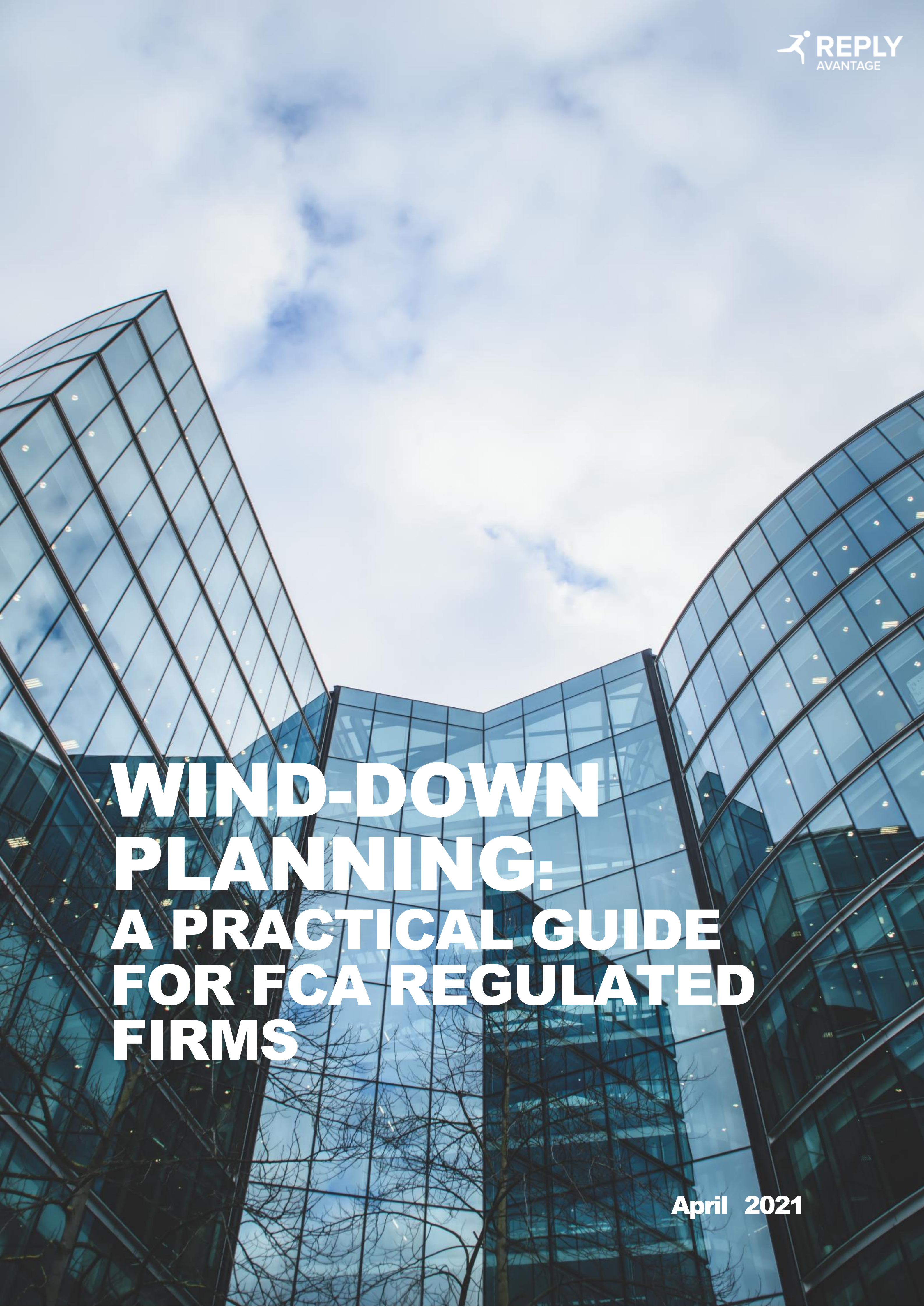


REPLY AVANTAGE

WIND-DOWN PLANNING: A PRACTICAL GUIDE FOR FCA REGULATED FIRMS

April 2021

CONTENTS

1. EXECUTIVE SUMMARY

Background

Wind-Down Planning remains high on the agenda of the Financial Conduct Authority (FCA). FCA regulated firms regularly receive Supervisory Review and Evaluation Process (SREP) feedback regarding shortcomings in their Wind-Down Plans (WDPs) and supporting documentation.

