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Dear Mr. Farkas,

***DB response to EBA draft Regulatory Technical Standards specifying the range of scenarios to be used in recovery plans and on the assessment of recovery plans in the draft directive for recovery and resolution of credit institutions and investment firms***

Deutsche Bank welcomes the opportunity to comment on the EBA's draft regulatory technical standards (RTS) on scenarios and assessments for recovery plans in advance of formal adoption of the Recovery and Resolution Directive (RRD), as this facilitates planning by firms and authorities and helps to identify areas with unintended consequences.

Our detailed answers to the questions in both consultation papers are below, based on our experience of an ongoing group-wide recovery planning exercise which has been reviewed with our regulators represented on DB's Crisis Management Group. As with our response to the EBA's draft RTS on the content of recovery plans, we welcome the effort to align with the EBA's January 2013 recommendation on recovery planning. We also welcome the EBA's principles-based approach, which recognises that a bank and its management are responsible for developing recovery plans in an iterative discussion with regulators.

We are concerned, however, that the draft RTS on the assessment of recovery plans does not take into account the co-legislators' positions on the RRD, both of which now place the emphasis on joint agreement on group level recovery plans before local institution plans may be requested. As decision-making on recovery planning in most banks will be taken at group level, we believe that additional local plans will incur significant additional cost with little additional benefit. The draft RTS should therefore cover coordination between home and host authorities, to encourage a group-wide approach to recovery planning and to minimise the risk and costs of duplicative individual institution plans. The draft RTS should also recognise that the preparation of recovery plans is an iterative dialogue between banks and supervisors. We therefore suggest the addition of a new Article covering coordination and communication.

Yours sincerely,

A handwritten signature in blue ink, appearing to be 'A. Procter', written over a light blue horizontal line.

Andrew Procter  
Global Head of Compliance, Government and  
Regulatory Affairs



## **Draft RTS specifying the range of scenarios to be used in recovery plans**

### **Q1. Have you already drafted financial distress scenarios for the purpose of testing a recovery plan or are you in the process of doing so? If so, are these financial distress scenarios in line with the contents of the draft RTS?**

Deutsche Bank's Group Recovery Plan includes a comprehensive suite of six stress scenarios, covering all risk types and all of our recovery triggers, as defined in the recovery plan. These are based on plausible near-default scenarios, two idiosyncratic and two systemic scenarios plus two combined internal scenarios, with one of each fast-moving and the other slow-moving. These are in line with the range of scenarios and events specified in Articles 3 and 4 of the draft RTS.

### **Q2. Have you developed group or solo specific scenarios to test the adequacy of the recovery plan?**

The six scenarios used in the DB Group Recovery Plan are designed to test the adequacy of a toolkit of recovery measures which are available across the group, each with a clear execution plan identifying key processes and potential barriers to implementation. The Recovery Plan identifies significant legal entities and branches within the group. We do not believe separate recovery plans, scenarios or measures are necessary at solo entity level.

### **Q3. Do you believe that the draft RTS on the range of scenarios for recovery plans is adequate to ensure that firms test their recovery plans against a range of scenarios of financial distress?**

We believe that the range of scenarios specified is adequate for firms to test their recovery plans. We request clarification, however, on the intent of the list of impacts to be assessed set out in paragraph 2 of Article 3.

Each bank will develop its own early warning indicators and recovery triggers as part of its recovery plan, and the stress scenarios should seek to breach these to test the credibility of recovery measures. The proposed list of impacts seems to suggest what these triggers should cover. If so, then it blurs the line between relatively "hard" triggers (i.e. capital and liquidity availability) and early warning indicators that may lead to those triggers being breached (challenges to business model and profitability). If it is the intention to set broad parameters for recovery triggers and early warning indicators, the EBA should clarify this. In this case, the wording should more closely reflect the wording on recovery triggers in the EBA's January 2013 recommendation on recovery plans. In particular, it should be clear that no specific recovery action should be linked to recovery triggers.

We are also not clear as to the intent of requiring an assessment of the specific impact upon payment and settlement operations. This is much narrower than the approach set out in the January recommendation, which recommended that the impact on core business lines and critical functions should be assessed. We suggest using this broader wording, as it is better aligned to the overall objective of the recovery plan to restore the viability of these functions.

