

Explanatory box on the ORC determination

This explanatory box provides an illustrative example of how the different steps for the ORC determination detailed in these guidelines could be practically implemented by institutions. Its objective is to increase clarity for institutions showing how the steps for the ORC determination may work in a simplified practical case.

It is relevant to highlight that the example presented, including its assumptions, figures, tables and graphical representations of the information, is purely fictional and it is meant for illustrative purposes only. Therefore, this box does not intend to provide any prescriptive criteria to be followed by the institutions when carrying out the relevant assessments and providing the related representation in their recovery plans, which should always be performed by the institutions according to their relevant specificities and internal practices in line with their risk management framework.

Background

Let's assume the case of Institution XYZ, a medium sized (no Global Systemically Important Banks – G-SIB, no Other Systematically Important Institutions – O-SII) banking institution based in the EU subject to the Directive 2014/59/EU requirements under Article 5 of drawing up and maintaining a full recovery plan.

In its recovery plan, Institution XYZ has identified a menu of credible and feasible recovery options that it could implement to restore its financial position following a significant deterioration. The recovery options identified are the following:

- A. Capital raising - issue of ordinary shares;
- B. Entity disposals - disposal of the subsidiary I in country Z;
- C. Risk reduction - reduction of existing loans and new business origination;
- D. Asset sales - disposal of credit portfolios and equity stakes;
- E. Cost savings - skip of bonuses;
- F. Earnings retention - dividend cancellation;
- G. Liability management - liability management transactions addressed to institutional investors;
- H. Access to standard central bank facilities - use of facilities/discounts at central bank by pledging eligible assets.

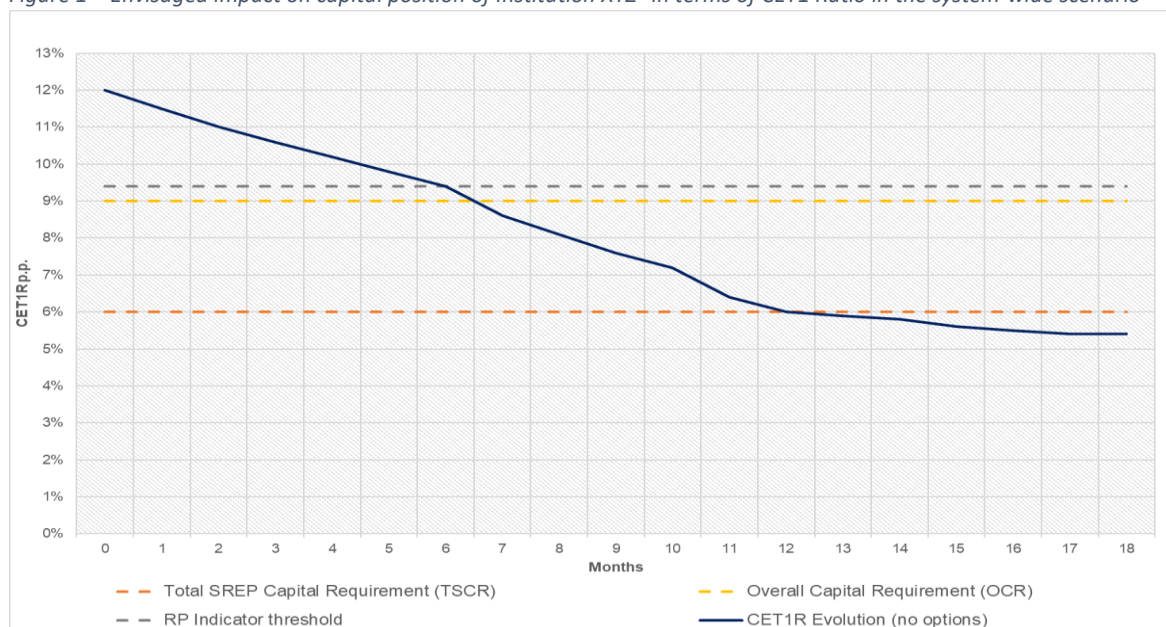
In accordance with the recovery plan requirements, Institution XYZ has developed the following three scenarios of severe financial and macroeconomic stress in order to test its recovery options. The type of scenarios considered, in line with the EBA/GL/2014/06, are the following:

- **Scenario 1** (*system-wide with slow-moving events*) - the effect of this scenario is mainly a significant negative impact on institution's capital profile;

- **Scenario 2** (*idiosyncratic with fast-moving events*) - the effect of this scenario is mainly a significant negative impact on institution’s liquidity profile;
- **Scenario 3** (*combination of system-wide and idiosyncratic events*) - the effect of this scenario is a significant negative impact both on the institution’s capital and liquidity profiles.

