BANKING
STAKEHOLDER
GROUP

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REVISED GUIDELINES ON RECOVERY PLAN INDICATORS

Response to the EBA Consultation Paper on Draft Revised Guidelines on recovery plan indicators under Article 9 of Directive 2014/59/EU (EBA/CP/2021/13)

Introduction

The EBA Banking Stakeholder Group (BSG) welcomes these Guidelines, which represent further progress towards harmonising the implementation of the Bank Recovery and Resolution Directive (BRRD II) across Member States.

Furthermore, the BSG welcomes the introduction in the framework of the Guidelines of further flexibility margins in line with Article 9(1)(b) of the BRRD which allows institutions to refrain from an action under its recovery plan "where the management body of the institution does not consider it to be appropriate in the circumstances of the situation". This flexibility is of importance, especially in times, such as those we are experiencing due to the pandemic, of great uncertainty about the impact that the crisis may have on bank balance sheets.

Question 1: Do you have any comments on the general requirements that should drive the calibration of recovery indicators as proposed in paragraph 27 of these guidelines?

The BSG notes that EBA may consider adding recovery indicators that reflect the systemic risk associated with an institution. Institutions that are deemed 'significant' or 'systemically important' tend to be more prominent, and therefore under particular scrutiny from the market. This could increase the risk of the market reacting negatively to any perceived distress, which may close off some of the proposed recovery plan options. 'Significant' or 'systemically important' institutions also pose a heightened risk to financial stability. It would appear prudent therefore to reflect that higher level of risk in the calibration of indicators by applying additional safety margins.

Question 2: Do you have any comments on the requirement that there should be no automatic recalibration of recovery indicators upon the application of temporary supervisory relief measures, however it could be allowed by competent authorities in those cases specified in paragraph 31 of these guidelines?

With regard to the proposed exceptions set out in par. 31 of the Guidelines the BSG considers that there is sufficient flexibility and room for discretionary judgment in the existing recovery framework, specifically the second sub-paragraph of Art. 9(1) of the BRRD, to ensure that recovery measures can be implemented judiciously and institutions are not forced to undertake potentially damaging and destabilising measures in the depths of a crisis.

Some members of the BSG welcome the EBA's approach conferring competent authorities, on a case-by-case assessment, to approve the decision of the institution the recalibration of recovery indicators in specific cases. Other members of the BSG disagree with the exceptions in par. 31 and note that the purpose of the recovery plan is to act as an 'early warning' system and to trigger remedial action by the institution before it breaches regulatory requirements. They are particularly concerned about the 'backstop' in subpar. (d) of par. 31, which seems to imply that it would be acceptable to set recovery plan indicators at, or close to, the minimum level of regulatory capital in times of crisis. This would be counterproductive as it would effectively reduce the timespan between triggering the recovery indicators, and hence the implementation of the recovery plan, and a potential 'failing or likely to fail' situation to near zero, obviating the purpose of recovery planning altogether. Temporary relief measures granted by supervisory authorities in a time of crisis should be considered as precisely that, i.e. temporary. They should not be construed as a 'new normal' and should not become a justification for not taking recovery measures.

Question 3: Do you have any comments on guidance introduced in relation to actions and notifications upon breaching recovery indicators, including the proposed timelines for internal escalation and notification to the competent authorities?

The BSG is supportive of the proposed timeframes for internal decision-making and communicating with the competent authorities. In a stressed situation time is often of the essence: the timely involvement of senior management and engagement with the competent authority is critical. The Guidelines should encourage competent authorities to remain engaged following a breach to ensure that the breach has been effectively remedied and its root causes have been addressed. Competent authorities should have formal policies in place to govern the process of post-breach monitoring and, where necessary, guide the use of supervisory measures.

Question 4: Do you have any comments on introducing a possibility for competent authorities to request institutions to provide a full set of recovery indicators (breached or not)?

For recovery indicators to fulfil their intended purpose they should be monitored by the institution constantly and reported to the competent authority on a regular basis. Regular reporting could help authorities, in particular, to identify whether any signs of stress observed are institution-specific or indicative of market-wide, i.e. systemic, issue. While monthly reporting appears adequate in the normal course of business, competent authorities should be able to apply shorter intervals when there are signs of stress. The availability of timely, and complete data would put authorities in a better position to engage with the institution's management, evaluate the proposed remedial action, and assess the need for additional supervisory measures.

Question 5: Do you have any comments on the proposed threshold calibration of regulatory capital indicators at levels above those requiring supervisory intervention and therefore to be generally calibrated above the combined capital buffer requirement while still allowing calibration within buffers only under certain conditions?

The BSG agrees with the principle that regulatory capital indicators should be calibrated above the institution's required minimum levels (par. 45), including the combined buffers, which constitute part of the legal requirements, and should be replenished and maintained in order to fulfil their designed role in times of crisis. In line with our comments under Q.2 the BSG observes that it appears inconsistent with the preventive character of recovery planning, and recovery triggers, to allow for threshold values to be set at levels at, or below, regulatory capital requirements, which include the combined buffer requirement (CBR).

