EBA Discussion Paper

on

a template for recovery plans

(EBA/DP/2012/2)

London, 15 May 2012

Contents

I. Responding to the Discussion Paper

The EBA invites comments on the issues discussed in this discussion paper (DP) and in particular on the specific questions in section IV.

Comments are most helpful if they:

- indicate the issue or the specific question to which the comment relates;
- contain a clear rationale;
- provide evidence to support the view expressed;
- describe any alternatives the EBA should consider; and
- where possible provide data for a cost and benefit analysis.

Please send your comments to the EBA by e-mail to DP-2012-02@eba.europa.eu by **15 June 2012**, including the reference to "EBA/DP/2012/2" in the subject field. Please note that comments submitted after the deadline, or sent to another e-mail address will not be processed.

Publication of responses

All contributions received will be published on the EBA's website following the close of the consultation, unless you request otherwise. Please indicate clearly and prominently in your submission any part you do not wish to be publicly disclosed. A standard confidentiality statement in an e-mail message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with the EBA's policy on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

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Disclaimer

This discussion paper expresses the EBA staff's preliminary views and will not bind in any way the EBA in any possible future development on the topic. It is aimed at eliciting discussion and gathering stakeholders' opinions at an early stage of the process.

II. Background and rationale of the template

Several banks in different Member States are currently drafting recovery plans, following initiatives undertaken within the European Union (EU) as well as at the international level.

On the global stage the initiatives on recovery and resolution planning – endorsed by the G-20 leaders – are being coordinated under the auspices of the Financial Stability Board (FSB), which in its Key Attributes of Effective Resolution Regimes for Financial Institutions (KAs) identifies the essential elements of recovery and resolution plans (RRPs), and recommends RRPs to be in place by end 2012 for all global systematically important financial institutions (G-SIFIs) and for any other firm which, according to its home supervisory authority, could have an impact on financial stability in the event of its failure.

At the EU level, the Conclusions of the Council of the European Union on Crisis Prevention, Management and Resolution of 18 May and of 7 December 2010 foresee explicitly that RRPs should be drafted at least for credit institutions for which a Cross-Border Stability Group (CBSG) has been established, and the EBA should facilitate this goal. Following these Conclusions, Article 25 of the Regulation (EU) 1093/2010 (EBA regulation) assigns generally to the EBA the task to contribute to and participate actively in the development and coordination of effective and consistent RRPs. In particular the EBA may identify best practices, and develop regulatory and implementing technical standards, with regard to the development of RRPs. The role and responsibility of the EBA are to be specified in an EU legislative act. In this regard, the forthcoming European Commission proposal for EU legislation establishing a framework for the recovery and resolution of credit institutions is expected to detail the nature and content of RRPs, clarify the scope of their application, and further define the role and powers of the EBA and national competent authorities (NCAs).

At national level, within the EU some jurisdictions have already introduced or started drafting specific legislation on RRPs. In a number of cases, these initiatives are addressing specific requests to reform resolution regimes within the context of the IMF/EU financial assistance program. On the other hand, several NCAs engaged directly in the RRP drafting process, even where they have no specific legislation on this issue, due to their involvement as FSB members in the international work on SIFIs.

In line with its institutional tasks, the EBA - in cooperation with the NCAs - is currently reviewing and examining the content of the various legislative and supervisory national initiatives taken with regard to RRPs, in order to help develop best practices and foster convergence on them within the EU. The stock-take so far carried out has highlighted a number of issues, showing *inter alia* that: (i) further thinking is being carried out on the legal implications and possible binding effects of the RRPs, since the latter could diminish the flexibility required, given the specific circumstances of each crisis, and delay the adoption of the necessary actions; (ii) the role of the scenarios for the purpose of RRPs should not be overestimated, since scenarios are seen by various NCAs solely as a means to highlight specific vulnerabilities and assess the impacts (on liquidity, solvency, etc.) for which institutions have to design a set of possible corrective measures; so following this line of thought the plan and the possible recovery measures should focus more on the various possible impacts/triggers than on the scenarios; (iii) the process of drafting RRPs and assessing them for large, cross-border groups should be shared among NCAs within a cooperation format, and adequate arrangements need to be in place to ensure appropriate coordination and preserve confidentiality .

In light of the above, and in line with the EBA's task to foster consistency and convergence on best practices, this DP focuses on recovery plans and presents the EBA staff's preliminary view on what the key elements of a recovery plan should be. For this purpose the DP presents, in the following section, a possible "template for recovery plan" which aims to cover the essential issues that should be addressed in a recovery plan and providing a non-exhaustive guide to the information that a recovery plan should provide to supervisory authorities.

