Regulatory framework for assessing recovery plans and establishing resolution plans: waivers, national discretion and the proportionality principle

Antonella Pisani, Senior Banking Expert, EBA

23 April 2015 | FINSAC Workshop
BRRD framework – a major step forward towards convergence

- The last financial crisis demonstrated need for a common set of resolution powers for authorities to avoid that national interests prevail over cooperation objectives potentially leading to disorderly resolution of cross-border banking groups.

- BRRD introduces a harmonised framework of rules for dealing with distressed and failing banks across the EU.

- Each resolution authority has similar legal powers – which are effective throughout the EU – and an obligation to use these in consultation with the authorities of all affected member states.

This convergence is major progress to ensure a consistent approach to recovery and resolution planning.
### Single Rulebook

*Identical technical standards driving further harmonisation and coordination of rules under crisis*

<table>
<thead>
<tr>
<th>EU Commission</th>
<th>EBA providing advice and opinions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sectoral Directives</td>
<td></td>
</tr>
<tr>
<td>‘Implementing legislation’</td>
<td>EBA developing binding technical standards, guidelines and recommendations</td>
</tr>
</tbody>
</table>
## EBA rulemaking

### Binding technical standards (BTS)

- BTS are binding in their entirely and directly applicable in all Member States (the Single Rulebook).
- BTS shall be technical and their content shall be delimited by the legislative acts on which they are based.
- There are two different types of BTS: regulatory technical standards (RTS) and implementing technical standards (ITS). RTS can supplement Level 1 text, whereas the ITS only ensure uniform conditions of application.

### Guidelines and Recommendations

- They are addressed to competent authorities or financial institutions which shall make every effort to comply with them.
- Each competent authority must confirm whether it complies/intends to comply with that guideline or recommendation and, if applicable, state its reasons for not complying (‘comply or explain rule’).
National discretion

- Limited National flexibility allowed within a European framework of «constrained discretion»: the possibility/risk of exemptions needs to be discussed _ex ante_ between home and host authorities as part of the resolution planning process («frontloading»).

- All parties need to have a _“common understanding”_ of what would happen in resolution (_an ex ante roadmap_), and believe that these arrangements are feasible and credible (_trust_)

- Exercise of national discretion could create an obstacle to orderly cross-border resolution and on ability to reach common agreement

- Importance of achieving joint –decision. To achieve this goal, the BRRD gives the EBA a clear _mediation_ role to identify and address conflicts between home and host authorities in order to facilitate reaching a single decision for the group as a whole.
Waivers

- Use of waivers in the BRRD is very limited

- Only few waivers included in the BRRD. For example:

Art. 4 (8)
- waiver to application of simplified obligations for recovery and resolution planning to institutions affiliated to a central body and exempted from prudential requirements according to Art.10 (CRR)
- waiver to application of simplified obligations for recovery planning to institutions that are members of an Institutional Protection Scheme (IPS)

Art.89 (4)
- waiver to requirement to establish a European resolution college if other groups or colleges perform the same functions and carry out the same tasks specified...for European resolution colleges
The Proportionality principle

Single Rulebook

*Maximum harmonisation*

*...but proportionate to specific circumstances*

- Addressing trade-off between need for flexibility and a consistent, coordinated approach

- Better substitute than *waivers* which could decrease the effectiveness of a rule

- Same rules apply but what varies is *the extent of application* that takes into account specific factors
The RTS/GLs aims are:

- to promote convergence of practice between competent authorities and resolution authorities through a common framework; and
- to facilitate cooperation among authorities in particular as regards institutions and groups with a cross-border presence.

The proportionality principle is consistently applied in EBA RTSs/GLs in line with the BRRD directive.

The RTS/GLs do not rule out the necessary flexibility while preventing regulatory arbitrage within the EU and facilitating joint decisions for cross-border groups.
Example of Proportionality: Article 4 BRRD

- Article 4 BRRD enables competent authorities and resolution authorities to apply simplified obligations with regard to:
  - the contents and details of recovery and resolution plans;
  - the date by which the first recovery and resolution plans are to be drawn up and the frequency for updating recovery and resolution plans;
  - the level of detail for the assessment of resolvability.

- Criteria eligibility for simplified obligations:
  - impact that the failure and subsequent winding up of the institution under normal insolvency proceedings could have on financial markets, on other institutions, on funding conditions, or on the wider economy.
EBA Guidelines under Article 4(5) BRRD

- Article 4(5) BRRD requires the EBA to issue guidelines to specify the criteria for application of simplified obligations. The guidelines set out two types of indicators: mandatory indicators and optional indicators.

