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THE BANK RECOVERY AND RESOLUTION DIRECTIVE

TECHNICAL STANDARDS ON THE CONTENT OF RECOVERY PLANS IN THE EUROPEAN UNION

Practical summary and guidelines for preparation

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About **Avantage Reply**
Established in 2004, Avantage Reply (a member firm of Reply) is a pan-European specialised management consultancy delivering change initiatives in the areas of Compliance, Finance, Risk and Treasury.

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Overview

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. In anticipation, the European Banking Authority ("EBA") adopted a formal Recommendation on 23 January 2013 to ensure that major EU cross-border banks developed group recovery plans by the end of 2013.

The Directive marks the Union's response to the critical issue of banks deemed 'too big to fail' during the recent financial crisis. Key to the BRRD are the principles that banks have adequate safeguards in place to prevent crises, that authorities have requisite powers to intervene to restore financial stability, and that, in cases of ultimate failure, banks are resolved in an orderly manner without adverse effects on taxpayers or the financial system as a whole.

As such, this Directive constitutes a major shift in the regulatory framework, particularly regarding the role of authorities. Authorities will now be empowered to take direct action on financial institutions under resolution, and monitor minimum requirements for own funds and eligible liabilities.

The preparation of recovery plans by institutions – to be reviewed annually – is a key component of the BRRD. Recovery plans are part of the broader process of crisis prevention, and are designed to ensure that the institution has appropriate processes and measures in place should it come under stress. Following a consultation process commencing March 2013, draft technical standards on the content of resolution plans were issued on 18 July 2014.

While the regulatory framework is currently being finalised, it is vital that institutions begin to analyse its impact. The objective of this paper, is to provide our clients with a comprehensive review of the technical standards related to recovery plans, and observations provided by the industry. Informed by Avantage Reply's experience in assisting our clients with the preparation of recovery plans, this paper also functions as a user-friendly guide to the technical process of recovery plan preparation.

The Bank Recovery and Resolution Directive: prevention, intervention and resolution

As specified in the Directive, the financial crisis highlighted the lack of adequate regulatory tools for dealing with unsound or failing institutions. As a consequence, the European Union made a commitment at the November 2008 G20 summit in Washington, DC, to review the resolution regime and bankruptcy laws. This new regime aims to ensure 'an orderly wind-down of large, complex cross-border financial institutions'.[1]

The Bank Recovery and Resolution Directive reflects this new resolution regime – but goes a major step further. Indeed, once resolution has to be initiated it is, in fact, too late.

Key to the BRRD is the principle that appropriate measures are set in place to avoid institutions being bailed out by governments and central banks, addressing the moral hazard of using taxpayers' contributions to maintain failing financial institutions.

The BRRD is designed to ensure that:

- Banks and authorities make adequate preparations for crisis.
- Authorities are equipped with the tools to intervene before the institution requires resolution.
- Harmonised tools are implemented across the European Union.
- Authorities can cooperate effectively in the case of a failing cross-border bank.
- Banks contribute to resolution financing arrangements to support the costs of restructuring.

[1] Note: Press release, Council of the European Union: "Council agrees position on bank resolution", 27 June 2013.

BRRD: Key areas of reform

1. **Preparation and prevention** through recovery and resolution planning

2. **Early intervention** measures through effective intervention triggers. Bank supervisors have expanded powers to intervene in cases of financial distress

3. **Resolution** arrangements for institutions to be 'bailed-in' by private sources, to protect taxpayers' money

4. **Cooperation** for cross- border resolution of institutions

To prevent failure, banks are now required to produce recovery plans that can be mobilised in situations of financial shock or distress. Recovery planning is designed to increase the likelihood that banks will have fully considered, and planned, the processes they will engage in should they come under stress – ideally, minimising the potential risk of bank failure. These plans will be subject to stress testing in line with EBA technical guidelines.

Recovery plans will include the development of indicators that, if breached, may trigger an escalation process to restore financial stability (which may involve the mobilisation of a prepared recovery option). Should the institution fail to recover, the authority then has the power to intervene directly in the strategic and business decisions required to rectify the financial and economic situation. If these measures prove insufficient, the financial institution will then be placed under resolution. Resolution will involve restructuring by the authority, through the use of identified resolution tools, to maintain the critical functions of the bank and restore viability of specified parts of the institution, while remaining parts are liquidated under normal insolvency proceedings.