Finally, if the intention of paragraph 2 is to set broad parameters for recovery triggers and early warning indicators, we question whether it is appropriate to include reputation in this section. A bank should of course monitor how changes in reputation will affect its viability, in terms of outflows of assets, reduced liquidity, reduced earnings or higher borrowing costs. However, a damaged reputation is the cause of these impacts, not the effect. As such, reputation should be covered elsewhere, e.g. particularly as part of idiosyncratic scenarios.



**Q4. How many scenarios have you been required to develop to test the adequacy of the recovery plan? Have you included slow or fast moving events?**

See Q1 above.

**Q5. Have you used reverse stress testing as a starting point for developing financial distress scenarios?**

No. The basis of our stress scenarios has been “near-default” - i.e. extreme but plausible events that breach our core capital and liquidity recovery triggers to the extent that management action will be necessary to restore the viability of the group.

The purpose of the stress scenarios is to test the credibility and effectiveness of recovery measures, which must remain plausible. We are concerned that requiring reverse stress-testing as a starting point would not meet this “plausibility” test. The severity of the scenarios as well as thresholds for recovery triggers clearly has to adapt and vary, especially as banks improve their capital ratios in line with regulatory requirements. It must be recognised, however, that at the same time the likelihood of extreme stress test scenarios occurring in practice will decrease.

We also think it is important for recovery triggers to be proportionate to changes in regulatory or economic capital or liquidity reserves and to be embedded in general risk management. Any drop in these reserves greater than a pre-determined amount should set in train an escalation and decision-making process to activate recovery measures - no matter how high the bank’s reserves. In contrast, triggers and scenarios based on reverse stress-testing would imply a threshold for action only when the bank’s solvency is threatened.

We agree, therefore, that the practice of reverse stress-testing may sometimes provide a helpful perspective for banks and supervisors, and that it is good practice in risk management. However, reverse stress-testing should not be a mandatory part of the recovery planning framework. Recital (5) should be revised to specify that reverse stress-testing can inform recovery planning but its use should not undermine the plausibility of stress scenarios or the testing of recovery measures for effectiveness.

**Q6. What are the additional costs to develop financial distress scenarios in respect to the current practices of reverse stress testing?**

It is less a matter of additional costs than of questionable incremental benefits. If the purpose of the stress scenarios is to test the credibility and effectiveness of recovery measures, their events should be designed to bring the institution near enough to default that without such measures, the viability of the bank would be threatened. As outlined above, mandatory reverse-stress testing in recovery plans has the potential to undermine the plausibility of such events and, in turn, the credibility of recovery measures.

**Q7. Do you believe that the events that institutions or groups need to consider and include where relevant are most suitable? If not, what other events ought to be taken into account?**

The draft RTS suggests a sufficient range of relevant events that banks should consider. We strongly welcome the clarification in paragraph 4 of Article 4 that these should be included in scenarios subject to the general principle that scenarios shall be based on events that are most relevant to the individual bank.



**Q8. Do you have any general or specific comments on the draft RTS?**

Generally, we welcome the EBA's approach, which sets minimum high level requirements and largely avoids a prescriptive approach. Experience has demonstrated that, to be effective, recovery plans should be appropriate to the individual bank and reflect an iterative discussion with key regulators.

**Q9. Are the definitions and terminology used in the draft RTS clear?**

As discussed in our answer to Q3, we are concerned at the lack of alignment with the EBA's January recommendation on recovery plans, and the blurring of "hard" recovery triggers (i.e. changes in capital and liquidity) with more qualitative factors (e.g. early warning indicators).

**Q10. Do you agree that, for an institution, the costs of developing financial distress scenarios to test a recovery plan are likely to be proportional to the size/complexity of the firm and so of the costs its failure may create? If not, could you explain why?**

For group level recovery plans, the costs of conducting the tests themselves will vary significantly by a bank's size and complexity of its activities, but the cost of developing scenarios should not as the level of detail required to conduct a robust test should be consistent. Clearly, if additional scenarios to the minimum of three are required, the cost of developing new ones will be additional. These costs will be less for systemic scenarios than idiosyncratic ones, as banks should already be considering macro-economic events which could affect the bank as part of broader internal stress-testing.