The template aims to elicit discussion and gathering stakeholder opinions at an early stage of the process. These inputs will assist the EBA in the performance of its role according to Article 25 of the EBA regulation and the specific tasks that will be detailed by the forthcoming Commission proposal. To this end, the concluding section of this DP presents questions on some issues which appear, so far, to be most important in order to receive stakeholder feedback.

The content of the template has taken into consideration the FSB's recommendations, and the Commission's consultation documents on this issue as well as the experience of national authorities in the EU.

Drafting a recovery plan is an exercise undertaken prior to a crisis in order to assess the potential options that a financial institution could implement to restore financial strength and viability when the firm comes under severe stress. A key assumption is that neither the state nor central banks intervene to manage the crisis. The plan is therefore drafted and owned by the financial institution.

The objective of the plan is not to forecast the factors which could prompt a crisis but rather to assess if options available to counter it are sufficiently robust and if their nature is sufficiently varied to face a wide range of shocks of different natures. A key component of the recovery plan is, therefore, a strategic analysis that identifies the firm's core businesses and sets out the key actions to be taken in relation to them and the remaining components of the firm in a stress situation. The recovery plan should include measures to reduce the risk profile of a firm, react to liquidity shocks and reinforce capital as well as strategic options, such as divesture of business lines and restructuring of liabilities.

In a crisis situation, the recovery plan may then serve as a guide to the recovery of a distressed firm. Pre-identified recovery measures could be implemented if there is a reasonable prospect of recovery after their implementation. If not, and other recovery measures are not identified, the institution may need to enter the resolution phase. To the extent that resolution plans are not addressed in this template, issues such as the different forms of State intervention and of their consequences are not dealt with in the template.

The template does not represent a draft document which could be recognised as guidance in the sense of Article 16 of the EBA regulation. Rather it serves as a basis from which to develop an EU view on the essential elements of a recovery plan. In the current conditions it remains, ultimately, a national decision to implement recovery plans and any common template, such as the one discussed in this paper can only serve as a guide to identify elements which, if applied by different member states, would contribute to increased convergence of supervisory practices and comparability of results.

National legal frameworks with regards to the establishment of recovery plans differ greatly among EU member states. Therefore, for as long as the proposal of the European Commission has not been adopted, this template aims to provide a flexible tool to apply in different contexts, such as:

- in countries in which there is a legal framework obliging credit institutions to draft recovery plans and in countries in which there is no such legal obligation;
- in countries in which the recovery plan is binding and in countries in which it is not;
- in home and host countries, with regard to the group on a consolidated basis and/or its main systemically important branches and subsidiaries on a sub-consolidated or solo basis;
- to large and complex cross border financial institutions or to smaller and less complex ones. In that context, authorities will want to apply recovery plans in such a way that the content of the plan is proportionate to the nature, activities and complexity of the institution concerned.

Finally, the development of a recovery plan is an interactive and iterative process where supervisory authorities and the institution are supposed to have frequent mutual exchanges. A template serves only as a first basis for these discussions and it may need to be adapted over time, to reflect the content of these discussions and to better fit the institution's features, its recovery options, its potential weaknesses and sources of vulnerability.

III. Template for recovery plan

The template is split into three main chapters. The first (A) provides general but comprehensive information on the institution, on the governance structure with regard to the recovery plan, as well as summarizes the main conclusions of the plan. The second (B) includes the core of the recovery plan, namely the assumptions behind the list of options available in a crisis situation and an assessment of their execution and impact. The third (C) identifies measures that the institution plans to implement to facilitate the drafting of the recovery plan, its update or its implementation in crisis times.