PREPARATION	FINANCIAL DISTRESS	RESOLUTION
Recovery plan	**Early intervention triggers**	**Institution is failing or likely to fail**
• Prepared by institution • Assessed by competent authority • Updated annually or following substantial changes • Recovery indicators continuously monitored	• When breached, the competent authority may: - Use an early intervention tool - Require the institution to implement the recovery plan • Implementation of the resolution plan by resolution authorities, if the bank's recovery plan did not restore financial or economic stability	• No alternative private sector interventions to prevent failing within a reasonable time frame • Resolution necessary. The following tools may be utilised: - Private sector acquisitions - Temporary structure (e.g. 'bridge bank') - Bail-in - Asset separation

Table 1 - Overview of recovery and resolution process

This paper focuses on the technical requirements and effective approaches to the development of recovery plans, informed by Avantage Reply's experience in assisting our clients with the preparation of recovery plans and engaging with the regulatory community.

A. Regulatory Technical Standards and Guidelines

The BRRD mandates the EBA to establish guidelines and technical standards for the implementation of the various components of the Directive. As such, the EBA has developed **Regulatory Technical Standards** ("RTS") and **Guidelines** establishing the concrete requirements for recovery plans.

The first set of RTS provides that recovery plans must include the following breakdown of information (figure 1).

Figure 1 - Recovery plan components at a glance

The second set of RTS identifies the principles and criteria that supervisory authorities shall follow when assessing i) the completeness, ii) the quality, and iii) the credibility of recovery plans. Further detail on these principles and criteria will be outlined in the following **'Review of recovery plans'** section.

The Guidelines specify the range of scenarios by which institutions are to test the effectiveness of their recovery plan, assessing the institution's resilience against a variety of shocks. Scenarios of macroeconomic and financial distress therefore need to take into account the specific nature of the institution or group, including its size and interconnectedness with other institutions and markets. The scenarios should describe 'near-default' situations, i.e., outline cases that would bring the institution close to failure but no further.

SIMPLIFIED OBLIGATIONS: CLARIFICATION BY THE EBA

During the consultation process, it was suggested by respondents that the RTS disproportionally target institutions that are of systemic importance to financial markets. As Article 1 specifies that the draft RTS establishes minimum requirements for institutions, respondents argued that the proportionality principle was not adequately reflected in the RTS. The EBA has since clarified that the RTS on recovery plan minimum content only applies to institutions not subject to simplified obligations (as outlined in Article 4 of the BRRD).

In determining whether an institution is subject to simplified obligations, competent authorities will consider aspects such as the nature and size of an institution, its interconnectedness with other institutions or the financial system in general, and the scope and complexity of its activities.

B. Recovery plans in context

The preparation of recovery plans is carried out under the auspices of the Financial Stability Board ("FSB"), which identified the essential key elements in its standard **Key Attributes of Effective Resolution Regimes for Financial Institutions**. These attributes have been taken into account by the EBA, along with the recommendations from the industry and the feedback provided on the consultation paper.

C. Regulatory framework of recovery planning

The regulatory framework of recovery planning is still evolving, with the BRRD augmented by a number of EBA Guidelines, RTS and Implementing Technical Standards ("ITS"), many of which are currently under development or in consultation phases. Table 2 provides an overview of the various EBA pronouncements related to recovery planning as of December 2014:

EBA REGULATORY TECHNICAL STANDARDS, IMPLEMENTATION TECHNICAL STANDARDS AND GUIDELINES RELATED TO RECOVERY PLAN

Guidelines/RTS/ITS	Status	Section in this paper	Required actions/next steps
Draft RTS on the conditions for the provision of group financial support. **Draft Guidelines** specifying the various conditions for group financial support. **Draft ITS** on the disclosure of group financial support agreements (Consultation Paper).	Consultation	**Section C, page 22**	Consultation period runs until 4 January 2015.
Draft Guidelines on recovery plan indicators (Consultation Paper).	Consultation	**Section 2, page 11**	Consultation period runs until 2 January 2015.
Draft ITS on simplified obligations (Consultation Paper). **Draft Guidelines** on simplified obligations (Consultation Paper).	Consultation	**Section A, page 6**	Open for comment submissions until 3 January 2015. Public hearing took place on 25 November 2014.
Guidelines on the range of scenarios to be used in recovery plans.	Final draft	**Section C, page 22**	

