

GENERAL COMMENTS

Santander welcomes the opportunity to respond to the EBA's Consultation Paper on Draft Regulatory Technical Standards *specifying the range of scenarios to be used in recovery plans under the draft directive establishing a framework for the recovery and resolution of credit institutions and investment firms* (RRD), published on May 20, 2013.

Santander strongly supports the EBA's efforts in the establishment of a harmonized framework of standards on the design and content of scenarios to test the effectiveness of recovery options. Equally, a common benchmark is key to avoid non-level playing field implications arising from divergent national requirements. Therefore, **Santander endorses that the RTS be adopted by means of a regulation so that they are binding in their entirety and directly applicable in all Member States.** Moreover, from a global standpoint, a similar aim is desirable given the current trend we are experiencing of asymmetric requirements in different jurisdictions.

Going forward, **we would also encourage the development of guidelines covering the coordination of the design and the content (especially regarding the degree of severity and the likelihood of occurrence) of scenarios in recovery plans and those envisaged in other documents for other purposes** (i.e. capital planning, liquidity contingency plans, public stress tests). In our view, significant scale economies could be reaped by using common baseline scenarios to these exercises provided this coordination exists (via enhanced procedures in supervisory colleges).

In our view, this Consultation remains largely open-ended regarding the baseline structure of scenarios. We recognize the complexity of striking the right balance between flexibility for entities to develop their own scenarios and concreteness on the design and content of scenarios. However, we consider key greater conciseness on the baseline structure of scenarios. In this regard, we would welcome that articles 3 and 4, which amount to the main body of this Consultation, provide a more detailed list of the various impacts and events which should be considered by entities when designing their scenarios, and the interrelation between impacts and proposed events.

In this respect, we consider RTS need to be provided **at least** on:

- **The number of scenarios that should be considered in the short run and those which could occur in the long run**, with unequivocal definitions on both the "short run" and the "long run."
- **Definitions on parameters** (or "events" as they are referred to in art.4) which may lead to a liquidity strain in the short term or a capital shortfall

in the long term. And, **most importantly, RTS need to link the list of parameters (art. 4) to potential impacts (art.3) in a structured and straightforward manner.** This linkage is key to avoid unrealistic scenarios by which, for instance, a macroeconomic downturn (which would need to be defined in the Consultation as we petition on this very point, and similarly with other parameters) would induce a capital shortfall in the short term, a highly unlikely possibility given that macroeconomic variables erode over long periods of time.

The two aforementioned points do not constrain entities' flexibility to develop their own scenarios. Indeed, **Santander agrees that an overarching principle in the specification of scenarios is that they should be based on those events which are most relevant to the institution or group.** Provided that the general baseline structure requested prevails as a starting point, this would allow entities to use events different from those listed under art.4, (as suggested later on in art. 4.4).

A further refinement to consider dwells on events listed under an idiosyncratic scenario. We seriously doubt whether some of the events (i.e. failure of significant counterparties, decline of asset prices) **envisaged under an idiosyncratic scenario** align with the statement on paragraph (6), pg. 8, which reads that events should be those which "*most typically threaten the failure of institutions or groups.*" In this regard, and as we explain later on in our response to question N.7, it seems rather unlikely that the failure of a significant counterparty and/or the decline of asset prices would "*typically threaten the failure of institutions or groups*" (6, pg. 8) in an idiosyncratic scenario.

Another major source of concern for us is the absence of RTS on the definition of severity and on the parameters that determine the likelihood of occurrence of scenarios which would be useful to avoid the perils linked to differing national supervisory requirements.

For the purpose of clarity, suppose for instance that the degree of severity needed to threaten the viability of a bank which exhibits core equity of 15% in jurisdiction A is much higher than one for a bank which displays core equity of 9% in jurisdiction B. National supervisors in jurisdiction A might be tempted to apply to its bank a disproportionate degree of financial distress relative to the one in jurisdiction B to obtain a similar capital shortfall scenario for both banks. However, this degree of distress will possibly lead to fringe, if not impossible, scenarios given the relatively robust starting point for the bank in jurisdiction A.

In other words, it is not possible to obtain similar scenarios for both banks unless the likelihood of occurrence is calibrated to fit these different starting points. In our example that would mean that the probability for the bank in jurisdiction A to enter into a scenario that results in financial distress similar to the one experienced by the bank in jurisdiction B is very low, if not virtually nil.

Thus, we consider that scenarios cannot be based on events which are *both* extraordinary and plausible, contrary to what the Consultation states on art. 3.c. (pg.9).

To avoid this conceptual pitfall, we would appreciate the issuance of RTS on the definition of severity and the parameters that determine the likelihood of occurrence to provide a minimum degree of harmonization that will ensure that the level-playing field effectively prevails in the Single Market.

SANTANDER RESPONSE TO CONSULTATION QUESTIONS

Q.1. Have you already drafted financial distress scenarios for the purpose of testing 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?

Yes. In general, our financial distress scenarios are aligned with the contents of the draft RTS.

Q.2. Have you developed group or solo specific scenarios to test the adequacy of the recovery plans?

Santander has developed both system-wide and legal-entity specific scenarios to test the adequacy of recovery options in its plans.

