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Guiding Principles Simplified Obligations Recovery Plans

Scope
Belgian credit institutions.

Summary/Objectives
The purpose of this Communication is to provide a set of Guiding Principles that gives instructions for drafting a simplified recovery plan. This Communication replaces and modifies the previous Communication NBB_2015_19 by incorporating the recently published EBA Recommendation on the coverage of entities in a group recovery plan.

Dear Madam,
Dear Sir,

The present guidelines describe the recovery plan requirements for banks that have been designated as qualifying for simplified recovery plan obligations.[1] While the guidelines offer a set of general principles that should be followed in developing a simplified recovery plan, the NBB reserves the right to adapt these requirements to the circumstances of individual banks.

General overview and motivation

A recovery plan is a management strategy aimed at preventing a credit institution from failing when faced with severe stress. The objective of a recovery plan is not to forecast the factors that could prompt a crisis but rather to identify the options that might be available in responding to a crisis and to assess whether these options are sufficiently robust. The recovery plan should thus aid credit institutions in preparing their responses to potential crises, although it is understood that in an actual crisis, specific decisions will need to be taken as a function of the particular features of the crisis. The recovery plan must exclude from consideration any extraordinary form of state or central bank support.

[1] Art. 113, § 2 Wet 25 april 2014 op het statuut van en het toezicht op kredietinstellingen, *BS* 7 mei 2014 (ed.2).

Credit institutions that qualify for simplified recovery plan obligations are expected to develop a recovery plan that is appropriate for the institution's size, business model, complexity, and shareholding structure. As described below, simplified recovery plans should include the following components: (1) a brief summary of the plan and of the institution's own assessment of its recovery capacity; (2) a description of the institution's key vulnerabilities and of relevant scenarios that could severely impact the institution; (3) a description of recovery options that could be used to address an extreme solvency or liquidity shock; (4) information regarding activation of the recovery plan, including a monitoring framework with indicators that could detect stress at a sufficiently early stage.

A recovery plan requires identification of scenarios that are severe enough to threaten the bank's survival, given its business model, risks, and vulnerabilities. While banks may find that scenarios developed in the context of other regulatory exercises, such as stress tests or ICAAP, may serve as a helpful starting point for the development of recovery plan scenarios, the recovery plan exercise is nevertheless a distinct exercise. Because the recovery plan requires bank management to consider how the bank would react in a crisis situation, the severity of the scenarios considered in the context of the plan must go beyond the scenarios considered in other regulatory exercises.

Each of the components of the recovery plan are described in more detail below. Point 5 contains a checklist of information to be provided for each component of the plan.

1. Summary of the plan

A brief summary of the plan should be provided, describing the process by which the plan was developed and the procedures undertaken for approval and validation of the plan. The summary should also present the main conclusions from the analysis of the institution's vulnerabilities and recovery options, as well as the institution's assessment of its recovery capacity. The institution should also indicate any preparatory measures that it has taken or plans to take in order to facilitate the implementation of the recovery plan or to improve its potential effectiveness, for example, by reducing impediments to the implementation of certain recovery options.

2. Identification of key vulnerabilities and stress scenarios

The institution should describe its business model and identify its core business lines, major risk drivers, and key vulnerabilities. (To the extent that the institution has already provided similar information in other regulatory reports, it can cut and paste the text from those reports.) The institution's vulnerabilities will likely be directly related to its core business lines and/or its major sources of funding. Vulnerabilities may also be linked to concentrations of certain security holdings.

The institution should develop descriptions of relevant scenarios which, in light of the identified vulnerabilities, would create a crisis for the institution. The shocks incorporated in the scenarios should be severe enough to threaten the institution's viability in the absence of any reaction on its part. This means that the shocks should place the institution well below the Pillar 1 and Pillar 2 regulatory capital or liquidity requirements, but above the point at which the institution believes it would likely be forced into resolution. Institutions should consider scenarios with different levels of severity, including at least one "very severe" scenario that is closer to the point of resolution and one "severe" scenario that is closer to the minimum regulatory requirements.

3. Recovery options

The institution should provide a list of the options it could take to recover from a solvency or liquidity crisis. These options could include measures such as an increase in capital or the sale of certain portfolios or business lines. The list should include not only actions to strengthen capital but also more radical measures such as disposing of certain activities or business lines, selling subsidiaries, or restructuring debt. These options should not involve any assumption of extraordinary forms of state aid or extraordinary central bank support. They should also be implementable at very short notice and should have a tangible impact in the short run. Recovery options shall include measures which are extraordinary in nature and which are not measures taken in the course of the institution's normal business. The following types of measures should be included where appropriate:

1. Measures to improve the capital position of the institution through external recapitalisations or internal measures.

2. Measures to ensure that the institution has adequate access to contingency funding sources, including potential liquidity sources.

3. Measures to reduce risk and leverage or to restructure business lines including, where appropriate, possible divestments of assets, legal entities, or business lines.

4. Measures to achieve a voluntary restructuring of liabilities, without triggering an event of default, termination, or similar event.