EBA REGULATORY TECHNICAL STANDARDS, IMPLEMENTATION TECHNICAL STANDARDS AND GUIDELINES RELATED TO RECOVERY PLAN

Guidelines/RTS/ITS	Status	Section in this paper	Required actions/next steps
RTS on the assessment of recovery plans.	Final draft adopted by the EBA and submitted to the European Commission	Page 24	
RTS on the content of recovery plans.	Final draft adopted by the EBA and submitted to the European Commission	Section B, page 18	
Recommendation on the development of recovery plans.	Final recom-mendation		

Table 2 - EBA Technical Guidelines, Standards and Recommendations for Bank Recovery

Developing a recovery plan: regulatory requirements and strategic approach

The following section outlines the regulatory requirements for recovery plans and provides an advised process for developing the various components of the plan.

A. Recommended preparation sequence

Based on our experience in assisting our clients with the preparation of recovery plans, we recommend developing a recovery plan through the following progression of activities (figure 2):

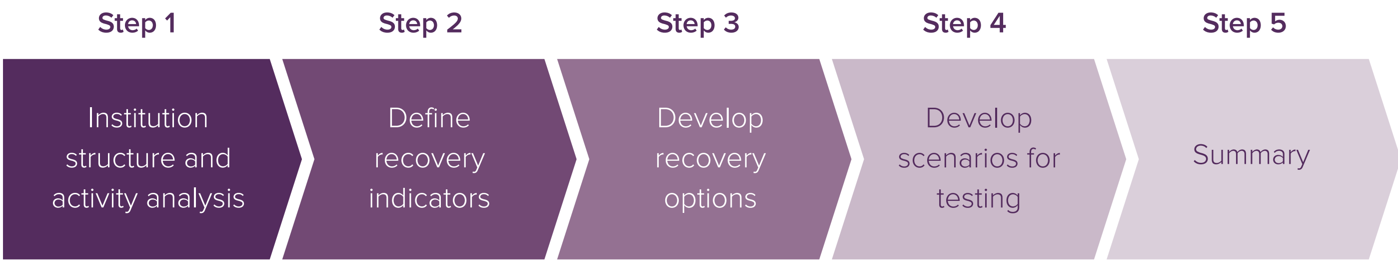

Figure 2 - Key steps in developing a recovery plan

Step 1:
In this approach, we start by analysing the institution/group covered by the recovery plan. This step involves defining elements of the governance of the recovery plan, including internal escalation and risk management processes, and approval policies. At this stage, it is also useful to commence the strategic analysis of the institution/group, identifying entities covered by the recovery plan, and core business lines and critical functions.

Step 2:
Based on this analysis, a set of recovery indicators can then be defined. The development of recovery indicators should be in line with the EBA **Guidelines** relating to recovery indicators.

Step 3:
Our third step will then be to develop recovery options, which shall outline the different actions to be taken depending on the situation at hand. Communication plans, covering both internal and external communication, should be developed in line with each recovery option.

Step 4:
These options should be assessed according to a set of scenarios relevant to the institution/group. These scenarios should also be in line with the EBA **Guidelines** on the range of scenarios to be used in recovery planning.

Step 5:
Finally, a summary can then be developed outlining the above sections, along with any material changes.

This developmental approach is compliant with the RTS, as it covers the five core sections required to be included in a recovery plan. The content required for each section will be outlined in detail in the following Section. While we recommend developing the components of a recovery plan using the above sequence, we have outlined the details of the required content in the final order suggested in the RTS.