A. General overview

The General overview forms an integral part of the recovery plan. It should provide a summary of the plan, background information on the structure of the group/sub-group/firm and on the governance of the plan.

a) *Summary of the plan*: In this section, the institution is expected to summarize the main conclusions of its recovery plan. The summary should include at least the following elements:
    - the key elements presented in the different sections of the plan ;
    - the main changes since the last update;
    - a general overview of the steps that need to be undertaken before the finalisation/update of the plan.

b) Description of the group/institution: The first element of this part of the recovery plan is of a general overview of the institution's legal structure (including significant branches), its activities, and the interdependencies between the different entities within the group. This section should identify the main activities performed by the institution, the core businesses it operates, and map them into the legal structure. In addition, it should provide an overview of interdependencies within the group. It should comprise at least a section providing:
    - a general description of main activities, including a discussion of the overall global strategy of the institution, its business model, the identification of the main core business lines and the reasons supporting this identification, and the main jurisdictions in which the institution is active.
    - a mapping (and detailed description):
        - of the legal and operational structures (which should also include an organisational chart showing business units, the legal entities in which these business units are located and activities conducted as well as a breakdown of employees by business unit);
        - of the legal and financial structures (with a breakdown of turnover, cash flows, liquid assets, funding needs, large exposures, P&L, and Tier-1 capital by legal entity)

The mapping should not include all the different entities but should rather focus on the significant branches and legal entities. A significant branch or legal entity is defined as any entity:

  - that substantially contributes to the profit of the group or its funding, or that holds an important share of its assets or capital; or
  - that performs key commercial activities; or
  - that centrally performs key operational, risk or administrative functions (e.g. IT); or
  - that bears substantial risks that could, in a worst-case scenario, jeopardize the survival of the group; or
  - that cannot be disposed of or liquidated without triggering a major risk for the group as a whole; or
  - that is important for the financial stability of the country in which it operates.

  There is no need to provide detailed information regarding entities that have no material impact on the operations, capital structure or governance of the group and that are not systemically important in the country in which they are located.

- a description of intra-group financial links between the different legal entities. This includes a discussion of all existing material intra-group exposures and funding relationships, a description of the capital mobility within the group, as well as of intra-group guarantees existing both in normal and in crisis times.
- a description of critical or systemically relevant functions performed by the group. This primarily concerns external functions, such as payment systems and services provided to other institutions, but also include centralised functions that are critical for the group, such as treasury, collateral management, IT, access to market infrastructures (as recipient and as provider), administrative, operational, outsourcing.

c) *Discussion of internal governance* with regard to the design of the recovery plan, the approval process and the governance process in case it needs to be implemented in a crisis situation. This section should at least provide a description of :

- how the plan was developed: including the identification of persons responsible for developing the different sections of the plan, a discussion of how the plan is integrated in the corporate governance of the group/institution, (and of potential links with the stress testing framework of the group/institution).
- by whom the current version of the plan was approved: including the involvement of senior management, whether the plan was presented to the internal and/or external auditor and/or the risk committee. The plan should explain why the plan was approved at a lower level than the Board of Directors, if the national legal framework allows for this .
- the governance of the recovery measures in a crisis situation: the document needs to explain how the escalation process (if any) is designed. It should also clearly describe the decision making process with regard to the activation of the plan. This includes a discussion of who is involved in this

process, in which conditions the plan will be activated, the procedures that need to be followed, the criteria that will determine which option will be implemented, and a description and assessment of how management information systems are managed and whether they will be able to provide the necessary information on short notice.

- how the institution intends to update the plan: this includes a description of who is responsible for keeping the plan up-to-date, the frequency with which the plan will be updated, and a description of the process in case the plan needs to be updated to respond to material changes affecting the institution or its environment.

B. Core of recovery plan

The objective of a recovery plan is not to forecast the factors which could prompt a crisis but rather to assess if options available to counter a crisis are sufficiently robust and if their nature is sufficiently varied to face a wide range of shocks of different natures. A key component of the recovery plan is, therefore, a strategic analysis that identifies the firm's core businesses and sets out the key actions to be taken in relation to them and the remaining components of the firm in a stress situation. Consistently with this objective this second chapter aims to provide a "menu of options" which consists of a range of possible recovery measures to respond to financial stress, whether idiosyncratic or systemic, and to assess their feasibility and impact. We expect at least the following information to be provided in this section.

a) *General overview of recovery options/measures*

The purpose of this section is to give a general description of all available recovery options/measures that could be available and the actions that would be taken to enable the early execution of such options (*i.e.* when early warnings and triggers materialise). The following paragraphs would then assess the extent to which these recovery options/measures could be implemented in the different scenarios/assumptions

b) *Recovery early warnings and triggers*

Early warnings and recovery triggers specify the moment in time when institutions start to consider and determine which specific recovery option/measure (if any) they want to apply in reaction to the actual situation that has materialised. Since each crisis is different, early warnings and triggers do not automatically activate a specific recovery option but rather an early identification of the best way forward with the recovery plan. They should not be understood as thresholds leading to a compulsory pre-identified reaction but rather as the point in time at which the efficiency of the different recovery options is reassessed and their potential implementation envisaged. Early warnings and triggers are thus a key part of the escalation and decision-making process.