As outlined below, costs of developing scenarios escalate very quickly once multiple recovery plans for multiple jurisdictions and legal entities have to be produced. The cost of developing scenarios in these circumstances will vary significantly by institution, based on size, number of legal entities, geographical reach and scope and complexity of their activities.

**Q11. Do you agree with our analysis of the impact of the proposals in this CP? If not, can you provide any evidence or data that would explain why you disagree or might further inform our analysis of the likely impacts of the proposals?**

We agree with the analysis of the impact of proposals on group level plans. However, the EBA does not estimate the costs involved with banks being required to replicate recovery plans for all individual institutions within the group, regardless of their significance to the Member State concerned or the systemic impact of their failure. We think this would be considerable and unjustified in relation to the additional benefit on top of a group level plan which can be deployed flexibility within the group.



## **Draft RTS on the assessment of recovery plans**

**Q1. If your recovery plan has already been assessed by a competent authority, what are your general comments to this RTS on the basis of your experience? In particular, which elements do you suggest to add to the assessment criteria specified in this RTS?**

DB has a Group Recovery Plan which is discussed jointly by its Crisis Management Group. The draft RTS do not exactly reflect our experience, as they describe assessments of elements of individual institution and group plans separately. We do not believe individual institution recovery plans are necessary. In our experience, it is more effective to use existing mechanisms for local supervisors to ensure that local management are fully aware of how the Group Recovery Plan applies to them and the potential impact on the local ICAAP.

In general we are concerned that the EBA's draft RTS disregards developments in the RRD negotiations over the process for agreeing group recovery plans and the extent to which banks will be required to prepare individual institution recovery plans. In both the agreed Council and Parliament texts, it is clear that the co-legislators wish to place the emphasis on supervisors and resolution authorities of cross-border banks first seeking to reach agreement on a group recovery plan. Only if this is not possible would individual institution plans be required. This makes it even more important to have effective measures in place to jointly agree group level plans, and we are concerned that the EBA RTS does not address this.

In DB's view, local recovery planning is of limited benefit, compared to the considerable effort involved in developing and keeping plans updated. Decision-making on recovery will be taken at group level for most banks. Local plans, especially for centrally capitalised or funded banks, will therefore mostly refer to the group recovery plan. We are concerned by the potential for this duplication of effort to undermine the effectiveness of both group level and local plans, as it would discourage home/host authority cooperation and communication. This will heighten the risk of fragmented decision-making and measures which ring-fence banking activity in individual Member States to the potential detriment of other jurisdictions. We are therefore very concerned that the EBA draft RTS does not address the areas in which or the process by which home and host authorities should seek to communicate and cooperate.

In addition, the RTS seem to assume that assessments take place in a one-off exercise conducted by regulators, whereas in reality the process is iterative between the institution and authorities as well as between authorities themselves. A new Article should therefore be introduced which addresses communication and coordination.

For cooperation between authorities, this should include elements such as: the need for the group recovery plan to be effectively communicated to all relevant EU and, where cooperation and information sharing agreements exist, third country authorities; the need to seek comment and have proper regards to the views from relevant supervisory authorities of individual institutions within the group; the requirement for relevant supervisory authorities to approve the intra-group funding support agreement; and the identification of any regulatory barriers to implementation of recovery measures.

For communication between the institution and authorities, it should include elements such as: the need to inform the institution of any lack of completeness, quality or credibility and to provide an opportunity to address this in an appropriate timescale; and the need to identify barriers to recovery and to give the institution an appropriate time period in which to determine the necessary steps and timing of measures to address these. Once the initial recovery plan is complete, authorities should also consider the extent to which it will communicate with the institution to embed recovery planning in the risk management processes and keep the recovery plan up to date on an ongoing basis.