B. Content of the recovery plan

As introduced, the RTS provides that recovery plans must include the following breakdown of information:

1. GOVERNANCE

- Development of the recovery plan (how, who, cooperation within the group)
- Policies and procedures for approval and implementation
- Indicators
- Management information systems

2. STRATEGIC GOVERNANCE

- Core business lines and critical functions
- Entities covered by the recovery plan
- Recovery options

Summary

3. COMMUNICATION PLAN

- Internal
- External
- Managing market reaction

4. PREPARATORY MEASURES

- Measures required to facilitate implementation of the recovery plan

Figure 3 - Recovery plan components

This section outlines, in further detail, the content required for each component of the recovery plan.

1. Summary of the recovery plan

Recovery plans should open with a summary identifying the main conclusions of the four key sections of the recovery plan. The summary should also acknowledge any significant changes that have occurred since the last update, and an overview of steps that need to be taken before updating or finalising the plan.

2. Governance

The required information on governance includes the identification of responsible persons and the escalation and decision-making process, as well as indicators that would trigger this process, all with a view to ensuring the timely implementation of an institution's recovery plan.

GOVERNANCE: INFORMATION TO INCLUDE	
How the recovery plan was developed	Include the roles and responsibilities of the person(s) involved in developing and maintaining the recovery plan; how the plan is integrated into an institution's corporate governance; if the institution is part of a group and measures to ensure consistency of the recovery plan at group and individual levels.
Approval polices	Policies and procedures governing **approval** of the recovery plan, including whether the plan has been subjected to external or internal audit and/or reviewed by the institution's/group's risk committee. It must also be confirmed by EU parent or approved by management.
Implementation procedures	Conditions and procedures necessary to ensure timely implementation of recovery options, including description of the **internal escalation** and **decision-making processes**, and a detailed description of the recovery **indicators.**
Risk management framework	Confirm alignment of the risk management framework with the institution's/group's existing risk management framework.
Management information systems	Include a description of how it will be ensured that the information necessary for the implementation of recovery options is available for decision-making in stressed conditions, in a reliable and timely way.

Table 3 - Governance

2.1 Developing recovery plan indicators

To ensure consistency across the Union, the EBA released Guidelines specifying the requirements for recovery indicators in a Consultation Paper on 26 September 2014.

According to the Guidelines, institutions should develop indicators in (at least) the following categories:

1. Capital
2. Liquidity
3. Profitability and
4. Asset quality indicators.

Market-based indicators and **macroeconomic indicators** should also be included unless the institution justifies that they are not relevant to its legal structure, risk profile, size and/or complexity (i.e., a rebuttable position).

ESCALATION PROCESSES AND RECOVERY OPTIONS

Importantly, the breach of an indicator does not necessarily trigger a recovery option — a fact strongly welcomed by industry during the consultation process. Rather, an escalation and decision-making process will commence, which may involve the application of a recovery option if deemed necessary.

Furthermore, recovery indicators should be calibrated so that they provide sufficient notice to allow the institution/group to take corrective action — i.e., they should alert an institution/group at a stage well before authorities are required to take intervention measures.

RECOVERY INDICATORS

Recovery indicator category	Key aspects	Required indicators
Capital indicators [2]	• Should identify a significant actual or likely future deterioration of the quantity and quality of capital, including increasing level of leverage • Should be integrated in the institution's Internal Capital Adequacy Assessment Process ("ICAAP")	• Common Equity Tier 1 ratio • Total Capital ratio • Leverage ratio
Liquidity indicators	• Should inform an institution of the potential for, or an actual deterioration of the capacity of the institution to meet its current and foreseen liquidity and funding needs • Should refer both to short-term and long-term liquidity	• Liquidity Coverage Ratio • Short-term wholesale funding ratio • Net outflow of retail and corporate funding • Cost of wholesale funding

[2] Note: The capacity of capital indicators to allow for a timely reaction can be lower than for other types of indicators, with addressing measures subject to longer execution periods. This may be addressed by forward-looking projections, which should consider material contractual maturities relating to capital instruments.