As far as the severity of the scenario is concerned, Figure 1 illustratively represents the impact of the system-wide scenario on Institution XYZ capital requirements, in terms of CET1 Ratio, in case no recovery options were implemented (i.e. the ‘unmanaged case’). In line with the proposed guidance in paragraph 21 of these guidelines, Institution XYZ has developed this scenario so that it would lead to the breach of its Total SREP Capital Requirement (TSCR) for CET1 Ratio¹ in the ‘unmanaged case’ (within 12 months).

Figure 1 – Envisaged impact on capital position of Institution XYZ² in terms of CET1 Ratio in the system-wide scenario



Determining the ORC

Step 1 – Selection of recovery options

Based on the nature of the macroeconomic and financial stress, Institution XYZ will choose credible and feasible options which, in terms of their effects on the ‘relevant RP indicators’ would be the most effective in the respective scenarios.

¹ Where TSCR = P1 + P2R, in this example TSCR = 4.5% + 1.5% = 6%.

² Only binding regulatory requirements have been included in the ‘capital requirements stack’, therefore P2G has not been represented in this illustrative example.

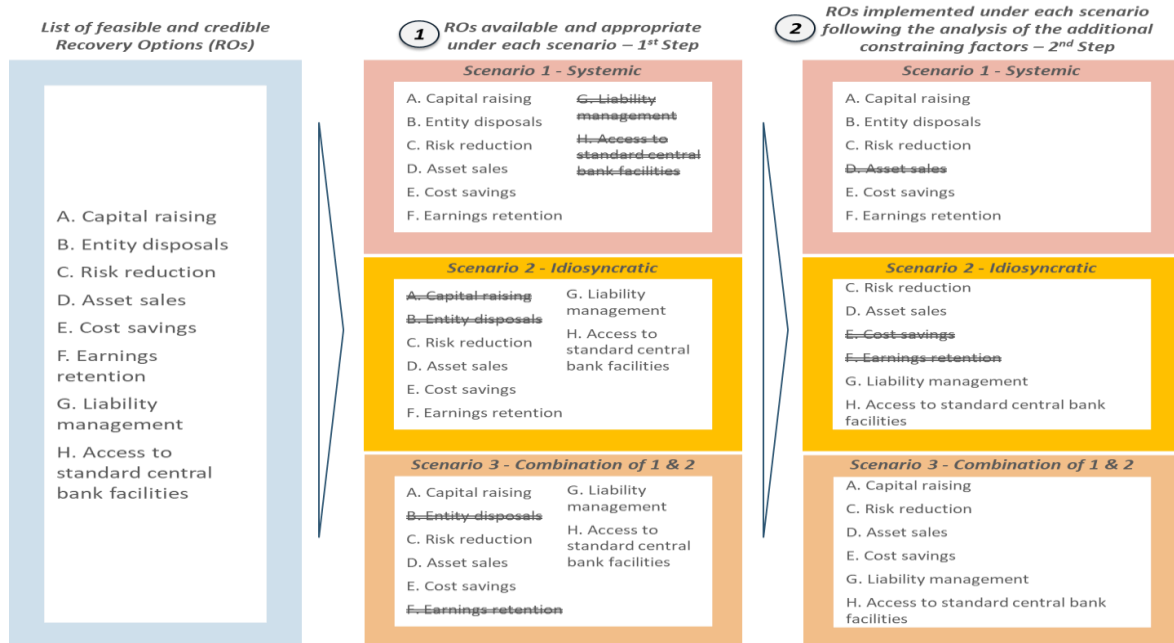
Step 2 – Adjustment of recovery options: additional constraining factors

In selecting recovery options, Institution XYZ takes into account at least the relevant constraining factors related to the simultaneous and sequential implementation of recovery options in accordance with paragraph 30 of these guidelines.

