Why are savvy Financial Services Directors of stable and growing firms talking about solvent wind-down plans? David Taylor unravels the mystery.

Teneo Insights / July 2021

Ever since the last financial crisis, the PRA and FCA have been tackling the issue of how to avoid the next one. Recovery and Resolution Plans and increases in regulatory capital were the first iteration, which focused on banks. Over the last decade the scope of regulatory interest has expanded and evolved. Now both the PRA and FCA are increasingly recognising the value of solvent wind-down plans (SWDPs) and requiring Directors to take them seriously. Importantly for directors, they are requiring both executive and non-executive directors to get involved, to know their plans and to be accountable for them. Directors who fully engage with the process are much less likely to breach their statutory duties, particularly in challenging times.

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What is a Solvent Wind-Down Plan?

The FCA state in their FCA Wind-down Planning Guidebook that the aim of an effective wind-down plan is, "to enable a firm to cease its regulated activities and achieve cancellation of its permission with minimal adverse impact on its clients, counterparties or the wider markets". Although the PRA has not written a guidebook (although it states in its Discussion Paper DP1/21 April 2021 – A strong and simple prudential framework for non-systemic banks and building societies that it may do) its view that SWDPs are a key component of recovery and resolution planning is clear. Its definition is, "SWD is a way for firms to exit the market in an orderly way, by winding down their business in its entirety to the point it can be liquidated safely, repaying all depositors and creditors in full."[1]

The FCA states[2] that the wind-down plan should include/address the following:

- information which would help an administrator or liquidator to quickly identify customer funds and return them as a priority;
- funding to cover the solvent wind-down of the firm, including the return of all customer funds;
- realistic triggers to start a solvent wind-down;
- the need for any counterparties (e.g. merchants) to find alternative providers, and
- realistic triggers to seek advice on entering an insolvency process.

We look at it slightly more broadly; the interests of the shareholders are also important and the efficient execution of a solvent wind-down will help to protect shareholder value. Whether you're single or dual regulated, it is clear that a robust, coherent SWDP, that could be executed in whole or in part should the need arise, is becoming a requirement for a broad range of financial services firms.

It is reassuring to know that the regulators do recognise that the effort to prepare SWDPs should be proportionate to the size and complexity of the firms, and that some planning can be left to be triggered by early warning indicators, as long as they are in place.

Who needs one?

This is neither a simple nor static question, the requirements are changing rapidly. Back in 2016 when SWDPs were first talked about, it was very much in the vein of, "we think they're quite a good idea".

The requirement has expanded ever since. The FCA states that they are relevant to (but not a requirement of) all holders of Part 4a permissions. The PRA proposes in its discussion paper DP1/21[3] to review bank's SWDPs bi-annually, alternating with their Recovery plans and states that, "…new and growing banks should have board-approved solvent wind-down (SWD) plans in place at the point of authorisation, and should maintain these plans, regularly updating them to ensure they remain appropriate as the business develops". It further suggests, "an option would be to extend the role of SWD planning to all firms".

The FCA recently extended the range of firms who require SWDPs to include Payment Services Providers (PSPs) including payments institutions (PIs) and e-money institutions (EMIs) in its Finalised Guidance - Coronavirus and safeguarding customers' funds: additional guidance for payment and e-money firms. Stating that, "We are clarifying that, as part of satisfying us that they have such procedures, we require APIs, AEMIs, and SEMIs, to have a wind-down plan to manage their liquidity, operational and resolution risks. The wind-down plan should consider the winding-down of the firm's business under different scenarios, including a solvent and insolvent scenario".

Although the requirement is changing, the regulators are clear that it is not just relevant to stressed firms; the FCA states "…there is no guarantee that a normally functioning firm will not fail in the future. Failure of a firm could occur suddenly. Without proper advanced planning, a firm running into difficulties has an increased likelihood of a disorderly wind-down…"[4]

In short, even for those firms where there is currently no formal requirement now, it might be coming soon! Irrespective of this, well advised directors should consider developing a plan as it will help anticipate potential problems before they become major issues, whilst there is still time to identify a resolution.

Why should Directors take an interest?

The regulators have recognised that for many firms the preparation of an SWDP has not been a priority activity and has been delegated down the organisation. The SWDPs have been rather theoretical, developed in a silo, focus on balance sheet wind-down to the exclusion of the practical elements, and the board is not necessarily aware of the detail. The regulators are not comfortable with this and have been taking an increasingly active approach in addressing their concerns.

1 PRA SS3/21 April 2021
2 FCA Finalised guidance Coronavirus and safeguarding customers' funds: additional guidance for payment and e-money firms, 9 July 2020
3 DP1/21 April 2021 – A strong and simple prudential framework for non-systemic banks and building societies
4 FCA Wind-down Planning Guidebook

The FCA says, "Wind-down plans need to be credible and have realistic timescales and assessments of how financial and non-financial resources are maintained while the firm exits the market".[5] A clear indication that the regulators require practical and operationalised plans, and will no longer accept a theoretical exercise. Ultimately, executive and non-executive directors are responsible for the SWDPs and are increasingly being held accountable for them by the regulators.

What happens if they don't?

As mentioned above, the range of firms where there is a formal requirement to have an SWDP is increasing and is not limited to stressed firms. Where the regulators have any concern, they will review the SWDPs in detail. They will be looking to ensure that the SWDPs are realistic in the environment in which they are likely to be executed and that they are actionable; "IP ready", i.e. that an Insolvency Practitioner (IP)/Administrator could pick the plan up and be able to implement it without significant rework. If the regulators feel that the plans are not actionable and/or the scenarios and assumptions are not realistic then they may ask for the plan to be reworked, typically within a couple of weeks. If the result is still not a robust SWDP, and getting there may be a significant effort, then they may use their powers under Section 166[6] to force the firm to engage an independent Skilled Person to advise on SWDP update and report back to them, again in a very short timescale. This is expensive, avoidable and will not enhance the firm's reputation with them. Given the fact that the directors are accountable for the SWDPs, this also puts significant pressure on them, frequently at a time when there are plenty of other important priorities. There is also much greater risk of the directors being in breach of their statutory duties and corporate governance requirements. This could lead to the possibility of incurring personal liabilities.

What's the opportunity?

As well as addressing regulatory requirements or guidance, developing an SWDP can be an advantageous process, particularly if it is integrated into the overall governance process, benefits include:

- It can provide the directors with confidence that the regulatory requirements are being met and that a solvent wind-down could be achieved in extremis.
- It can help highlight, and therefore address, operational risks such as key person risk, onerous/difficult to exit contracts, deficiencies in management information or as a trigger to resolve background issues (e.g. dormant/non-contactable clients or an overly complex group legal entity structure).
- It also gives the directors confidence that their statutory requirements and duties would be appropriately managed should the business become financially challenged, as the SWDP will include triggers to ensure appropriate action is taken before the "point of no return" and insolvency is reached.

Conclusion

The scope of firms required by their regulator(s) to have an SWDP is increasing and the required content of the SWDPs is expanding to include practical wind-down considerations.

The regulators are taking a more active role in ensuring that the plans produced are fit for purpose and that the directors:

- have taken an active role in their preparation;
- know the key elements of them;
- understand the triggers to implement them, and
- will be willing to trigger them before it's too late and an insolvent exit is the only outcome.

Executive director leadership and NED challenge of the firm's SWDP is critical and expected. Preparation and review of SWDPs is better undertaken unprompted when it can be completed over time and with maximum benefit to the business, rather than in extremis and when under pressure.

5 FCA – FG 20/1 Our framework: assessing adequate financial resources
6 Section 166 of the Financial Services and Markets Act 2000

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