With an uncertain business environment following COVID-19, the FCA is monitoring the effects of the economic downturn on firms, closely focusing on those with the greatest risk and potential impact of failure. FCA is ensuring that they have robust WDPs and appropriate resources to wind-down in an orderly manner.

What is a Wind-Down Plan?

The FCA first introduced WDP **requirements**[1] formally in 2016, requiring firms to consider how they would wind-down their regulated business activities in an orderly fashion with minimal impact on customers, counterparties and the wider financial markets.

A robust WDP helps prepare a firm to assess the resources (e.g. capital, liquidity, knowledge and human resources) it would need to wind-down in an orderly manner.

In addition, it provides the regulator with details on how a firm would unwind their regulated business activities, which make ceasing to trade the most viable option for all stakeholders.

Applicability

The requirement to produce a WDP **applies to all FCA solo-regulated firms**, regardless of their size and complexity. The FCA has made it clear that the WDP is different from other similar requirements, such as the "Solvent Wind Down Plan" (SWDP) or "Recovery and Resolution Plans" (RRP).

Key themes of a WDP

The WDP is expected to be a comprehensive document covering several key elements. However, in the course of our work with clients, we have noted four recurring themes where improvements to the WDP process and associated documentation are typically identified.

The first part of this paper describes the WDP in more detail, summarising its purpose, differences to other regulatory requirements, and what information should a plan include for it to be compliant. The following section lays out practical considerations on the four key themes that firms should scrutinise when improving their WDP.

A WDP is an FCA requirement, first introduced in 2016 for all solo-regulated firms. The FCA expects firms to consider how they would wind-down their regulated business activities in an orderly fashion with minimal impact on customers and the wider financial markets.

1 https://www.handbook.fca.org.uk/handbook/WDPG/1/?view=chapter

Table 1: Key themes

Wind-Down Scenarios and Indicators	*WDP should be a forward-looking document, considering possible scenarios which could make the business unviable. Relevant risk metrics should be identified, monitored and reported in a timely manner.*
Wind-Down Action Plan	*WDP should include a granular and credible action plan detailing all steps and timeframe a firm would take to wind-down its regulated business.*
Financial Analysis	*The WDP should provide financial projections and analysis that support the firm's intended plans, covering three distinct phases: (i) business as usual, (ii) scenario impact period, and (iii) the wind-down period.*
Communication Plan	*A plan which clearly demonstrates the intended strategy and purpose through three broad stages: (i) initial communication of the decision to wind-down the firm; (ii) communication during the wind-down process; and (iii) communication after the closure of the business.*

2. BUILDING BLOCKS OF A WIND-DOWN PLAN

Why the FCA requires entities to develop WDPs

Two of the three statutory objectives of FCA are to protect the customers and ensure the integrity of the UK financial system.

Having a detailed and well-thought plan ensures that firms will be able to wind-down their regulated business in an orderly manner whilst continuing to provide services and avoiding customer harm.

Another main reason for developing a WDP is to set early warning indicators (EWI) for senior management to monitor regularly and report to the Board of Directors ('BoD' or the Board) of a potential failure of the business promptly when a trigger is breached.

Difference of WDP to other regulatory requirements

The presence of many other similar regulatory requirements out there to WDP may be confusing, and that is because, in many ways, some of their parts may overlap with each other. For example, the objective of WDP and a SWD is to wind-down, but the first is to wind-down the whole regulated business of FCA solo-regulated firms, and the latter is to wind-down the trading book of a UK bank.

In addition, one may ask why a firm should develop a WDP when they already have a Business Continuity Plan (BCP) in place. In this instance, there are some overlaps to the requirements, but the core objective of these regulations is different. The BCP only aims to save the business, detailing how to firm will operate in unforeseen conditions whilst it recovers. More details on different regulations are provided in Table 2.

Table 2: Other similar regulatory requirements

CASS Resolution Pack (CASS RP)	CASS RP is a set of rules that requires firms to maintain retrievable CASS records to ensure timely return of client money and assets in the event of insolvency or resolution.
Business Continuity Plan (BCP)	BCP requirement requires firms to have a process in place to identify, test and revise relevant capabilities that would mitigate harm in the event of an incident, insuring that firms are able to function normally.
Reverse Stress Test (RST)	An RST is an exercise where firms identify a range of adverse circumstances, which would cause their business to become unviable.
Operational Continuity in Resolution (OCIR)	The OCIR is a requirement for banks and systemically important investment firms, ensuring that they have the ability to provide critical functions to thirds parties while executing an orderly resolution.
Disaster Recovery Plan (DRP)	A DRP details how a firm would resume its operations promptly and with the least impact following an unforeseen event.