- In selecting and applying the optional indicators, each authority should choose those indicators relevant to the institution, or category of institution (e.g. credit institution or investment firm), in question.

The combination of the mandatory and optional indicators ensures that the assessment process can be conducted in a proportionate manner in line with the characteristics of the institution, or category of institution, under consideration in the jurisdiction concerned.
EBA role in recovery planning

- The BRRD text sets out in broad terms the required content of recovery plans, and the criteria supervisors must use to assess them.

- Under the BRRD, EBA had several mandates to further specify these requirements:
  - Technical Standards on content of recovery plans
  - Guidelines on indicators for triggering recovery actions
  - Guidelines on scenarios to be included in recovery plans
  - Technical Standards on the assessment of recovery plans

- The EBA has completed and published the final set of draft technical standards and guidelines for recovery planning. To be adopted by the European Commission and be published in the Official Journal.
 RTS on content of recovery plans

Main areas of a recovery plan:

1. Summary of the key elements of the RP
2. Governance
3. Strategic analysis
4. Communication and disclosure plan
5. Preparatory measures

The Draft RTS specifies the minimum elements that must be included in recovery plans. However, in line with Art.4 of BRRD competent authorities may apply simplified obligations in accordance with the principle of proportionality and based on the objectives of the Directive.
RTS on content of recovery plans

**Governance**
- Description on how the RP was developed
- Policies and procedures governing approval of RP
- Conditions and procedures to ensure timely implementation

**Strategic Analysis**
- Core business lines (CBLs) and critical functions (CFs)
- Mapping of CBLs and CFs to legal entities
- Internal and external interconnectedness

**Recovery options**
- List and description
- For each: impact and feasibility assessment, implementation timeframe
- Effectiveness of options and adequacy of indicators in a range of scenarios
GL on scenarios

- **Scenarios** are intended to test the impact and feasibility of recovery options – not to predict the nature of some future crisis

- Design principles:
  - Relevant for institution/group
  - Exceptional but plausible events which threaten to cause failure (link to reverse stress testing)
  - Include assessment of impact

- Should cover a **system wide** event, an **idiosyncratic** event, and a **combination**

- In line with the principle of proportionality, global systemically important institutions (G-SIIs) and other systemically important institutions should include at least four scenarios
### Main characteristics of the framework

| Adequate to an institution | • Adapted to business model, strategy and risk profile of an institution  
|                           | • Identifies its key vulnerabilities  
|                           | • Adequate to its size and complexity |
| Aligned with internal governance | • Aligned with overall risk management framework  
|                             | • Integrated into governance, escalation and decision-making procedures |
| Based on appropriate indicators | • Has quantitative and qualitative indicators  
|                                 | • Include also forward looking indicators  
|                                 | • Can be easily monitored by institutions  
|                                 | • Properly calibrated indicators |
Categories of RP indicators

- Obligatory categories of indicators:
  - Capital indicators
  - Profitability indicators
  - Liquidity indicators
  - Asset quality indicators

- Categories subject to rebuttable presumption (they can be excluded if not relevant to the legal structure, risk profile, size and/or complexity of the institution):
  - Market based indicators
  - Macroeconomic indicators
Specific list of RP indicators

**Goal:** Ensuring common standards (minimum list of categories and indicators) but allowing flexibility at the same time (rebuttable presumption)

- Indicators from the minimum list should be included unless the institution can justify to the competent authority that they are not relevant for its characteristics (rebuttable presumption)

- Institutions should not limit themselves to the minimum list of indicators included in the GL

- Institutions should calibrate quantitative indicators according to the rules specified in the GL and taking into account their own characteristics

**Overarching principle:** Institutions should include in their RPs these indicators which are the most relevant for them
**RTS on assessment of recovery plans**

Challenge: **to identify common standards**, and at the same time **allow for necessary supervisory discretion** within the EU framework

**Building blocks approach:** common metrics and processes for assessment should come in the next stage – starting with the Handbook
Criteria for the assessment of recovery plans

Completeness

- Are requirements in BRRD and RTS met?

Quality

- Is the plan clear, consistent, comprehensive and relevant?