RECOVERY INDICATORS

Recovery indicator category	Key aspects	Required indicators
Profitabiltiy indicators	• Should capture any income-related aspect that could lead to a rapid deterioration of the institution's financial condition through lowered retained earnings (or increased losses) impacting on the own funds of the institution	• Return on Assets • Return on Equity • Significant losses due to administrative / regulatory fine, etc.
Asset quality indicators	• Should specifically indicate when asset quality deterioration could lead to the point at which the institution should consider taking an action described in the recovery plan or not • May include both a stock and flow ratio of non-performing exposures in order to capture their level and dynamics • Should include aspects such as the off-balance sheet exposures and the impact of non-performing loans on the asset quality	• Impaired and past due loans / total loans • Coverage ratio (loans and debt instruments) • Non-performing loans by counterparty sector

Table 4 - Required recovery indicators

REBUTTABLE RECOVERY INDICATORS [3]

Recovery indicator category	Key aspects	Required indicators
Market-based indicators	• Should aim at capturing expectations from market participants on a rapidly deteriorating financial condition of the institution that could potentially lead to disruptions in access to funding and capital markets • Should capture equity-based indicators, debt-based indicators, portfolio-related indicators, and rating downgrades	• Rating under review and/or rating downgrade • CDS spread • Stock price variation (daily or weekly) • Default of a peer institution
Macroeconomic indicators	• Should be aimed at capturing signals of deterioration of the economic conditions where the institution/group operates, or of concentrations of exposures or funding • Should capture geographical macroeconomic indicators (related to different jurisdictions to which the institution/group is exposed, also giving consideration to risks stemming from potential legal barriers) • Should capture sectoral macroeconomic indicators (related to major specific sectors of economic activity to which the institution/group is exposed, such as shipping and real estate)	• GDP variations • CDS of sovereigns • Rating downgrades of sovereigns

Table 5 - Recovery indicators subject to a rebuttable position

[3] Note: These should be included unless an institution can justify that they are not relevant to its legal structure, risk profile, size and/or complexity.

It is important that institutions be able to monitor their recovery indicators regularly, and that they are clearly relevant to the institution. For this reason, it is recommended that developed indicators reflect monitoring activities already employed.

DIFFERENCE BETWEEN RECOVERY AND EARLY WARNING INDICATORS

During consultation, several respondents sought clarification on the difference between risk indicators or early warning indicators that are used in day-to-day risk management, and indicators triggering the escalation process described in the recovery plan.

The EBA advised that in addition to recovery indicators, early warning indicators may be used by institutions to identify negative trends (to be monitored on a business-as-usual basis). These early warning indicators are conceptually similar to recovery indicators, but are distinguished primarily by the point in time on the recovery timeline; i.e., an early warning indicator would be calibrated so that it alerts the institution to negative trends earlier than a recovery indicator. In this way, a bank's business-as-usual risk management processes can form an integral part of a robust monitoring process.

3. Strategic analysis

The strategic analysis requires the identification of core business lines and critical functions, and the key steps to maintaining these in situations of financial stress. The strategic analysis should comprise two key sections:

- Description of the entity or entities covered by the recovery plan; and
- Recovery options.

3.1 Description of entity

The first step in developing the strategic analysis is identifying the institution's legal structure (including significant branches), activities, and interdependencies within the group. This step should also identify the core activities undertaken by the institution, mapped onto the legal structure, and should also outline interdependencies within the group.

DESCRIPTION OF THE ENTITY OR ENTITIES: INFORMATION TO INCLUDE	
Description of the entity/ies	Overall global business and risk strategy, business model and plan (including main jurisdiction/s in which the institution/group is active), core business lines and critical functions and description of process for identifying core business lines and critical functions.
Mapping	Map core business lines and functions to legal entities and branches. Mapping should not focus on all entities, but rather on **significant branches and legal entities.**
Detailed description of legal and financial structures	Includes intra-group exposures and funding entities and branches. Mapping should not focus on all entities, but rather on significant entities.
Description of external interconnectness	Include significant exposures and liabilities to main counterparties; significant financial products and services provided to other market participants, and significant services which third parties provide.

Table 6 - Description of entity or entities

In our experience, preparing the description of entities and their associated activities can prove to be an extensive task. However, it is only necessary to provide a detailed description of the core activities or the activities to be disposed of.