Solvent Wind-Down Plan	The SWDP is a requirement seeking to ensure that banks are able to wind-down part or all of their regulated business. This regulation is particularly focused on the investment activities of banks; for example, it aims to assess the ability to wind-down the trading book of a UK subsidiary of an overseas bank or the investment-banking arm after bank's ring-fencing regulation in a stressed scenario.
Recovery and Resolution	The RRP only applies to banks and full scope (IFPRU €730k) investment firms. Recovery plans seek to prepare firms for possible financial difficulties and restore their viability in a timely manner. In contrast, resolution plans are a set of credible resolution actions prepared by the resolution authority that will be exercised in a situation where a firm may require resolution.

Key sections for a WDP to be compliant

One of the key concerns expressed by the FCA is that, in many instances, the WDPs they have reviewed were either generic or not detailed enough. In our experience, but also what the FCA would expect, a good WDP should be based on the firm's business model and specific circumstances that relate to them, including business structure and if it is part of a wider group, operating model, the market that they operate in, internal processes and human resources. Moreover, the plan should ensure that the firm has enough financial resources to execute the plan whilst still maintaining the capital and liquidity regulatory requirement.

Therefore, for a WDP to be compliant, it should take into consideration different aspects and include the sections explained in Table 3 below.

Table 3: Key sections of a WDP

SECTION	DESCRIPTION
Introduction	Provide information on the purpose and aim of the document, the entity or entities in scope, and WDP governance.
Entity Overview and Business Model	Overview of the entity, detailing the legal structure of the firm, main business lines and other critical functions. This section should provide detailed information on how the firm generates income, including the products and services it offers, key clients and geographical footprint. Firms should also include the latest approved financial statement and balance sheet.
Governance and Risk Management Framework	This section should summarize the corporate governance and risk management framework of the firm, providing sufficient details regarding the key senior managers, forums and committees and risk management processes and controls.

SECTION	DESCRIPTION
Wind-Down Scenario, Indicators, Recovery Options and Invocation	The chosen wind-down scenario and the reason why it was selected should be provided; the "long-list" of scenarios considered should be included in the appendix. Details on the EWIs should be provided and how they are monitored on an ongoing basis and reported promptly. Firms should consider scenario-specific recovery options, which are exercised in a case where there is an EWI threshold breach while the firm is still viable. The decision-making process to invoke the WDP should be clearly outlined, with roles and responsibilities clearly highlighted.
Operational Analysis and Wind-Down Action Plan	An overview of the operational analysis and impact assessments that the firm has completed should be provided. Detailed analysis and assessments of the resources, impact of the wind-down, IT infrastructure, etc. should be included in the appendix. The action plan should detail all the steps a firm would take to wind-down its regulated business and how long each would last, covering the period from the announcement of the decision until the return of the FCA license.

3. KEY THEMES

3.1. WIND-DOWN SCENARIOS AND INDICATORS

The WDP must be a forward-looking document supported by an effective risk management framework. When the FCA uses the term “forward-looking”, it is asking firms to consider possible scenarios where their business activities could become unviable.

Wind-Down Scenarios

Management should consider several severe but plausible scenarios in which the firm is no longer viable and is forced to wind-down its business. A diverse range of scenarios should initially be considered, but only one scenario could ultimately be selected for the purpose of the planning process. Scenarios should take into consideration factors such as but not limited to (i) significant financial loss, (ii) loss of key clients and (iii) loss of critical infrastructure, with no signs of a timely recovery.

Our practical experience has taught us that firms must manage the generation of possible scenarios by incorporating as wide a range of opinions from across the business as possible. Firms should also aim to link the possible scenarios with the previously identified business risks, which could include factors such as rapid changes in technology, new competitors entering the market, changes in customer behaviour, or rising operations costs, which cannot be offset by increased margins. In any event, to remain cautious and conservative, the most adverse yet still plausible scenario should be selected.

Early Warning Indicators

Identifying business-appropriate risks is directly linked to the quality of a firm’s Risk Appetite Framework (RAF).