**Q2. Do you think that the elements which shall be subject to assessment according to this Article are comprehensive? Do you think that some of the elements should be amended? Do you think that some additional elements should be added?**

The elements subject to assessment in this Article are comprehensive, but as outlined above we consider that they should refer to the group level recovery planning process only. Further requirements (e.g. intra-group funding and identification of obstacles to implementation) could then be provided for in a separate Article for use only if there is no agreement on group plans.

**Q3. Do you think that the elements which shall be subject to assessment according to this Article are comprehensive? Do you think that some of the elements should be amended? Do you think that some additional elements should be added?**

The elements subject to assessment in this Article are comprehensive and sufficient. We suggest that point c.ii. “does not omit any relevant recovery options or potential indicators” should be amended to read “does not preclude the use of additional recovery options or potential indicators”. It is difficult to anticipate the exact nature of a crisis and no institution or regulator can anticipate in advance the full range of risks that may materialise or potential actions to deal with them. As such, banks should be able to deploy additional tools or react to additional indicators as needed to restore the institution’s viability. On internal consistency, we agree that the group recovery plan should ensure that recovery measures to be taken at the level of individual institutions are consistent with the group plan. Therefore d.i. should be replaced with wording to this effect and d.ii. with “in the case that separate recovery plans are required for individual institutions, the internal consistency between this and the group plan.”

**Q4. Do you think that the elements which shall be subject to assessment according to this Article are comprehensive? Do you think that some of the elements should be amended? Do you think that some additional elements should be added?**

The elements subject to assessment in this Article are comprehensive and sufficient, but we suggest further clarification in two areas. First in paragraph 2, in the absence of guidance on communication in line with our suggestions under Q1, it is not clear who would assess these conflicts, the extent to which these would be communicated to banks or whether banks would be given an opportunity to propose enhancements to the recovery plan to address them. It is appropriate for supervisors - and, in particular the EBA given the integrated nature of EU financial markets - to assess the market impact of multiple institutions implementing similar recovery measures at the same time. On the basis of that assessment, they should communicate risks around simultaneous activation to banks to be taken into account, e.g. by considering alternatives are in place in the recovery measure toolbox or including mitigating measures to ensure the success of the recovery measure. Supervisors should not automatically reject a recovery measure because it is proposed by multiple banks, but rather seek a broad set of robust tools which can be deployed flexibly, depending on the situation.

We also question the wording of 1.e. While we agree that necessary preparatory measures and barriers to implementation of recovery options should be identified, the extent to which preparatory measures should be implemented will depend on both the nature of the recovery option and the barriers to implementation presented. Many preparatory measures (e.g. preparing a data room for a disposal) are not appropriate when an institution is not yet approaching its early warning indicators, let alone anywhere near its recovery triggers. As such, this point should read “whether necessary preparatory measures have been adequately identified and, where necessary and appropriate, they are implemented or a plan to implement them is prepared.”



**Q5. Could you describe what key elements the competent authority should assess when reviewing the matters stipulated in Article 5(3) letters a) to d)?**

We agree that these are the key elements that supervisors should review, but we suggest adding further points around regulatory cooperation: have the relevant supervisors within the group received the group plan or approved the intra-group support agreement? Are there any further regulatory barriers which need to be addressed for recovery measures to be effective?

In addition, under 3.a. we suggest the use of walk-throughs to demonstrate the effectiveness of recovery measures. We have found these a very useful exercise for identifying barriers, preparatory measures or operational requirements for implementing recovery measures and anticipating and addressing any unforeseen consequences of their implementation.

Finally, under 3.b. we support taking into account the governance structure within the group, but this should only be as relevant for material legal entities or those directly affected by recovery measures, as otherwise this is a cumbersome and unnecessary exercise.

**Q6. Do you agree with our analysis of the impact of the proposals in this CP? If not, can you provide any evidence or data that would explain why you disagree or might further inform our analysis of the likely impacts of the proposals?**

Yes, we agree with the analysis of the impact. It seems reasonable given the variation in numbers of banks within Member States that the costs of implementation would vary considerably by supervisory authority. This emphasises the importance of group level planning wherever possible, supported where necessary by coordination and communication with relevant host authorities, rather than duplicative local plans which in many cases add little benefit beyond referring to the group recovery plan.