In particular, in each scenario Institution XYZ analyses possible interactions between the selected recovery options and explains why the selected recovery options do not conflict with each other and to what extent interdependencies between the recovery options exist. For example, Institution XYZ explains why the recovery option ‘Risk reduction - reduction of existing loans and new business origination’ does not affect the feasibility and effectiveness of the recovery option ‘Liability management - liability management transactions addressed to institutional investors’. When interdependencies have been detected, this analysis could either result into the exclusion of one of the mutually exclusive options or into the adjustment of their expected impact when they are combined.

Additionally, the analysis performed by Institution XYZ shows at what stage each recovery option is taken. The quantitative impact of the recovery options on the ‘relevant RP indicators’ over time is also shown. Let’s assume the outcome of step 1 & 2, for the sake of simplicity, may be summarized as follows.

Figure 2 – Selection of Recovery Options (ROs) and adjustment for the additional constraining factors



Step 3 – Calculation of ‘scenario-specific recovery capacity’

Once the recovery options have been identified and selected according to the previous steps, Institution XYZ expresses the ‘scenario-specific recovery capacity’ as the sum of their impacts over time according to paragraph 25 of these guidelines, representing it in terms of the ‘relevant RP indicators’ provided in paragraph 27.

Scenario 1 - System-wide with slow-moving events whose impact is mainly on the capital side

Figure 3 – 'Scenario-specific recovery capacity' for Scenario 1 for CET1 Ratio & Total Capital Ratio (TCR)