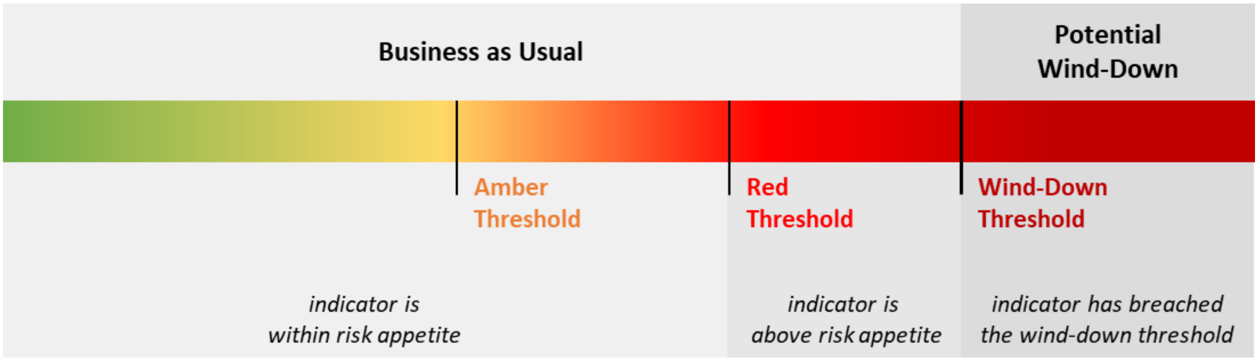
A good RAF must define the risk levels that the Board is comfortable with when executing its business objectives. The main risks that threaten the viability of the business must be monitored in the form of Early Warning Indicators (EWIs) and reported to the Board regularly. In our experience, we have seen that some firms already capture some of this information within their Risk Appetite Statement (RAS).

We recommend that the newly identified EWIs that have not been captured by the RAS should be incorporated, ensuring the appropriate red and amber thresholds are set.

All EWIs should also include a “Wind-Down Threshold”, illustrated by Figure 1, to alert the Board of any issue that may threaten the viability of the firm. Monitoring these indicators will help demonstrate to the regulator that suitable All EWIs should also include a wind-down limit threshold to alert the Board of any issue that may threaten the viability of the firm. Monitoring these indicators will help demonstrate to the regulator that suitable monitoring of risk factors have been established and provide the Board with sufficient warning to take measures to resolve the underlying issue or, in an extreme situation, make a timely decision to wind-down the firm.

The breach of a wind-down limit threshold should trigger a Board discussion about whether or not the firm should wind-down its business. However, a single trigger should not precipitate a decision to wind-down the business; hence, a firm should review a range of EWIs in combination over a few months before a decision to cease trading is considered. If the Board believes that no reasonable actions can be taken to prevent further deterioration, then it should trigger the decision to wind-down its regulated business.

Figure 1: Risk tolerance levels



3.2. WIND-DOWN ACTION PLAN

In our experience, a common area of required improvement is the level of detailed planning outlined in the WDP. FCA expectations often exceed the level of detail first provided by a firm. A Wind-Down Action Plan, as illustrated in Table 4, should be seen as part of the operational analysis, and it should detail the actions and timeframe a firm would take to wind-down its business.

The preparation of a comprehensive and realistic plan needs to be developed as a firm-wide exercise. Given the importance of the WDP, the FCA expects that a wide range of stakeholders take part in its development. We recommend that functions such as Legal and HR, in addition to the Business units, Risk and Finance functions, as well as subject matter experts from across the firm, are involved during the development of the plan. The discussions should consider aspects, such as:

- The complexity of the firm's products;
- A conservative estimate of the likely time that would be required to cease new business operations and to off-board existing clients;
- An evaluation of the firm's internal processes, systems and available human resources needed to execute the step-plan; and,
- Consideration of the legal obligations associated with winding down the business.

Table 4: Assessing different aspects of the Wind-Down Action Plan

ASPECT	POSSIBLE QUESTIONS
Product complexity	Does the firm have market dominance in the products or services offered by us, or do our competitors provide similar value propositions?
	Are products offered by the firm traded on an exchange or an OTC market?
	What are the liquidity implications, to the firm and the client, of unwinding a transaction?