The institution is expected to specify these specific triggers (including examples and metrics), in particular, the institution should determine quantitative or qualitative triggers:

- relating to its solvency position
- relating to its liquidity situation
- relating to stress scenarios and the deterioration of the conditions in which it operates

c) *Assumptions and scenarios*

The objective of this section is for the institution to define several stress scenarios and tentatively assess their potential impact. The objective of this section is not to identify the next crisis but, rather, to define a set of scenarios under which the efficiency of the different recovery options will be assessed. This will allow testing of the sensitivity of the efficiency of the different recovery options/measures, which need to be fit to achieve their goals (*i.e.* to restore long-term viability) also in situations other than the identified scenarios and assumptions.

The institution is expected to specify several scenarios which should cover at least the following types of financial stress (in each case, the institution is required to differentiate slow and fast moving financial stress):

- Idiosyncratic shock, systemic shock, and a combination of both
- Contagion risks, including an analysis of large exposures and of the strategy to respond to the default of one systemically important counterpart or any other material / relevant counterpart for the institution.
- An analysis of the strategy to respond to the default of a material entity within the group, including the parent entity.

Each of the scenarios considered should be severe enough to have a serious, negative impact on the institution. The institution should choose scenarios judged to be relevant for triggering several measures in the recovery plan and believed to be sufficiently likely to occur.

The institution is expected to tentatively assess the impact on each of these scenarios on the solvency, liquidity, funding, profitability, and operations of the main entities, businesses, etc., identified in the organisational description (Section A).

d) *Recovery measures*

This section lists and assesses the different recovery options. The recovery options are not business-as-usual measures but should be extraordinary in nature. Options that can be considered include an external recapitalisation, the divestment of assets, subsidiaries, or business units, or the institution as a whole, a voluntary restructuring of liabilities, a reduction in the size of the balance sheet, or a strengthening of the liquidity position. For each recovery measure identified, the institution is expected to describe the measure in a general way and to identify the possible obstacles to its implementation. In addition, the institution is expected to provide the following analyses for each option:

- **Impact assessment** of the recovery measures comprising at least an assessment of the:
    - financial and operational impact: *i.e.* the impact foreseen on the solvency, liquidity, and funding positions, on profitability and on operations. This impact should be tentatively assessed both in a normal situation and in the different stress scenarios. In addition, it should clearly identify the different entities of the group which may be affected by the option or involved in its implementation.
    - external impact: the impact foreseen on critical or systemically relevant functions performed by the institution as well as on other market participants, customers, creditors and shareholders.

  The impact assessment should clearly mention the valuation assumptions and all other assumptions made, concerning *inter alia*. the marketability of assets, the behaviour of other financial institutions, etc.

- **Risk assessment**: for each option, the institution is expected to make an analysis of the risk associated with it. This includes both the risks that the option cannot be implemented (feasibility) and the risk resulting from its implementation (systemic consequences):

- Feasibility: the institution should provide answer to the following questions: (i) what is the estimated success rate on a scale, and why; (i) which factors could reduce its effectiveness and how could they be mitigated, (iii) which factors could make it impossible to implement the measure. These factors should at least consider legal, operational, business, financial, and reputational risks (including risk of rating downgrade).

  The bank is also invited to discuss its potential experience in executing such a measure or similar ones.

- Systemic consequences: the institution should identify any potential system-wide implications associated with the implementation of the option, as well as its impact on any future resolution in case recovery options would not be effective.

When substantial obstacles or hurdles have been identified, the institution is invited to outline solutions for overcoming these potential problems.

- **Decision making process**: the institution needs to describe the internal decision making process in case the option needs to be implemented, including the steps to be followed, the timing and parties involved, up to the point of implementing the option. If the timing is uncertain, estimated ranges may be provided, together with reference to factors that would affect these ranges.

e) *Operational contingency plan*

For each of these options the institution is expected to provide an operational contingency plan, which explains how the continuity of its operations can be maintained in a recovery phase if the recovery option is implemented. This includes at least an analysis of both its internal operations (e.g. its IT systems, its suppliers, and its HR operations) and its access to market infrastructure (e.g. clearing and settlement facilities, payment systems, additional requirements in terms of collateral).