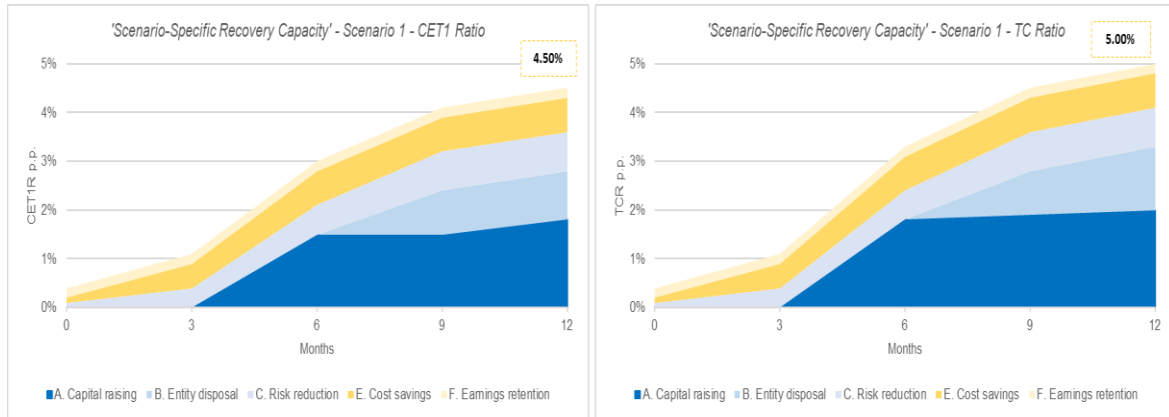
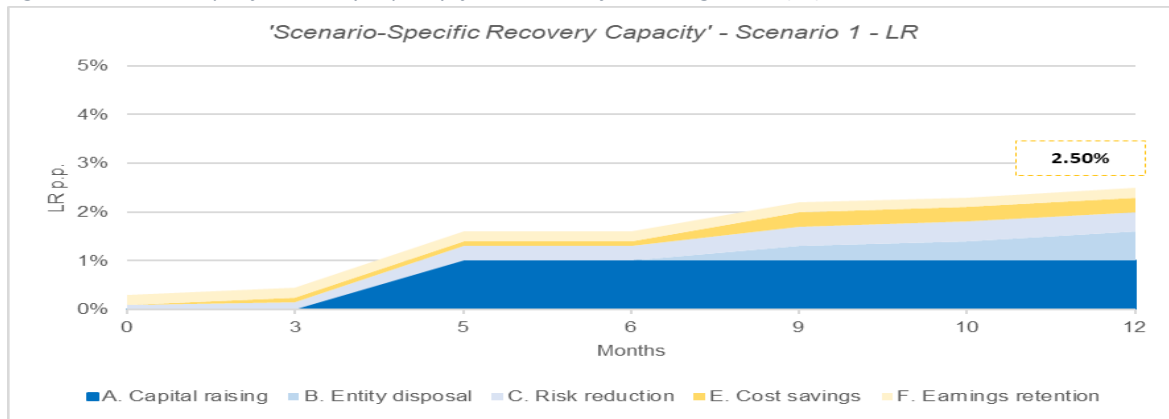
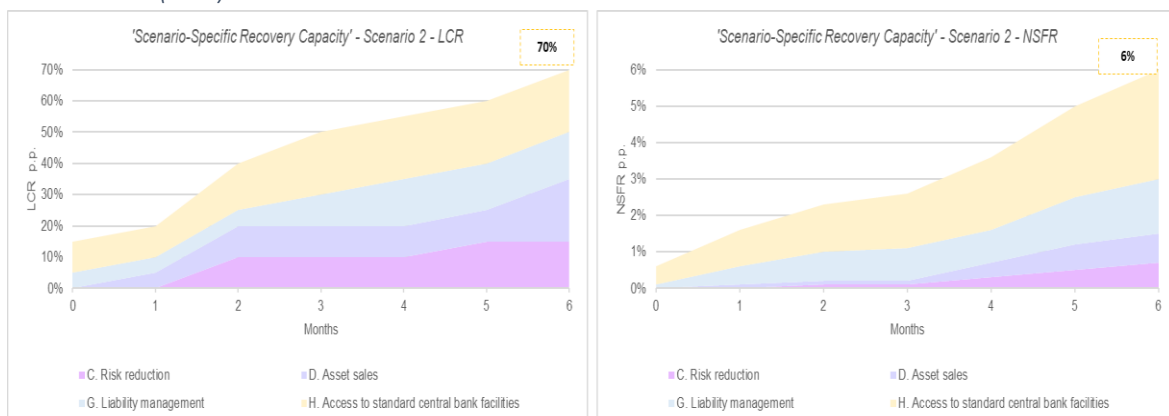


Figure 4 – 'Scenario-specific recovery capacity' for Scenario 1 for Leverage Ratio (LR)



Scenario 2 - Idiosyncratic with fast-moving events whose impact is mainly on the liquidity side

Figure 5 – 'Scenario-specific recovery capacity' for Scenario 2 for Liquidity Coverage Ratio (LCR) & Net Stable Funding Ratio (NSFR)



Scenario 3 - Combination of system-wide and idiosyncratic events whose impact is both on capital and liquidity side

Figure 6 – 'Scenario-specific recovery capacity' for Scenario 3 for CET1 Ratio & Total Capital Ratio (TCR)

