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Communication

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Guidelines on simplified obligations for recovery plans

Scope

Belgian credit institutions that are eligible for a regime of simplified obligations[1].

Summary/Objectives

The purpose of this Communication is to provide a set of guidelines for drafting a simplified recovery plan. This Communication replaces the previous Communication NBB_2018_09, which is modified to incorporate the revised EBA Guidelines on recovery plan indicators[2]. The changes mainy relate to section 5 of this communication.

Structure

1. General overview and motivation
2. Summary of the recovery plan
3. Identification of key vulnerabilities and stress scenarios
4. Recovery options
5. Activation of the recovery plan
6. Checklist of information to be included in a simplified recovery plan

1 For credit institutions falling under the supervision of the NBB, the NBB determines which institutions are eligible for simplified obligations on the basis of the criterion laid down in article 113, § 4 of the Banking Law, and further specified in the EBA Guidelines of 7 July 2015 on the application of simplified obligations under Article 4(5) of Directive 2014/59/EU (EBA/GL/2015/16).

2 See Guidelines EBA/GL/2021/11 of 9 November 2021 on recovery plan indicators.

Dear Madam,
Dear Sir,

This Communication sets out the requirements for the recovery plans to be drafted by credit institutions that have been designated as qualifying for simplified recovery plan obligations[3]. While the guidelines provided in this Communication 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 institutions.

1. General overview and motivation

1. Recovery planning 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. Recovery plans should thus aid credit institutions in preparing their responses to potential crises, although it is understood that in an actual crisis, specific decisions should be taken depending on the particular features of the crisis. Recovery plans must exclude from consideration any extraordinary form of government or central bank support.

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. Simplified recovery plans should include the following components, which are described further below:

   (a) a brief summary of the plan and of the institution's own assessment of its overall recovery capacity;

   (b) a description of the institution's key vulnerabilities and of relevant scenarios that could severely impact the institution;

   (c) a description of recovery options that could be used to address an extreme solvency or liquidity shock;

   (d) information regarding activation of the recovery plan, including a monitoring framework with indicators that can detect stress at a sufficiently early stage.

3. Recovery planning requires institutions to identify scenarios that are severe enough to threaten their survival, taking into account their business model, risks, and vulnerabilities. While scenarios developed in the context of other regulatory exercises, such as stress tests or ICAAP, can serve as a helpful starting point for developing recovery plan scenarios, recovery planning is nevertheless a separate exercise. As recovery plans require institutions' management to consider how the institution would react in a crisis situation, the severity of the scenarios considered in the recovery plan must exceed that of the scenarios considered in other regulatory exercises.

4. Each component of the recovery plan is described in more detail below. Point 6 contains a checklist of information to be provided for each component of the plan.

2. Summary of the recovery plan

5. The institution should provide a brief summary of the recovery plan which describes the process of developing the plan and the procedures for approving and validating it. The summary should also outline the main conclusions from the analysis of the institution's vulnerabilities and recovery options, as well as the institution's assessment of its overall recovery capacity. The institution should also specify any preparatory measures 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.

[3] Article 113 of the Banking Law.

3. Identification of key vulnerabilities and stress scenarios

6. The institution should describe its business model and identify its core business lines, major risk drivers, and key vulnerabilities. Where the institution has already provided similar information in other regulatory reports, it may 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.

7. The institution should describe relevant scenarios which, in light of the identified vulnerabilities, would trigger a crisis for the institution. The shocks considered in the scenarios should be severe enough to threaten the institution's viability in the absence of any response 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.

4. Recovery options

8. The institution should provide a list of the options it could activate to recover from a solvency or liquidity crisis. These options could include measures such as a capital increase or the sale of certain portfolios. 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 government or central bank support. They should also be implementable at very short notice and should have a tangible impact in the short run. Recovery options should 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:

   (a) Measures to improve the institution's capital position through external recapitalisations or internal measures.

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

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

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

   (e) Any other management actions or strategies aimed at restoring the financial soundness of the institution or group.[4]

9. For each option, institutions should provide the following:

   (a) **A brief description of the recovery option**.

   (b) **A description of the internal decision-making process for activating the option,** including the steps to be followed, the required timing, and the parties involved in the decision.

   (c) **A qualitative risk assessment of the option**, with a view to assess the feasibility of the option and to identify potential obstacles to implementing it. The main assumptions relating to the option and its feasibility should be outlined, in particular the conditions 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 not falling within these three categories. Where

[4] For more information on group recovery plans, see Recommendation EBA/REC/2017/02 of 1 November 2017 on the coverage of entities in a group recovery plan.

possible, the assessment of the risk associated with the recovery option should draw on any prior experience relating to the 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 mentioned, covering, if applicable, the issues of shareholder rights, competition law, tax issues, and social law.

(d) **A quantitative impact assessment of the 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) **A ranking of the recovery options.** On the basis of the conclusions from the risk and impact assessments, a score should be assigned to each recovery option in every scenario, reflecting the effectiveness/appropriateness of the option for the specific scenario.