INCLUDING CRITICAL FUNCTIONS IN THE STRATEGIC ANALYSIS: INDUSTRY CRITICISMS

During the consultation process, it was suggested that some of the items required in the strategic analysis — particularly the critical functions of the entities — were more suited to resolution plans, rather than recovery plans. Respondents argued that the recovery plan should focus on options for recovery, rather than maintaining critical functions of institutions. However, the EBA responded that identifying these critical functions is necessary to facilitate the assessment of key recovery options (such as divestments and the selling of business lines). For this reason, the EBA maintains that is necessary to identify the legal entities in which core business lines are located, as well as analysing intra-group connectedness.

3.2 Recovery options

The second part of the strategic analysis consists of the identification and assessment of possible recovery options. The **recovery options** should be designed to respond to a range of financial stress scenarios and be reasonably expected to maintain or restore the viability and financial position of the entities covered by the recovery plan. These recovery options should include measures that are **extraordinary** in nature as well as measures that could also be taken in the course of the **normal** business of the entity or entities covered by the recovery plan.

They should include capital and liquidity actions, and measures to ensure access to contingency funding. Identified recovery options should initially be described without reference to a specific scenario of financial stress. This will enhance general crisis-preparedness and assist the institution or the group in reacting flexibly to crisis.

RECOVERY OPTIONS: INFORMATION TO INCLUDE	
Recovery options	List and description of each recovery option
The following actions, arrangements, or measures (or at least their consideration)	Capital and liquidity actions; external recapitalisation and internal measures to improve capital position; access to contingency funding sources; arrangements and measures to reduce risk and leverage; and voluntary restructuring of liabilities (without triggering default, termination, downgrade, etc.).
Impact assessment of each recovery option	Including financial and operational impact; external impact and systemic consequences; and valuation assumptions.
Feasibility assessment of each recovery option	Including risk assessment; analysis of material impediments and potential solutions; assessment of operational contingency.
Expected time frame	For the implementation and effectiveness of each recovery option.
Range of scenarios	To test the effectiveness of each recovery option.

Table 7 - Recovery options

3.3 Guidelines on the range of scenarios to be used

The strategic analysis should then set out how recovery options have been tested against specific scenarios of financial stress to tentatively assess which recovery options would be efficient in each of these scenarios, providing a practical test for the efficiency of recovery options and the adequacy of indicators. As for the governance indicators, the EBA has published a series of **Guidelines** specifying a range of scenarios which institutions should use to test the effectiveness of their recovery plans. Ultimately, **the scenarios** should demonstrate that the recovery options chosen are valid in restoring financial stability. Institutions will need to include at least three scenarios of severe macroeconomic and financial distress in their recovery plans, including a **system-wide event** (having serious negative consequences for the financial system or the real economy), an **idiosyncratic event** (having serious negative consequences for a single institution), and a **combination** of the two (occurring simultaneously and interactively). Global systemically important institutions – and other systemically important institutions as identified by Article 131 of the Capital Requirements Directive ("CRD") – need to include at least four scenarios.

3.4 Designing scenarios

Scenarios may be identified based on either an existing ICAAP analysis – with the goal being to define a scenario of greater stress than the ICAAP scenario – or through a reverse stress test analysis, which is more severe than a recovery scenario. The scenarios of severe macroeconomic and financial distress should be designed in a way that they would threaten the failure of an institution or group if recovery measures were not implemented in a timely manner. However, given that the aim of a recovery plan is to prove the capacity to restore the viability of an institution, these scenarios should be designed as **'near-default'** situations: i.e., they should bring an institution close to failure but no further. This element should be applied, for example, when considering using reverse stress testing to identify the most appropriate scenarios.