It is important in this context to consider the interaction between recovery planning and the internal capital adequacy assessment process (ICAAP). Under normal, i.e. non-stressed conditions, management buffers under ICAAP should be available, over and above the baseline requirement, including Pillar 2 Guidance (P2G). When institutions are permitted to use capital buffers in a stressed situation, such as the current Covid-19 pandemic, this use should be seen as an exceptional, and temporary measure. It does not alter the fact that a) the institution has encountered a 'significant deterioration of its financial situation' for the purposes of Art. 5(1) BRRD II; and b) the institution is obliged to restore its financial position as soon as practicable. The purpose of recovery planning is to provide a formal framework for this process, and to ensure that preventive action is being taken. Art. 9(2) BRRD II confers a significant degree of discretion upon the institution's management to decide whether it feels confident that the capital position can be restored, in a timely manner, in the normal course of business or whether it appears appropriate to activate recovery plan measures. The purpose of recovery indicators, in our view, is to initiate this process, and to ensure that senior management, and competent authorities, are fully engaged at an early stage. This purpose is achieved only when indicators are set at a level that reflects the onset of a potential crisis situation, i.e. at least the baseline (unstressed) capital requirement. The Guidelines should not envisage a scenario where capital buffers are (partially) depleted before recovery planning is even formally triggered.

Question 6: Do you have any comments on the proposed calibration of the recovery threshold for MREL?

As discussed in our response to Q.5 above, the BSG agrees that threshold values should be set so that the availability of adequate levels of MREL is preserved, including in stressed scenarios. The BSG agrees that recovery indicators should be calibrated in accordance with the institution's resolution strategy so that institutions that comprise multiple resolution groups are confident that each of them has access to the necessary loss-absorbing and, if appropriate, recapitalisation capacity to implement its resolution plan. We concur that resolution authorities should be consulted in the process of calibrating threshold values and informed, as soon as practicable, of any breach of MREL-related recovery indicators. The BSG believes that this process could be simplified, potentially, if institutions are permitted to notify the competent and resolution authorities concurrently in the event of such a breach.

Question 7: Do you have any comments on the proposed threshold calibration of regulatory liquidity indicators (LCR and NSFR) above their minimum regulatory requirement, i.e. 100%?

We refer to our responses to Q.5 and Q.6 above. As with ICAAP, the internal liquidity adequacy assessment process (ILAAP) requires institutions to provide for internal liquidity buffers, i.e. excess liquidity that is available in periods of stress, in line with a given (minimum) survival period. In line with the preventive character of recovery planning it appears appropriate that liquidity indicators should be set at a level that alerts senior management, and the authorities, of the risk that buffers are being depleted and regulatory minima could be breached shortly. We agree that this assessment should take into account the funding needs and arrangements of the institution, e.g. its reliance on wholesale markets, maturity structure of short-term-funding, and currency exposure, as appropriate.

Question 9: Do you have any comments on the proposed changes to the minimum list of recovery plan indicators?

The BSG notes that some institutions are required to closely monitor their capacity to make certain distributions, e.g. to holders of AT1 capital instruments. A shortfall leading to the cancellation of a contracted, or expected pay-out would undermine market confidence and could precipitate a crisis. The availability of a maximum distributable amount (MDA) is therefore of significant importance and EBA should consider adding an MDA-based indicator in section 5 of Annex III.

The BSG agrees with the exclusion of “cost of wholesale funding” from the minimum list of recovery plan indicators, due to its practical limitations: banks’ wholesale funding costs largely rely and depend on external and market expectations which are not easily foreseeable, let alone manageable. This indicator may still be useful as an additional indicator, however, in particular for banks that rely heavily on wholesale funding.

Some members raise the question, from a more general point of view, whether the right indicators are used at all – knowing that this is not within the scope of the present discussion paper. There has been criticism of the current ratios and it might be the time to prove with certainty that these indicators really work. A starting point could always be the pure ’fair value’ measurement, minus appropriate discounts for ’haircuts’ reflecting illiquidity in the case of forced sales.

Question 10: Do you have any comments on the impact assessment?

As stated previously, the BSG agrees with the stated policy objectives of a) ensuring that authorities are able to implement temporary relief measures without affecting the calibration of recovery indicators; and b) clarifying that a triggering of recovery indicators does not automatically activate the implementation of the recovery plan. The BSG concurs with the EBA’s assessment, expressed in Option 2, that supervisory relief measures should not automatically entail a recalibration of recovery indicators. There is no particular need, in our view, to further expand on the existing Level 1 requirement, in Art. 5(2) BRRD II, that recovery plans should be amended after any material change in the institution’s organisational structure, business or financial profile.