She has advised financial institutions, international organisations and start-ups on regulatory and compliance matters in respect of business models, licensing, regulatory reporting requirements, risk management, distribution of products, business conduct requirements and recovery planning in Europe and Asia. She is able to develop a deep understanding of evolving regulatory frameworks and guidelines to ensure adherence and has experience of collaborating with internal and external stakeholders to gather necessary data and information in order to prepare and submit accurate and timely regulatory reports to relevant authorities.