Overall Credibility

- Would the options work to restore viability?
- Can they be implemented effectively without causing contagion?
**RTS on assessment of RPs: Completeness**

**In every case** competent authorities should check if RPs include at least:

- Information listed in the BRRD and further specified in the RTS
- Up-to-date information
- Testing of recovery plans against the range of scenarios
- A framework of indicators to identify points for action
- Use of available collateral and central bank facilities in stressed conditions (where applicable)

**Additional matters** to be assessed for **group RPs**:

- Intra-group financial support arrangements (where applicable)
- Identification of obstacles to implementation of recovery options within the group (for each scenario used)
- Identification of impediments to prompt transfer of own funds or repayment of liabilities/assets within the group
RTS on assessment of RPs: Quality

Assessment of *at least* the following aspects of RPs:

- **Clarity** (self-explanatory material, clear language, consistent use of definitions; explanation of assumptions and valuations; limited references to external documents)
- **Internal consistency** within the individual plan and the group plan
- **Comprehensiveness** (sufficient range of recovery options and indicators, appropriate level of details – *subject to the principle of proportionality*)
- **Relevance of information** (providing only information relevant for identification of recovery options, not too much information)
## RTS on assessment of RPs: Credibility (1/2)

### Assessment whether recovery plan/options are reasonably likely to:

#### Maintain or restore viability and financial position (**operational test**):

- integration with general corporate governance
- sufficient number of plausible and viable recovery options
- timescale and preparedness
- adequacy of scenarios and testing process
- realistic and plausible assumptions and valuations

#### Be implemented effectively without causing adverse effects on the financial system (**impact test**):

- sufficiently broad range of recovery options to cater for the risk of simultaneous application of recovery options
- focus on potential conflict between banks with similar vulnerabilities/business models

*Article 6(2)(a) of BRRD*

*Article 6(2)(b) of BRRD*
## RTS on assessment of RPs: Credibility (2/2)

Assessment to what extent a group RP achieves stabilisation of the group and each institution within that group

<table>
<thead>
<tr>
<th>To what extent the group RP:</th>
<th>Articles 7(3) and (5) of BRRD</th>
</tr>
</thead>
<tbody>
<tr>
<td>▪ ensures coordination and consistency of measures to be taken at the level of parent company and individual institutions</td>
<td></td>
</tr>
<tr>
<td>▪ provides solutions to identified:</td>
<td></td>
</tr>
<tr>
<td>▪ impediments to implementation of recovery options</td>
<td></td>
</tr>
<tr>
<td>▪ obstacles to a prompt transfer of own funds or repayment of liabilities /assets</td>
<td></td>
</tr>
</tbody>
</table>
Assessment of recovery plans – Building blocks approach

Building blocks approach – creating a comprehensive set of common European rules for assessing recovery plans

1st step

> RTS on the assessment of recovery plans
> Specifying the matters/general criteria to be assessed by competent authorities

2nd step

> Additional EBA Guidelines or the Single Supervisory Handbook
> Setting up common processes and procedures for assessing recovery plans (potentially involving also harmonised scoring criteria)
Resolution plans – Legal basis and EBA mandates

- The BRRD requires resolution authorities to draw up resolution plans, updated at least annually, for institutions and groups. Art. 10 & 12 contain a range of requirements for the content of these plans.

- EBA is mandated to develop draft regulatory technical standards further specifying the contents of the resolution plan.

- In parallel with updating of resolution plans, resolution authorities are required to assess the extent to which institutions and groups are resolvable, without assuming extraordinary public financial support. EBA is mandated to develop draft regulatory technical standards specifying the criteria for this assessment.

- NB that Article 4 of the BRRD allows resolution authorities to apply simplified resolution planning obligations when certain conditions are met.
Content of resolution plans: objectives and approach

• Resolution plans provide the basis for effective implementation of resolution actions and for the assessment of resolvability.

• Based on the experience to date of authorities in drawing up resolution plans, this can only be done on the basis of one or more identified resolution strategies. Resolution authorities may wish to identify both a preferred strategy and variants which could be applied in circumstances when the preferred strategy is not feasible or credible.

• The draft RTS identifies eight categories of information which the plan should contain, encompassing the requirements of the BRRD.

• This approach allows for inherent proportionality to be respected: less complex institutions should require less complex resolution plans.
Conclusions

✓ Regulatory framework on recovery and resolution represents a good compromise between allowing harmonisation and common rules with some regulatory discretion

✓ Proportionality principle main tool to allow flexibility in order to adapt to specific circumstances

Questions?