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18 December 2014

European Banking Authority
Floor 46
One Canada Square
London
E14 5AA

Submitted via the EBA website

Consultation paper on draft guidelines on the minimum list of qualitative and quantitative recovery plan indicators

Dear Sir / Madam

Please find enclosed AFME's response to the EBA consultation paper on draft guidelines on the minimum list of qualitative and quantitative recovery plan indicators (EBA/CP/2014/28).

Please do not hesitate to contact us if you have any questions.

Yours faithfully

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Consultation response

EBA consultation paper on draft guidelines on the minimum list of qualitative and quantitative recovery plan indicators (EBA/CP/2014/28)

18 December 2014

The Association for Financial Markets in Europe ("**AFME**") welcomes the opportunity to comment on the European Banking Authority ("**EBA**") Consultation Paper (the "**CP**") on draft guidelines on the minimum list of qualitative and quantitative recovery plan indicators (EBA/CP/2014/28).

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.[1]

We set out below our comments in response to the CP. Unless otherwise indicated, references to paragraphs are references to paragraphs of the draft guidelines.

A. General comments

As recognised in the executive summary of the CP, the risks which each institution faces vary significantly depending upon its business and funding model, activities, structure, size and interconnectedness. It is therefore essential that recovery plan indicators are developed by the institution according to the relevant risks that it faces.

In this regard, we support the overarching principles set out in paragraph 15 of the draft guidelines. It is necessary to ensure that the indicators applied are relevant to the particular bank.

While guidelines on the categories of indicators that should be included could be helpful to improve consistency across the EU, we caution against including too detailed or specific indicators that have to be included in all recovery plans, irrespective of the particular risks faced by the institution. Such requirements would be contrary to the principles set out in paragraph 15. While the EBA's mandate is to provide guidelines on the minimum list of indicators, article 9(1) of the Bank Recovery and Resolution Directive ("BRRD") explicitly states that the indicators should be "established by the institution". These factors point towards a more restrained approach by the EBA with less detail and prescription, such that the minimum list includes only those indicators that are relevant to all types of institutions.

[1] AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia. AFME is listed on the EU Register of Interest Representatives, registration number 65110063986-76.

The proposed categories of capital and liquidity are sufficiently broad to be applicable to all institutions. However, the proposed categories of profitability and asset quality are not necessarily applicable to all institutions. The profitability indicator, for example, may not be relevant for subsidiary institutions where the returns for the institution need to be considered in the context of its wider group and also the ability and appetite of the group to maintain a subsidiary with lower or variable profitability. The proposed category of asset quality indicators may not be relevant for institutions with immaterial banking books.

Furthermore, both categories are ultimately subsumed into the capital indicator – profitability through the effect on retained earnings and asset quality through impairments. Therefore, we propose that the minimum list of mandatory categories in section A of Annex I should be limited to capital and liquidity indicators, with all other categories being illustrative. The illustrative categories should be considered by firms depending upon their specific risk profile.

The advantages of this approach are (i) indicators can be optimally tailored to the risk profile and risk management processes of a firm; (ii) the selected indicators can be agreed with the supervisory body during the annual recovery plan process; and (iii) firms and supervisors can shift their focus away from discussion of rebuttable presumptions to the assessment of recovery options, which is equally, if not more important aspect of recovery planning.

If, however, this approach does not meet with EBA approval, we suggest, as a minimum, that the two categories of profitability and asset quality be made subject to a rebuttable presumption alongside market-based indicators.

We do not support the use of macroeconomic data as recovery plan indicators as these factors do not reflect the institution's actual position. The impact of macroeconomic factors on the institution will be captured by other institution-specific indicators.

Further, rather than a "rebuttable presumption" that the detailed indicators listed in paragraphs three to six of Section C of Annex I of the draft guidelines must apply, we consider that these indicators should be included in Annex II. They would then provide illustrative examples of indicators that could be applied in respect of the minimum list of categories of indicators when applying the principles set out in Titles II to VIII of the draft guidelines.

This would lead to a less rigid regime and reduce the burden on competent authorities and institutions in assessing whether the presumption is rebutted in each instance. It would also make it easier for institutions to leverage recovery plan indicators in their broader risk management framework as required by paragraph 15(d) and the FSB guidance on recovery triggers and stress scenarios.[2] The focus of institutions and competent authorities should be to ensure that the most relevant indicators are selected for each institution. At a minimum it should be clarified that the principles in paragraph 15 should be of general application and override any rebuttable presumption that a particular indicator must be included. Moreover the overarching principle should be that the retained indicators are closely connected to the relevant activity, easy to monitor and simple to parse, to ensure that they build an efficient warning system.

When considering the application of the guidelines, it should also be considered whether the indicators are to be applied at a group or subsidiary level. As discussed further below, a number of indicators are likely to be of less relevance at a subsidiary level for groups that would take

[2] FSB, Recovery and Resolution Planning for Systemically Important Financial Institutions: Guidance on Recovery Triggers and Stress Scenarios, 16 July 2013.

recovery action at the group/parent level. Furthermore, indicators at a subsidiary level may not be relevant to determine whether the group needs to take recovery action when considered at the group level. Therefore, the guidelines should provide that different requirements may apply for subsidiaries than at a group level.