ASPECT	POSSIBLE QUESTIONS
Timeframe to cease business operations	Has the firm considered a possible sale of all or part of the business, and how this will impact the timeline to cease business operations?
	What is the set of legal obligations to give notice to existing clients to cease services provided to them?
	Has the firm considered the moral obligation to serve well its clients and the impact it would have on its wider group, if applicable?
	Will customers, regulators or other external stakeholders perceive the firm is breaching their responsibilities of "treating customers fairly"?
	Has the firm taken reasonable measures to deal with possible client complaints?
	Will the firm be able to meet its regulatory requirements during the wind-down?
Firm's internal processes, systems and human resources	Will the systems (e.g. IT systems) used by the firm still be available during wind-down?
	Have critical third-party service providers been identified? Will they be available during the wind-down, and does the firm have sufficient resources to ensure the delivery of these services?
	How will the firm ensure that outsourced systems will be available throughout the wind-down process?
	How will the firm keep the employees it needs during the wind-down process?
	Is there a process in place to maintain client data?
	Has the firm considered engaging with professional advisors during the wind-down?
Product complexity	What legal obligations does the firm have towards: • Employees; • Clients; • External vendors and outsourcing partners; • Regulator(s); and • Shareholders.
	Can the firm terminate existing contractual commitments within the planned wind-down period?

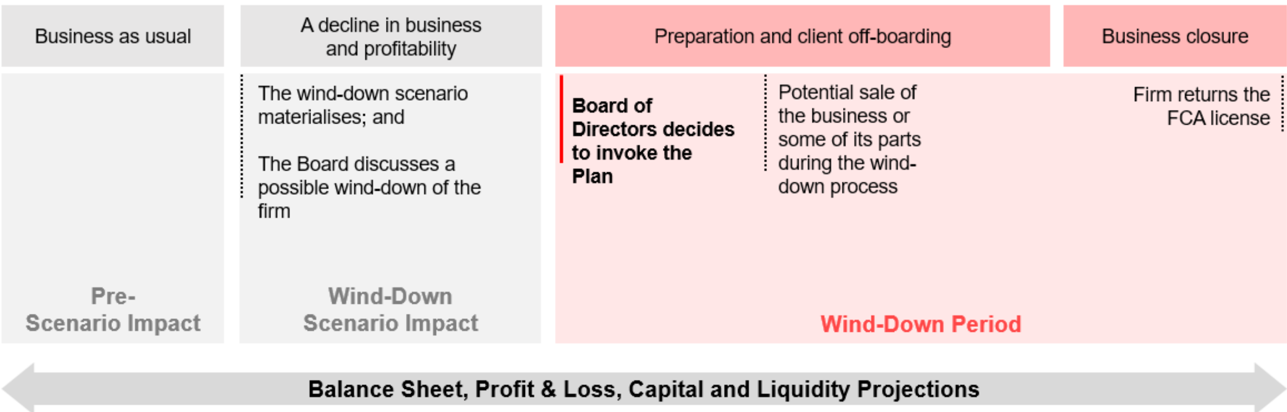
3.3. FINANCIAL ANALYSIS

The financial analysis section is unsurprisingly a key area of scrutiny for the FCA. The WDP must include comprehensive projections of the Profit & Loss Statement, Balance Sheet and liquidity of the firm to demonstrate that minimum capital and liquidity requirements are maintained throughout the wind-down period. If any shortfalls are projected to occur during the process, a detailed and credible explanation of the source of additional capital or liquidity must be included.

The financial projections should cover three distinct phases: (i) business as usual, (ii) a period covering the decline in business and profitability, and (iii) the period from the time that the Board takes the decision to wind down the business until the FCA authorisation is returned. This is illustrated in Figure 2 below. In our experience, the cash flow should be produced at least weekly for the first month of the 'Wind-Down Period' and then on a monthly basis. Additionally, the cash flow should be linked to the 'Action Plan', reflecting the financial impacts of each step the firm takes to wind-down its business.

The sale of all or part of the business may not be considered as an effective solution to manage risks in a wind-down scenario, as there is no guarantee that it could be achieved. However, if such opportunities arise, firms should consider what arrangements are necessary for client migration and how the firm will communicate it to them, as well as the financial impacts it would have.

Figure 2: Period covered by Profit & Loss and Balance sheet projections



3.4. COMMUNICATION PLAN

To effectively support the execution of the WDP, a firm should have a pre-determined communication plan in place to help give a clear message to customers, shareholders and the wider financial market and hopefully to avoid any short term reactions of clients, suppliers and funding providers. A well-thought-out and comprehensive plan provides the regulator with the confidence that any wind-down is a controlled exit.

The communication plan should be prepared and managed centrally by a designated forum. In our experience, the communication plan is significantly linked to the size and complexity of the firm; usually, as the size of the firm increases, so does the number of parties that need to be informed and updated.