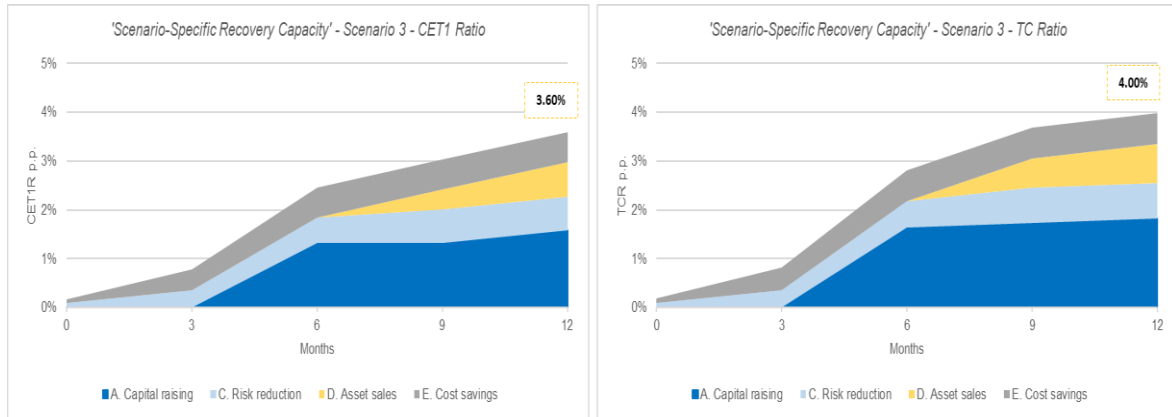
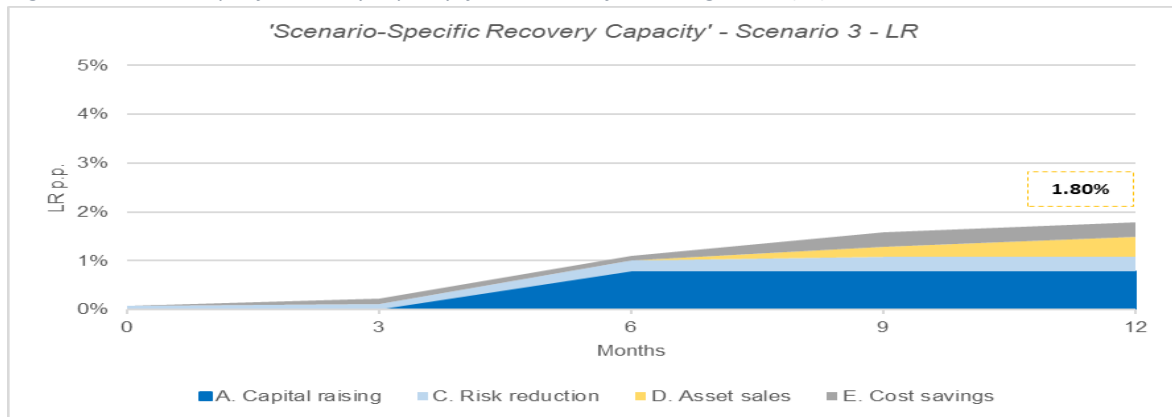
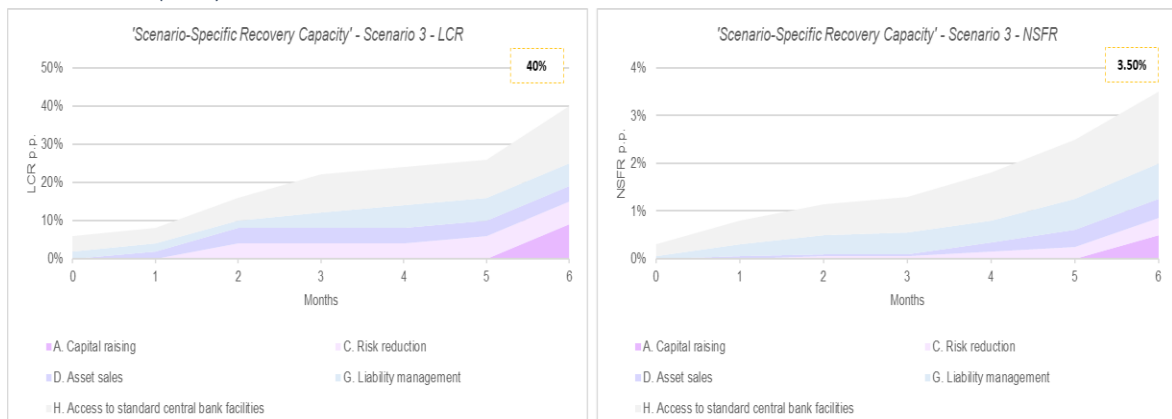


Figure 7 – 'Scenario-specific recovery capacity' for Scenario 3 for Leverage Ratio (LR)



*Options G & H are assumed to have an immaterial impact on capital and leverage and therefore they are not reported in these figures

Figure 8 – 'Scenario-specific recovery capacity' for Scenario 3 for Liquidity Coverage Ratio (LCR) & Net Stable Funding Ratio (NSFR)