5. Any other management actions or strategies aimed at restoring the financial soundness of the institution or group.[2]

For each option, banks should provide: 1) a brief description of the option; 2) the decision process for triggering the option; 3) a qualitative risk assessment; and 4) a quantitative impact assessment. These are described below.

a. ***Description*** *of the recovery option.*

b. ***Process.*** The internal decision making process for triggering the option should be described, including the steps to be followed, the required timing, and the parties involved in the decision.

c. ***Risk assessment.*** The objective of this part is to assess the feasibility of the option and to identify the potential obstacles to implementing it. The main assumptions relating to the option and its feasibility should be outlined. In particular, what conditions need to be satisfied in order for the option to be feasible? For example, it may be necessary for specific markets to be operating normally or for certain legal or operational requirements to be fulfilled. The main risks associated with the option, including financial, operational, and reputation risks, should also be reported, as well as any other significant risk that may not fall into these three categories. Where possible, the assessment of the risk associated with the recovery option should draw on any prior experience relating to implementation of the recovery option or of a similar measure. Information on the profiles of possible buyers for disposals of any activities or entities, should also be provided, where possible. Finally, any potential legal or regulatory obstacles should be cited, covering, where relevant, the issues of shareholder rights, competition law, tax issues, and social law.

[2] For more detail on group recovery plans, see the EBA Recommendation on coverage of entities in a group recovery plan. EBA/REC/2017/02 November 1, 2017: https://www.eba.europa.eu/regulation-and-policy/recovery-and-resolution/recommendations-on-the-coverage-of-entities-in-a-group-recovery-plan.

d. ***Impact assessment.*** The objective of this section is to provide an impact assessment for each recovery option. An assessment should be made of the maximum impact of each recovery option on the institution's capital position, liquidity, and profitability. Any other material impact on the institution should also be mentioned.

e. ***Ranking of recovery options.*** A score, combining the conclusions from the risk and impact assessments, should be provided for each recovery option in each scenario, reflecting the effectiveness/appropriateness of the option for the specific scenario.

4. Activating the plan

The institution should provide information on the activation of the recovery plan, so as to demonstrate that the plan will be implemented early enough, when problems are still manageable. A monitoring framework should be included, with indicators designed to detect stress at a sufficiently early stage and which could be used to trigger the decision making process linked to potential activation of recovery options.

Together with a description of the indicators that are included in the monitoring framework, the relevant trigger values for the indicators should be specified, as well as the decision-making processes in place to activate the recovery plan. The indicators should be chosen in light of the institution's identified vulnerabilities and, as a minimum, they should include the capital position, liquidity situation, and profitability of the institution.

It is good practice to specify, where possible, two threshold values for each of the quantitative indicators that are included in the monitoring framework: (1) an early warning threshold; and (2) a "recovery plan threshold". Early warning threshold values should be high enough so that they signal emerging stress, at a point well before a recovery plan would be expected to be activated. Recovery plan thresholds should trigger the escalation process of decision making associated with a recovery plan, whereby a decision is taken as to whether to activate any recovery option and which ones to activate. The recovery plan threshold values for indicators of capital and liquidity should nevertheless be set above the levels at which Pillar 1 plus Pillar 2 regulatory requirements would be breached. The institution should plan to inform the supervisor in the case where either the early warning or the recovery plan threshold values of an indicator are exceeded.

Institutions should integrate their asset encumbrance indicator threshold values and the asset encumbrance monitoring framework in their general recovery plan monitoring framework. More guidance on the asset encumbrance requirements can be found in the NBB Communication on asset encumbrance of April 9, 2015.[3]

The institution should also discuss the consistency of the recovery plan monitoring framework with the institution's regular risk management framework. The indicators in the recovery monitoring framework may already be included in the risk management framework; however, the trigger values in each would be expected to differ. Discussion should also be included as to when and how the NBB will be informed about the fact that the indicator trigger values have been exceeded.

[3] www.nbb.be/doc/cp/nl/2015/nbb_2015_18_cools.pdf.

5. Checklist of information to include in a simplified recovery plan

1. Summary	- Description of process of developing the plan. - Description of procedure for approving and validating the plan. - Main conclusions from analysis of vulnerabilities and recovery options. - Institution's assessment of its recovery capacity. - Description of any preparatory measures.
2. Vulnerabilities and scenarios	- Description of institution's key vulnerabilities and links to its business model and risk drivers. - Description of scenarios, including their severity. Types of shocks considered.
3. Recovery options	- The below information should be provided per recovery option:
Description of recovery options	- Description of the option.
Process	- Description of the internal decision making process, including the timing and steps involved in the decision to implement the option.
Risk assessment	- Description of the main assumptions relating to the feasibility of the option and its impacts. - Identification of the main impediments and risks associated with the option, making a distinction between financial, operational and reputation risks. - Identification of the potential types of buyers if the option is a disposal. - Identification of potential legal and regulatory constraints, such as shareholder/third party approval, pre-emption rights, breach of contractual covenant, the stopping of a service line, competition law contractual obstacles, tax issues, pensions or HR issues.
Impact assessment	- Description of the expected impact of the recovery option on: Capital/solvency; Funding/liquidity; Profitability; Operations. - Description of any other material impact, if any.
Combined risk and impact assessement	- A score, combining the conclusions from the risk and impact assessments, should be provided for each recovery option in each scenario, reflecting the effectiveness/appropriateness of the option for the specific scenario.
4. Activation of the plan	- List of indicators included in monitoring framework, the monitoring frequency, and the early warning and recovery plan threshold value per indicator. - Description of the decision-making process following a breach of the threshold value of an indicator. - Discussion of consistency of the monitoring framework with the regular risk management process. - Indication of when and how the NBB will be informed of breach of indicator threshold values.

Yours faithfully,

Jan Smets
Governor