Q.3. 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?

As stated in our general comments, the draft RTS on the range of scenarios provide a very general framework for firms to test their recovery plans. Indeed, firms will test their recovery options against scenarios but these might be insufficient to test the consistency of measures put forth by entities in different Member States given that national supervisors will be challenged by the differing structure of scenarios and the non-harmonized criteria on elements such as severity and the likelihood of occurrence.

Therefore, **Santander** encourages the EBA to go a step further by providing clear, unequivocal RTS on the structure of scenarios and on the definition of severity and parameters that determine the likelihood of occurrence to ensure the level-playing field in the Single Market.

Q.4. 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?

The requirement varies considerably depending on each jurisdiction since the exact number will depend on the nature of each plan, though in general each plan includes six or more scenarios.

These scenarios comprise:

- Fast moving system-wide and/or idiosyncratic events such as liquidity squeezes ranging from 30 to up to 90 days.
- Slow moving (long-term) system-wide capital deterioration events.
- Reverse stress testing scenarios for capital deterioration upon any event.

Going forward, **we would welcome guidelines covering the coordination of the design and content (especially regarding the degree of severity and the likelihood of occurrence) of scenarios in recovery plans and those envisaged in other documents for other purposes** (i.e. capital planning, liquidity contingency plans, public stress tests). In our view, significant scale economies could be reaped by using common baseline scenarios to these exercises provided that coordination is effective (via enhanced procedures in supervisory colleges). By way of example, we consider that scenarios used for macroeconomic downturns should at least include those most severe resulting from ICAAP exercises and those provided by public stress tests on an annual basis.

Finally, we would like to stress that it is inconsistent to require liquidity shortage scenarios in the long term as currently requested by national supervisors in some jurisdictions. Conversely, it makes no sense to demand capital shortfall scenarios in the short run based on macroeconomic variables movements.

Q.5. Have you used reverse stress testing as a starting point for developing financial distress scenarios?

From our experience, we have perceived that not all supervisors and entities understand the term “reverse stress” in the same manner. Therefore, **we believe it would be helpful for the EBA to provide a definition on reverse stress testing as well as specific examples.**

We are of the view that reverse stress tests should be complementary to the rest of scenarios. This type of stress testing enables an entity to include scenarios that place it in near-to-default positions (for any reason) thereby helping to identify the set of causes which would reasonably put that entity at risk.

Given this background, **Santander** currently uses reverse stress testing to assess the context in which specific recovery options could be implemented (i.e. assuming a severe capital shortfall and its set of possible causes).

Q.6. What are the additional costs to develop financial distress scenarios in respect to the current practices of reverse stress testing?

The costs should range from small to none provided that reverse stress testing is a common practice integrated in the overall BAU risk management framework of an entity or group.

Q.7. 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?

Santander broadly agrees that the proposed events for both system-wide and idiosyncratic impacts provide a minimum framework to conduct stress testing.

The overarching principle in the specification of scenarios is that they should be based on those events which are most relevant to the institution or group. This implies the possibility of using different ones than those laid out under art.4, as suggested in art. 4.4 as long as the starting point is the EBA baseline structure. Similarly, the principle of proportionality should always prevail: Institutions should use an appropriate number of financial distress scenarios against which to test their recovery plans.

Nonetheless, we seriously doubt whether some of the events (i.e. failure of significant counterparties, decline of asset prices) **envisaged under an idiosyncratic scenario** align with the statement on paragraph (6), pg. 8, which holds that events should be those which “*most typically threaten the failure of institutions or groups.*”

In particular, we sustain that events such as the “*failure of a significant counterparty*” and “*an adverse movement in the price of assets to which the institution or group is predominantly exposed*” fall exclusively within the category of system-wide events and should not be considered as idiosyncratic events (art. 4.3.).

The failure of a significant counterparty will almost always occur during a period of widespread financial instability. Likewise, it is difficult to envisage scenarios in which only an entity’s assets are subject to adverse price movements given the strong correlation generally witnessed with falling stock markets during macroeconomic downturns.

Finally we would welcome greater conciseness concerning the impact of events on an entity’s “business model” and its “reputation,” as proposed under art.3.2.

Q.8. Do you have any general or specific comments on the draft RTS?

Please refer to our opening “general comments.”

Q.9. Are the definitions and terminology used in the draft RTS clear?

Yes, though subject to the general comments already made and our response to previous questions.

Further guidance would be useful as well as to the development of “mixed scenarios” consisting of both system-wide and idiosyncratic events which would occur “*simultaneously and interactively.*” (art. 4.1.c; pg. 10)

Q.10. 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 if so to the costs its failure may create? If not, could you explain why?

Santander sustains that the costs of developing financial distress scenarios are likely to be proportional to the complexity of the firm but not to its size.

The size of an entity/group does not *per se* entail greater costs to develop financial distress scenarios if its banking model is simple from an operational standpoint and the degree of its interconnectedness is clear and well-known. In this respect, size is neither a substitute nor a synonym for complexity or interconnectedness. Rather, size can provide significant scale and scope economies which simplify business and operational processes to achieve greater efficiency.

Q.11. 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?

No comment.