5. Activation of the recovery plan

10. The institution should provide information on the activation of the recovery plan, so as to demonstrate that the plan will be implemented at an early enough stage, when any problems are still manageable. The recovery plan should include a monitoring framework, with indicators designed to detect stress at a sufficiently early stage. This framework could also be used to trigger the decision-making process in view of the potential activation of recovery options.

11. In addition to describing the indicators included in the monitoring framework, institutions should specify the relevant trigger values for the indicators, 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 should include at least the institution's capital position, liquidity situation, profitability and asset quality.

12. Institutions should include the following 12 indicators in their recovery plan, divided into four categories, unless they can demonstrate that these indicators are not relevant to their legal structure, risk profile, size and/or complexity. In such a case, the institution should replace these indicators where possible with another indicator from the same category which is more relevant for this institution (e.g. growth rate of impairments on financial assets).

Category 1: Capital indicators
a) Common Equity Tier 1 ratio
b) Total Capital ratio
c) Leverage ratio
d) MREL and TLAC (where relevant)
Category 2: Liquidity indicators
a) Liquidity Coverage Ratio (LCR)
b) Net Stable Funding Ratio (NSFR)
c) Available central-bank eligible unencumbered assets
d) Liquidity position: other liquidity metrics used for internal monitoring
Category 3: Profitability indicators
a) Return on Assets (RoA) or Return on Equity (RoE)
b) Significant operational losses
Category 4: Asset quality indicators
a) Growth rate of gross non-performing loans
b) Coverage ratio (Provisions / Total non-performing loans)

13. It is good practice to specify, where possible, two threshold values for each of the quantitative indicators 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 well before a recovery plan would be expected to be activated. Breaches of 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 options and, if so, which ones.

14. For the calibration of the thresholds, the institution should consider the overall recovery capacity of the available options, the complexity of the options, and the time needed to implement them.

15. Generally, the thresholds for regulatory capital indicators should be calibrated above the combined capital buffer requirement[5]. Where an institution calibrates its capital indicators within the buffers, it should clearly demonstrate in its recovery plan that its recovery options can be implemented in a situation where the buffers have been totally or partially used. The thresholds for indicators based on regulatory liquidity requirements (LCR and NSFR indicators) should therefore be calibrated above the minimum requirements of 100 %.

16. The NBB, in its supervisory capacity, and the resolution authority may decide to implement temporary relief measures in the case of a systemic crisis with the aim of alleviating the regulatory requirements that could adversely impact the institutions' ability to continue supporting the real economy. Considering the temporary nature and the specific objective of such relief measures, their granting should not automatically result in the institutions recalibrating their recovery plan indicator thresholds.

17. Indicator threshold breaches do not automatically trigger the activation of a specific recovery option, but indicate that an escalation process should be started to decide whether to take action or not. In the context of that escalation process, the institution should:

    (a) alert the institution's management committee within one business day of observing the breach; and

    (b) notify the breach to the relevant competent authority at the latest within one additional business day.

18. 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[6].

19. The institution should also describe the consistency of the recovery plan monitoring framework with the institution's regular risk management framework. For the recovery plan monitoring framework, the institution may use indicators already included in the risk management framework, but the trigger values should in principle be different in both frameworks. The institution should also outline when and how the competent authorities would be informed that the indicator trigger values have been exceeded.

20. The institution is required to update the recovery plan at least every two years or more often if that is necessary following a change in its activities or financial position.[7]

5 Defined in article 96 of the Banking Law: the capital conservation buffer extended by, if applicable, the institution-specific countercyclical capital buffer, the capital buffer for systemically important institutions and the capital buffer for systemic or macroprudential risks.

6 Communication NBB 2016_34 of 18 July 2016 on recovery plans – obligations with regard to asset encumbrance (in French)

7 Article 111 of the Banking Law.

6. Checklist of information to be included in a simplified recovery plan

1. Summary	- Description of the process of developing the plan. - Description of the procedure for approving and validating the plan. - Main conclusions from the analysis of vulnerabilities and recovery options. - Institution's assessment of its overall recovery capacity. - Description of any preparatory measures.
2. Vulnerabilities and scenarios	- Description of the institution's key vulnerabilities and links to its business model and risk drivers. - Description of scenarios, including their severity, as well as the types of shocks considered.
3. Recovery options	The below information should be provided for each 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 option's feasibility and impact. - 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, obstacles relating to competition law, 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.
Combined risk and impact assessment score	- On the basis of the conclusions from the risk and impact assessments, a score should be assigned to each recovery option in every 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 values for each indicator. - Description of consistency of the monitoring framework with the regular risk management process. - Description of the internal decision-making process following a breach of the threshold value of an indicator, including the timing of the different steps. - Description of the procedure for informing the competent authorities of indicator threshold value breaches.

A copy of this communication is also sent to the accredited statutory auditor(s) of your institution.

Yours faithfully,

Pierre Wunsch
Governor