Where the option involves the separation of an entity from the group, the institution is also expected to demonstrate that separated entities can continue to operate without any group support.

f) *Communication plan*

The institution is expected to provide a detailed communication plan as well as an analysis of how this communication plan can be implemented in a recovery phase and for each of the different recovery options, providing an assessment of the potential impact on the business and on financial stability in general.

This communication plan should address both:

- internal communication to staff, trade unions, etc. ; and
- external communication towards shareholders, counterparts, financial markets/investors, market infrastructures, public/depositors, and authorities (including the supervisory college)

g) *Information management*

The institution is expected to describe its general policy with regard to information management. In particular, the institution should describe how the group/institution ensures that the right information is available within a short time frame for decision-making in a stress situation. A specific analysis is required for each recovery option in which the institution should define the information needs specific to this option and should demonstrate its capacity to deliver the necessary information.

In addition, the bank should also describe how it can provide, in a crisis situation, in a timely manner, the information that is necessary for authorities to assess the situation. Such information includes for example:

- actual intra-group exposures through intra-group guarantees and loans;
- actual trades booked on a back-to-back basis;
- actual amounts of liquid assets in the parent bank and subsidiaries;
- off-balance sheet activities;
- the bank's actual largest exposures towards other financial institutions as well as corporations.

C. Follow-up

The recovery plan is not only a plan but a whole process which should be integrated into the governance of the institution. The experience may require changes in the organisation either to facilitate the update of the plan and its implementation in the future, to monitor triggers, or because the process has identified some impediments complicating the implementation of recovery options. The organisation is likely to need to think about follow-up or corrective actions. The objective of this section is to describe precisely these actions. The following measures should be considered in the drafting of this section:

- Preparatory measures that can be taken in advance for a successful execution of the recovery measures (e.g. shortening execution time, maximising benefit)
- Areas for improvement (including new assumptions, new measures, changes to group/institution organisation, governance, training of staff, simulation exercises, etc.)

For each follow-up or corrective measure, the institution is expected to specify the reason why the measure is currently being considered and a timeframe for implementation.

IV. Questions

Q.1 Have you already drafted/approved a recovery plan or are you in the process of doing so? If so, please reply to the following questions referring to your experience

Q.2 Is your recovery plan or would your future recovery plan be in line with the contents of the template and its underlying approach? Please mention the relevant differences, if there are any

Q.3 Are there legal provisions and/or guidelines in place in your jurisdiction with regard to recovery plans and resolution plans? If so, are there any elements of this template which conflict with those provisions?

Q.4 What kind of legal implications and/or binding effects does the plan have in your jurisdictions, if any, and what should they be, in your opinion?

Q.5 Do you believe the draft recovery template to be sufficiently comprehensive and cover all the aspects relevant for the purpose of the recovery plan? If not, please specify what is missing.

Q.6 Should the recovery plan include scenarios and assumptions as possible points of reference for testing the various recovery options? What role should they play within the recovery plan and with respect to the possibility to consider *per se* the various triggers and negative impacts?

Q.7 How would/do you identify quantitative and qualitative recovery early warnings and triggers? What are the key metrics you would use to develop early warnings and triggers?

Q.8 What kind of corporate governance arrangements have you adopted or would you adopt for recovery planning? Please comment on differences to the template.

Q.9 How do/would you ensure the consistency between your group recovery plan and recovery plans drafted by your main entities? For this purpose, are you aware of any obstacles in the current legal framework?

Q.10 What range of recovery measures do you think should be envisaged in the template?

Q.11 Have you got any remarks or concerns related to the confidential nature of the information provided in the recovery plan? If so, please elaborate.

Q.12 Should the plan include a ranking among the various recovery measures, differentiating between them with regard to possible scenarios and assumptions and taking into account the expected impact of each measure?

Q.13 How would you assess the credibility of a recovery plan? Please comment on your experience

Q.14 What kind of information arrangements have you put in place to ensure that the right information is available within a short time frame for decision-making in a stress situation?

Q.15 How frequent should interactions/iterations between the supervisor and the financial institution be? What role should the supervisor play?

Q.16 The implementation of a recovery plan is likely to structurally modify the financial institution and its sources of revenues. Should a forward looking business plan, assuming the implementation of the recovery options, also be part of the recovery plan?

Q.17 Please provide views on the impact, including your costs and benefits analysis, of the issues involved in the preparation of a recovery plan?

Q.18 Have you made, or do you plan, changes in the organisation to facilitate successful implementation of the recovery plan in the future?