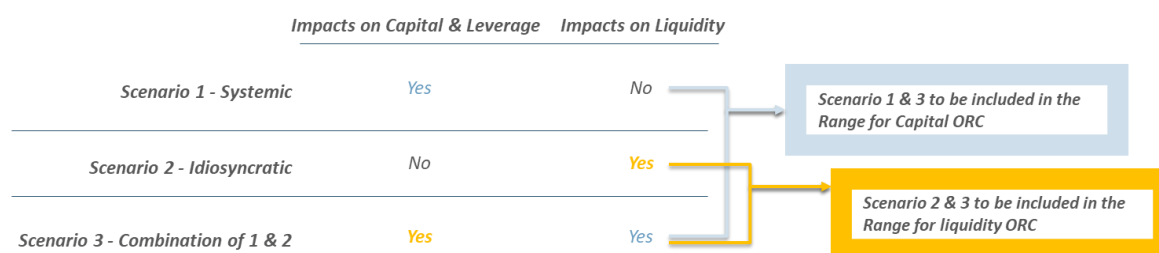


*Option E is assumed to have an immaterial impact on liquidity and therefore it is not reported in these figures

Step 4 – Determination of the ORC³ range

Institution XYZ is finally determining the ORC as the range of the ‘scenario-specific recovery capacity’, in line with the criteria defined in paragraph 32 of these guidelines. Given the nature and the impact of the three considered scenarios, for the determination of the ORC range in terms of capital including leverage (capital ORC) and liquidity (liquidity ORC) only relevant scenarios are considered - namely scenarios where a depletion of the financial position in terms of capital including leverage and/or liquidity has been observed.

Figure 9 – Relevant scenarios for the determination of the ORC



Considering the same illustrative figures used for the calculation of the ‘scenario-specific recovery capacities’ in step 3, Institution XYZ will finally determine the ORC range as follows.

Table 1 – Capital ORC determination

Relevant scenario	CET 1 Ratio	TC Ratio	LR
Scenario 1 – Systemic	+4.50% (450 bps)	+5.00% (500 bps)	+2.50% (250 bps)
Scenario 3 – Combined	+3.60% (360 bps)	+4.00% (400 bps)	+1.80% (180 bps)
Capital ORC	360 – 450 bps	400 – 500 bps	180 – 250 bps

Table 2 – Liquidity ORC determination

Relevant scenario	LCR	NSFR
Scenario 2 – Idiosyncratic	+70%	+6.00%
Scenario 3 – Combined	+40%	+3.50%
Liquidity ORC	40%-70%	3.50%-6.00%

Institution XYZ finally provides a graphical representation of its capital and liquidity ORC range as follows.

³ To support the determination of the ORC, institutions could use as a reference value their recovery capacity under the application of no scenario (Business as Usual-Recovery Capacity - ‘BAU-RC’): i.e., the sum of the impacts of the list of credible and feasible recovery options under no scenario while also adjusted for mutual exclusivity between certain options and any other constraining factors that would restrict the institutions’ ability to successfully implement and/or generate the full impact from the recovery options. The ‘BAU-RC’ represents a useful comparative reference value which institutions can use for the determination of the ORC when considering appropriate haircuts to the impacts of their recovery options under scenario-specific conditions. The steps for the calculation of the ‘BAU-RC’ should therefore follow those of the ‘scenario-specific recovery capacity’ provided that no scenario-specific assumptions should be applied in this case.