Each scenario should be designed to meet each of the following requirements:

A. The scenario should be based on events that are **most relevant** to the institution or group concerned. Institutions should take into account their business and funding model, activities and structure, size or interconnectedness to other institutions or to the financial system in general, and any **identified vulnerabilities** or weaknesses of the institution or group;

B. The events foreseen in the scenario would threaten to cause the failure of the institution or group, unless recovery measures were implemented in a timely manner; and

C. The scenario should be based on events that are exceptional but plausible.

EACH SCENARIO SHOULD INCLUDE (WHERE RELEVANT) AN IMPACT ASSESSMENT ON AT LEAST EACH OF THE FOLLOWING ASPECTS
A. Available capital
B. Available liquidity
C. Risk profile
D. Profitability
E. Operations, including payment and settlement operations
F. Reputation

Table 8 - Scenario impact assessments

I. System-wide events

In designing scenarios based on system-wide events the relevance of at least the following system-wide events should be taken into account: the failure of significant counterparties affecting financial stability; a decrease in liquidity available in the interbank lending market; increased country risk and generalised capital outflow from a significant country of operation of the institution or the group; adverse movements in the price of assets in one or several markets; and a macroeconomic downturn.

II. Idiosyncratic events

In designing scenarios based on idiosyncratic events the relevance of at least the following idiosyncratic events should be taken into account: the failure of significant counterparties; damage to the institution's or group's reputation; a severe outflow of liquidity; adverse movements in the prices of assets to which the institution or group is predominantly exposed; severe credit losses; and a severe operational risk loss.

GENERIC VS. SPECIFIC SCENARIOS: COMMENTS FROM INDUSTRY

During the consultation period, some respondents argued that it is very difficult to accurately predict the relevant economic environment in a recovery situation. As such, they suggested that general, rather than specific scenarios, should be analysed. One institution suggested that recovery plans should not contain pre-planning for specific supervisor-defined scenarios, as these are unlikely to reflect the actual scenarios that institutions will encounter.

The EBA responded that scenario analysis is designed to test not only the effectiveness, but the diversity of recovery options in a quantitative fashion. In this way, generic scenarios would not meet this requirement.

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4. Communication plan

Communication of the recovery plan is a key aspect of its effective implementation and of avoiding adverse effects on the financial system. The communication plan should address both internal communication to relevant internal bodies and the institution or group's staff, and external communication. It also needs to contain effective proposals for managing potential negative market reaction. Importantly, the communication plan should consider any specific needs for each relevant recovery option.

INDUSTRY CRITIQUE: PUBLIC DISCLOSURE AND 'EXCESSIVE' REQUIREMENTS OF COMMUNICATION PLANS

Several institutions have expressed concern about the external communication of recovery plans: in particular, the public disclosure of trigger breaches, or that an institution has activated its recovery plan. The EBA has responded that no ex ante communication is required concerning the recovery plan, and that the communication plan should only deal with the communication of recovery plan implementations as they occur. This response may not allay industry fears — communication of breaches and recovery plan activation remains central to the purpose of the communication plan.

Additionally, some institutions have suggested that a communication plan for each recovery option is 'excessive', and that a 'general' communication plan (to be adapted to required options) should suffice. The EBA, however, holds that it is necessary to consider the internal and external communication needs for each recovery option, as it may be too late once crisis ensues. That said, the EBA maintains that the communication plan should not preclude 'flexibility' in dealing with a specific crisis and implementing a recovery option. It is enough for an institution to have a general 'concept' that can be adapted to suit the specific actions taken which are connected with particular recovery options.

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5. Description of preparatory measures

Finally, the recovery plan should include an analysis of any preparatory measures that the institution has already taken, in addition to any measures which are necessary to facilitate the implementation of the recovery plan. A timeline for implementing these measures should also be included.

PREPARATORY MEASURES: A BURDEN?

Some respondents to the consultation were concerned that prior implementation of preparatory measures could constitute an excessive burden on institutions. Further respondents argued that the obligation to take preparatory measures would be automatically triggered or would impair the position of an institution to react flexibly to a given situation. The EBA has clarified that the RTS does not provide any automatic requirement to implement preparatory measures. Rather, the intention of preparatory measures is to ensure that if material impediments to the implementation of recovery options are identified (as outlined in Article 6(5)(b) of the BRRD), the institution should undergo steps to remove these impediments.