Additionally, we are unsure how the proposed requirement for institutions to consider using progressive metrics ("traffic light approach") in paragraph 16 is intended to fit with the existing requirements for internal escalation when any indicator is met. In particular we are unsure how this should be applied to qualitative indicators, which we understand are based on qualitative assessment rather than on predefined amber/red thresholds.

Finally, if notwithstanding our comments above, the EBA decides to take a prescriptive approach to the minimum list of indicators, we would encourage the EBA to provide definitions – within the corresponding section - for the following indicators:

- "Leverage ratio": it is our understanding that the EBA is referring to the CRR definition (which differs in some technical aspects from the one under Basel III).
- "Net outflow of retail and corporate funding": Further clarification is needed on the definition of "net outflow".
- "Short-term wholesale funding ratio": Further clarification is needed on the nature of the ratio (i.e. what is "short-term").
- "Cost of wholesale funding": the EBA should clarify that it is referring to the present cost of wholesale issuance and not to the cost linked to the stock amount of wholesale funding.
- "Impaired and past due loans/Total loans": it is necessary to clarify whether the indicator refers to both "impaired and past due loans," or instead to two separate concepts.
- "Non-performing loans by counterparty sector": the EBA should define whether this indicator in fact subsumes or not "impaired and/or past due loans." In addition, the EBA should clarify what types of counterparties it is referring to (i.e. retail, corporates, etc.).
- "Default of a peer institution": the scope of comparison needs to be clarified.

B. Responses to questions raised in the CP

Q1. Do you agree with the inclusion of both quantitative and qualitative indicators for recovery planning purposes?

We agree with the inclusion of both quantitative and qualitative indicators for recovery planning. Quantitative indicators could be enhanced, where necessary, by each institution with quantitative thresholds requiring traffic-light based escalation procedures within a firm. On the other hand, qualitative indicators represent early warning signals resulting in a qualitative assessment. As such, qualitative indicators should not have quantitative traffic-light escalation mechanisms.

The determination which indicators are quantitative and which qualitative should be made by a firm (and agreed by the supervisory body in the context of the agreement of the overall

Recovery Plan) in the context of the specific risk profile of the firm and the firm-internal risk management processes.

Q2. Do you consider that there are other categories of indicators apart from those reflected in the draft Guidelines which should be included in the minimum list of recovery plan indicators?

Please see the general comments section above. We are broadly supportive of the categories of capital and liquidity. We consider that these categories are sufficiently broad to capture the main risks faced and therefore we do not consider that any additional categories of indicators need to be included in the mandatory minimum list of indicators.

Q3. Do you agree with the list of specific recovery plan indicators included in Annex I, Section C, or would you propose to add other indicators to this Section?

Please see our general comments above regarding (i) the inclusion of a rebuttable presumption that every indicator in Section C of Annex I must be included in every recovery plan; (ii) that the profitability indicators are already captured by the capital indicators; and (iii) that macroeconomic indicators are not useful as they do not reflect the actual position of the institution.

With respect to the list of the other indicators themselves, the requirement in paragraph 33 to include indicators based on deviation from budgets would be difficult to monitor and would not provide a useful indicator of stress. We also consider that rather than using CDS spreads as an indicator, the impact of this is better captured through the liquidity indicators such as cost of wholesale funding.

We suggest that the proposed asset quality indicators could also be enhanced or replaced with an indicator of actual credit loss.

We suggest that the location within a group should be added as a factor when considering the relevance of these indicators, to ensure that the guidelines are appropriately proportionate. Some of the indicators are more relevant for ultimate parents and less relevant for subsidiaries depending upon the particular group. For example, stock price variation would generally be relevant only for an ultimate parent and a subsidiary may not be subject to a liquid CDS contract. Institutions should be able to consider this factor when justifying any lack of relevance to competent authorities.

Q4. Do you consider that these Guidelines should establish the threshold for each quantitative recovery plan indicator to define the point at which the institution may need to take recovery measures to restore its financial position?

No. We support the approach taken in paragraph 15 of the draft guidelines to establishing principles for establishing an appropriate framework of indicators, including the principles that the indicators should be adapted to the specific characteristics and risk profile of the institution. It is impossible to establish an appropriate quantitative threshold for each quantitative indicator that is of uniform application to all banks. As set out in our general comments above, it is essential that recovery plan indicators are tailored to the characteristics and risk profile of the

particular institution and therefore that thresholds, where necessary, be established by institutions themselves. This is consistent with the approach taken in the SREP/ICAAP process.

Q5. Do you agree with our analysis of the impact of the proposals in this Consultation Paper? 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 note that for Option D2 where any thresholds are established for quantitative recovery plan indicators, plans need to equally anticipate a stress that is sudden and would not practically be identified through gradual traffic lighting of specific indicators.

We generally agree with the assessment for the analysed options. The range of options for categories and minimum list of indicators is however not complete, for example the following additional options should be considered:

a) Option A4: The guidelines require mandatory use of the categories capital and liquidity and state further illustrative categories which should be considered by a firm depending on its specific risk profile; and
b) Option B3: The guidelines provide a list of illustrative indicators that should be applied by firm based on its specific risk profile.

We consider that these proposed options A4 and B3 are superior to the ones stated in the consultation paper as (i) indicators can be optimally tailored to the risk profile and risk management processes of a firm; (ii) the selected indicators can be agreed with the supervisory body during the annual recovery plan process; and (iii) firms and supervisors can shift their focus away from discussion of rebuttable presumptions to the assessment of recovery options, which is an equally, if not more important element of recovery planning.