Figure 10 – Minimum and maximum Capital ORC representation

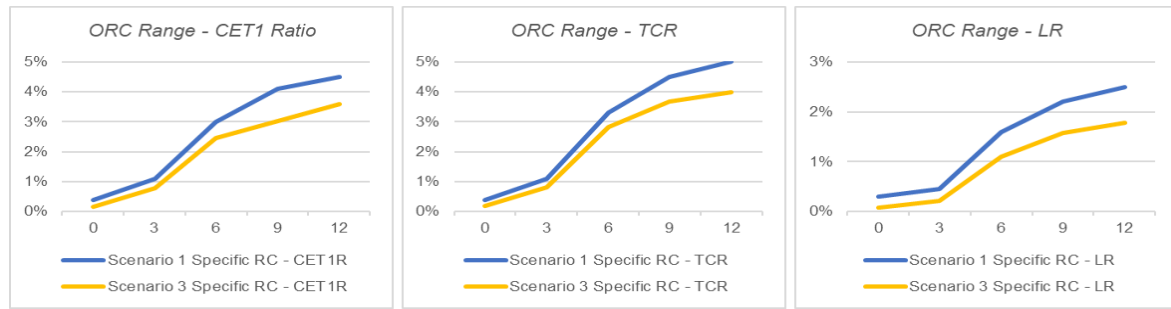


Figure 11 – Minimum and maximum liquidity ORC representation



ORC dynamics over time

With regard to the specific dynamics of the ORC over time, let's consider for illustrative purposes the Capital ORC by Institution XYZ in terms of CET1 Ratio. In particular, given the initial setting of Institution XYZ depicted in Figure 1, the institution is able to attain a level of the CET1 Ratio above the recovery plan indicator threshold in each scenario within the expected timeframe (i.e. 12-month for capital).

Figure 12 – ORC dynamics in terms of CET1 Ratio – Scenario 1

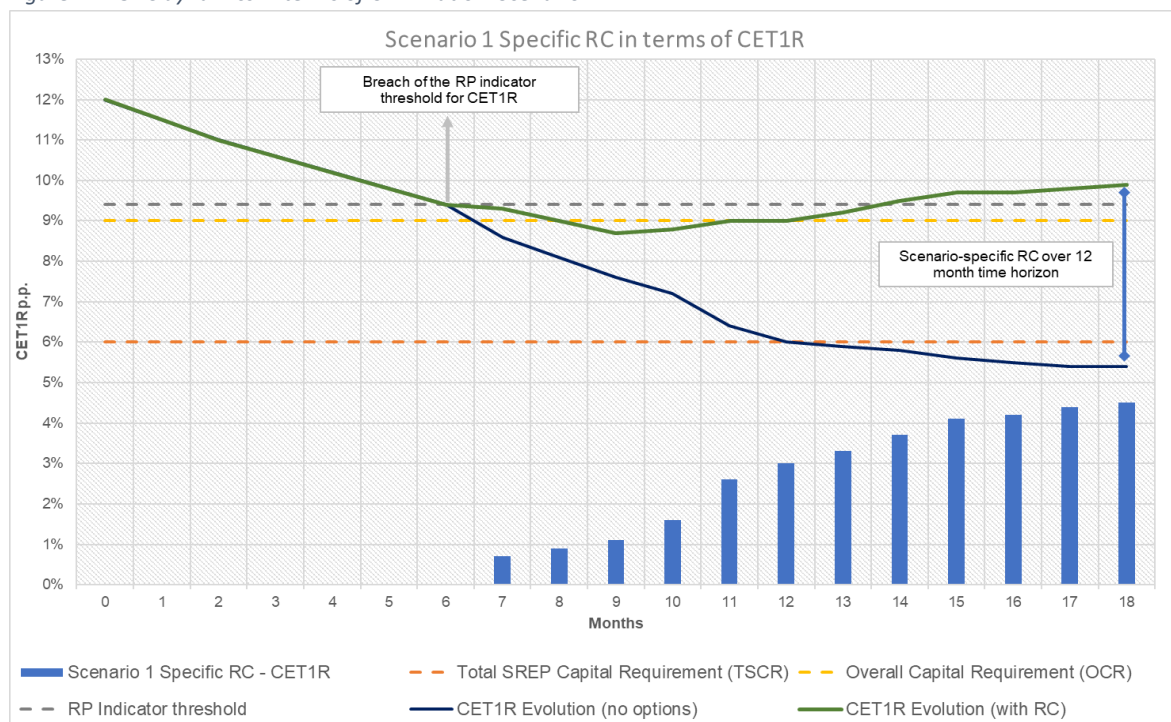


Figure 13 – ORC dynamics in terms of CET1 Ratio – Scenario 3

