



Abstract

As part of the regulatory requirements for ongoing recovery and resolution planning firms must be able to demonstrate the ability to wind down their trading books in an orderly manner.

The firm was requested by the FHC and PRA to undertake an analysis to determine the extent to which the trading book could be wound down prior to resolution and to produce a credible and detailed solvent wind down ("SWD").

Avantage Reply was engaged to support the execution of PRA and FHC capital projections over the wind-down horizon taking into account model sensitivity and back-test assumptions. The project included counterparty exposure modelling (EE, EEPE etc) for traded products, credit migration and stress testing analyses. The analysis also included a deep-dive on discounted cash flows and netting sets for all traded products.

Solvent Wind-down and Portfolio-wide Stress Testing Data Submissions

THE CLIENT

The Bank and its subsidiaries form part of a multinational financial services corporation. The Bank is a global leader in wealth management, investment banking and capital markets. Core services also include wealth management, sales, market-making and investment management services to a client base that includes governments, institutions, corporations and individuals. The Bank's UK subsidiary is one of Europe's leading financial services firms, with longstanding client relationships and a leading role in many landmark transactions. The core services for the UK subsidiary includes a wide range of services covering mergers, acquisitions, restructurings, fixed income and equity financing, as well as secondary trading, research, foreign exchange, commodities, securities lending, asset management and prime brokerage.

THE CHALLENGE

Bank recovery and resolution planning forms part of an international commitment that stems from November 2008 where G20 leaders called for a "review of resolution regimes and bankruptcy laws in light of recent experience to ensure that they permit an orderly wind-down of large complex cross-border institutions". In 2010, the US established a resolution framework for systemic financial institutions under the Dodd-Frank Act8. The powers provided under this Act complement those that were already in existence to resolve failing banks, whereby the Federal Deposit Insurance Corporation (FDIC) takes any failing bank into receivership, after which their business is transferred to a new entity or wound down with losses and costs allocated to shareholders and creditors to the necessary degree.

On 27 June 2013, the Council of the European Union ("EU") agreed on its position regarding bank resolution. Following this confirmation, the European Parliament published the Bank Recovery and Resolution Directive (2014/59/EU) ("BRRD") on 15 May 2014.

The main aims of a bank resolution are to: 1) safeguard the continuity of essential banking operations, 2) protect depositors, client assets and public funds, 3) minimise risks to financial stability, and 4) avoid the unnecessary destruction of value.

Avantage Reply was engaged to assist the client in the execution of Prudential Regulatory Authority ("PRA") and Federal Holding Company ("FHC") capital projections over the solvent wind down ("SWD") horizon.

APPROACH AND SOLUTION

The Avantage Reply consultants assisted the Credit Risk Analytics and Stress Testing teams to enhance the production of stressed exposure (EEPE), RWA and capital regulatory submissions as required for the solvent wind down data as part of effective recovery and resolution planning, with particular focus on the following key areas:

- Investigating the strengths and weaknesses of the approach to determining RWA impact of the wind-down strategy for both FHC and PRA, involving numerous recalculations of exposure profiles of netting sets under different scenarios;
- Reviewing and validating the FCG allocation and calculation of Counterparty Credit Risk RWA under the business units wind-down strategies;
- Providing recommendations of calculation approaches for future exercises and documentation of the approaches employed; and
- Producing a tool for use by the Stress Testing Team that delivered Capital and RWA calculations, FHC stress tests and solvent wind-down calculations, to provide a more robust and replicable means for stress testing capital and RWA.
- Designing and implementing an end to end portfolio stress testing tool.

RESULTS AND BENEFITS

Avantage Reply worked closely with the client to deliver a number of key benefits, including:

- **FHC Stressed Solvent Wind Down** – Sourcing Credit Risk and CVA data to calculate capital requirement under stress scenarios for all books (Standardised & IMM)
- **PRA Stressed Solvent Wind Down** - Estimating the capital requirements of the rates book (Rump Analysis) and performing a deep dive analysis on whether the long market value wind down of the balance sheet produced an accurate predictor of capital requirements
- A **summary of the findings and limitations** of the FED and PRA exercises
- A **consolidation** of all the files, code and output into one area including the verification of data sources and a fully documented process both logically and functionally to ensure the process to be replicated consistently.
- **Designing and implementing a standalone tool** that performs portfolio wide stress testing, stressed solvent wind down, CVA and Expected Loss calculations.
- **A roadmap to implement the holistic stressed SWD** as an independent but scalable module that complements the existing

programmes in place and the functionality of the current stressed RWA calculations.

Through these elements, under Avantage Reply guidance, the client was able to deliver their Stressed Solvent Wind Down calculations in compliance with the regulatory requirements and to leverage and embed the process as part of the firms ongoing recovery and resolution planning to include a portfolio wide stress testing tool.

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