We typically recommend that firms consider three broad stages when preparing their communication plan:

i. initial communication of the decision to wind-down the firm;

ii. communication during the wind-down process; and

iii. closing communication after the closure of the business.

For each of the stages, a firm must identify the stakeholders impacted, the high-level messages to be provided, and for each stakeholder, the objective to be achieved, as shown in Table 4. For example, during the initial communication, the firm should communicate to its clients the underlying reasons why the firm has taken the decision to wind-down, how this will impact their business and a detailed schedule of events. The order and timing of communication must be thought through carefully to limit the impact on the firm's clients, counterparties and the wider market.

Table 5: High-level message to stakeholders

STAKEHOLDER	HIGH-LEVEL MESSAGE	OBJECTIVE
	EXTERNAL STAKEHOLDERS	
FCA and regional regulators, if applicable (e.g. CSSF)	Inform the FCA and other regulators of the decision of the Board to wind-down the firm	Comply with regulatory requirements until the return of the FCA license
	Provide regular updates on the wind-down status	Ensure the credibility of the firm and of the Board remains in good standing throughout
Clients	Inform the clients of the situation, detail a schedule of events and actions to be taken	Ensure that the clients are off-boarded in an orderly manner and kept fully informed of where they stand in the wind-down process
Shareholders / Group	Inform the shareholders or the group of the decision and provide high-level information of all actions to be taken	Provide transparency to shareholders and guarantee that their interest is safeguarded at all times
Media	Inform	Provide an update to the wider audience and inform with confidence that this is a controlled exit to ensure that financial market stability is protected
	Q&A session(s)	

STAKEHOLDER	HIGH-LEVEL MESSAGE	OBJECTIVE
EXTERNAL STAKEHOLDERS		
External Vendors/ Outsourced Service Providers	Communicate the decision and secure service throughout the wind-down period	To guarantee that outsourced services needed to carry out all the wind-down steps are available
INTERNAL STAKEHOLDERS		
Key Governance Forums	CEO to inform the Board on the plan of action and communication plan to different stakeholders	Ensure that the Board is informed regularly to approve all action points, as they have the ultimate accountability for a successful wind-down of the firm
	The wind-down committee should keep up-to-date all relevant committees, such as the risk committee	Ensure that the wind-down committee responsible for executing the WDP is considering all possible options
Employees and Representatives	Inform all staff of the situation through a Town Hall	Safeguard all employee rights at all times
	HR to engage with employee representatives	
	Communicate to all employees detailing: • what is happening and why; • how it affects the employees; • details on future actions, including redeployment opportunities, redundancies and redundancy payments	Ensure that all necessary staff are trained to the new roles during the wind-down process
	Actively engage with employees answering any questions	

4. HOW CAN AVANTAGE REPLY HELP?

Avantage Reply has extensive experience helping firms build and improve their Wind-Down Plans. We can support our clients by assessing their plan and/or updating and improving the plan in place.

Wind-Down Plan assessment

Avantage Reply uses a proprietary diagnostic tool, the Integrated Risk and Performance Management (IRPMTM) tool, which supports a documented assessment of a firm's WDP. Our capability assessment helps firms identify opportunities and/or areas for improvement through measurement against regulatory requirements and by comparison to peer firms. The IRPM tool provides several benefits to our clients, including:

- reliable insight into the institution's WDP;
- reinforces the reliability of the plan as a process to wind-down its operations;
- identifies the areas where remedial actions may be required; and
- provides an element of benchmarking against peer firms.

Updating and improving your Wind-Down Plan

If you have received feedback from the regulator asking for further development of your plan or if you are addressing known weaknesses ahead of a SREP or building your very first plan, Avantage Reply can help you with:

- running workshops and individual interviews with stakeholders;
- analysing the information gathered against regulatory requirements and identify where improvements may be required; and drafting the WDP for senior management review, challenge and approval

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5. GLOSSARY

BCP	Business Continuity Plan
CASS RP	CASS Resolution Pack
DRP	Disaster Recovery Plan
EWI	Early Warning Indicator
FCA	Financial Conduct Authority
IFPRU	Prudential sourcebook for Investment Firms
OCIR	Operational Continuity in Resolution
RAF	Risk Appetite Framework
RAS	Risk Appetite Statement
RRP	Recovery and Resolution Planning
RST	Reverse Stress Test
SREP	Supervisory Review and Evaluation Process
SWDP	Solvent Wind-Down Plan
WDP	Wind-Down Plan


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