C. Group recovery planning

The BRRD aims to harmonise rules to allow for an optimal allocation of liquidity in groups in distress, particularly for cross-border groups. Currently, the legal framework for financial support within a group differs significantly across the EU, and can make it difficult for cross border groups to allocate liquidity in an optimal way, potentially putting individual entities at risk of failure, and destabilising the whole group. To strengthen recovery options for groups in distress, the BRRD requires Member States to remove any legal impediments or obstacles to intra-group financial support transactions that are undertaken in accordance with the BRRD, provided that limitations which may be imposed under the Capital Requirements Regulation ("CRR") and CRD IV are respected. As such, the BRRD enables group entities to assist other elements of the group in cases of financial distress, with parent companies able to help subsidiaries and vice versa, through forming group financial support agreements. Group recovery plans, therefore, must include arrangements for intra-group financial support in the recovery options.

Group financial support agreements

The BRRD establishes that a group may enter into an agreement to provide financial support to any other party that meets the conditions for early intervention, subject to a number of conditions, including whether there is a reasonable prospect that the financial support will rectify the financial distress, while not damaging the solvency of any of the entities providing support or breaching CRD IV/CRR capital, liquidity and large-exposure requirements (as outlined in Article 23 of the BRRD).

It should be noted, however, that a group financial support agreement is not an automatic condition for providing support within a group.

The EBA has recently launched a consultation on draft RTS and Guidelines outlining the various conditions for the provision of group financial support. The consultation also proposes draft Implementing Technical Standards (ITS) on the form and content of the disclosure of support agreements as required under the BRRD. For further information, see the EBA's **Consultation Paper EBA/CP/2014/30** and related ongoing developments.

D. Updating recovery plans

Institutions/groups are required to update their recovery plans at least annually or after a change to the legal or organisational structure of the institution, its business or its financial situation, which could have a material effect on the recovery plan. Competent authorities may require institutions/groups to update their recovery plans more frequently.

Review of recovery plans

Finally, in order to prepare a proper recovery plan, it is essential to verify how the resolution authorities will assess the completeness and accuracy of the recovery plan.

To ensure an aligned assessment framework across the Union, the EBA has been mandated to develop an **RTS** on the assessment of recovery plans. The draft RTS was issued on 18 July 2014, specifying the minimum criteria the authorities should apply in their assessment.

It requires competent authorities to assess recovery plans against three sets of criteria:

1. Completeness

The assessment of completeness will take into account whether the plan complies with the requirements of the BRRD and the EBA's RTS, as applicable. In particular, the assessment of institutions or groups will take into account whether the plan is up to date, including any changes to the legal or organisational structure; an analysis of how an institution or group may access central bank facilities and identify those assets which would be expected to qualify as collateral; whether the recovery plan adequately contemplates a range of scenarios of severe macroeconomic and financial stress relevant to the specific conditions of the entity or entities covered by the recovery plan; and whether the plan contains a framework of indicators which adequately identify points at which escalation may occur.

In the case of groups, the criteria also focus on whether arrangements are in place for intra-group financial support adopted pursuant to an agreement for group financial support, as applicable. The assessment will also take into account whether, for each of the scenarios of severe macroeconomic and financial stress contemplated, the plan identifies whether there are any obstacles to the implementation of recovery measures within the group, including at the level of individual entities covered by the plan, and whether there are any practical or legal impediments to the prompt transfer of own funds or the repayment of liabilities or assets within the group.

2. Quality

Competent authorities will need to consider whether recovery plans are clear and relevant to the identification of recovery options, whether they provide sufficient detail and a sufficient range of options, and whether they are internally consistent.

3. Credibility

The credibility of the recovery plan refers to the likelihood of being able to implement the identified recovery options successfully and without endangering financial stability. Competent authorities will consider (i) whether the implementation of the plan would be likely to restore or maintain the viability and financial soundness of the institution or group, and (ii) whether the plan, or specific options, could be implemented effectively in situations of financial distress, taking into account that other institutions may need to implement recovery options at the same time.

How we can help

With extensive experience and expertise in risk management and risk reporting, Avantage Reply is in the ideal position to assist our clients in the preparation or independent review of their recovery plans. Having already assisted a number of clients in recovery plan preparation, we have developed unique insights in how to best develop robust recovery plans that meet EBA requirements, as implemented by the Bank of England and the European Central Bank. Avantage Reply also provides services across other core elements of the BRRD, such as resolution funding, balance sheet management, capital adequacy and optimisation, and liquidity management.

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