

British Bankers' Association response to the European Banking Authority's discussion paper on 'a template for recovery plans'

Introduction

The British Bankers' Association ("BBA") is delighted to be able to respond to the European Banking Authority's discussion paper on a template for recovery plans¹. The BBA is the leading association for UK banking and financial services representing members on the full range of UK and international banking issues. It represents over 200 banking members active in the UK, which are headquartered in 50 countries and have operations in 180 countries worldwide. All the major banking groups in the UK are members of our association as are large international EU banks, US and Canadian banks operating in the UK as well as a range of other banks from Asia, including China, the Middle East, Africa and South America. The integrated nature of banking means that our members are engaged in activities ranging widely across the financial spectrum from deposit taking and other more conventional forms of retail and commercial banking to products and services as diverse as trade and project finance, primary and secondary securities trading, insurance, investment banking and wealth management. Members include banks headquartered in the UK, as well as UK subsidiaries and branches of foreign banks – all of which are potentially impacted by this Discussion Paper.

As the European Banking Authority (EBA) is aware a number of the largest UK banks, along with the UK operations of a few overseas banks, have been in close discussions with the Financial Services Authority (FSA) on the topic of recovery and resolution plans (RRP) and have already submitted very detailed elements of their RRP pack. Furthermore all UK banks, or whatever size, are expected to complete the majority of their RRP pack over the next six to nine months, based on principles of proportionality, which we fully support. Our response to the discussion paper is therefore based on this quite detailed experience which we are delighted to be able to share with the EBA.

¹ <http://www.eba.europa.eu/cebs/media/Publications/Discussion%20Papers/DP%202012%2002/Discussion-Paper-on-Template-for-Recovery-Plans.pdf>

Overarching principles

We support the EBA's early planning

We strongly believe that recovery and resolution plans should be a major component in the regulatory toolbox that will contribute to the prevention of future financial crises. It is therefore important that supervisory authorities across the EU have harmonised and adequate tools and powers to intervene promptly in bank should the need arise. This must be built on a harmonised approach to recovery planning so we support the EBA's approach in attempting to identify what such common components should be and look forward to commenting further on them as Regulatory technical standards are introduced in the future and hope that the comments contained in this response will be helpful in shaping them.

Recovery planning must be proportionate

Should a decision be made at EU level to require all credit institutions to complete recovery plans different institutions will likely face different financial stress situations. For many of them a bank insolvency process is the most likely outcome. It would be disproportionate and unwarranted use of regulatory and the bank's management resources to require particularly smaller banks, to prepare very detailed recovery and resolution plans, designed to deal with financial stress or else to facilitate resolution in the event of the recovery plan's failure and subject it to intense regulatory scrutiny. We believe regulatory effort is better devoted to those banks likely to cause wider contagion in the event of their failure and that for these will typically be those that operate across international borders.

Of course we fully recognise the importance of the bank's own management having a plan to recover from a period of escalating financial stress but believe that the EU authorities, including the EBA, should be more ambitious and consolidate into a single framework the rules for RRP, stress testing, capital planning buffers and contingency funding plans, which are already produced by the BBA's member banks. A consolidated approach could cover, in our view, all of the key elements of a recovery plan for a smaller bank in a proportionate way, avoiding overlap and duplication of documentation and be examined in a holistic and efficient way in the Pillar 2 process.

The recovery plan remains the responsibility of the bank's management

Our members view the recovery phase as being firmly their domain, during which the board of directors remains responsible for the management of the group. In this regard, the special manager role and early intervention powers envisaged by the EC Recovery and Resolution Directive are of

serious concern to our members. A transfer of control away from management before the point of non-viability risks disenfranchising shareholders and opens the supervisors up to moral hazard and criticisms if disproportionate and premature action is taken. At the same time however we expect the supervisor will be employing a graduated approach intensifying its supervisory engagement as the bank moves further along the continuum from going to gone concern based on one (or probably more) early warning signals (EWS), though we believe the 'first wave' of EWS should prompt a review by *management* of the potential need for recovery actions. This graduated approach protects against market reaction bringing forward the point of failure should it become known that the supervisor has intervened at an early stage. It also allows for sensitive discussions to be undertaken between the supervisor and the bank bilaterally so that all have a full understanding of the implications of the range of choices available before they are invoked.

Use of template supports consistency and comparison purposes

We support the use of a template as it ensures that institutions at least prepare their analysis to cover a set of common key areas required to assess the credibility of a Recovery Plan, which allows the regulator to undertake a more effective comparison of institutions recovery plans. It also ensures that all institutions have at least focused their efforts on analysis of a key set of issues/ risks that are important to recovery, which they can then further supplement for their specific needs.

Whilst a template is useful it should not be constraining as it is important that banks should remain at liberty to evolve the template to fit their own management information or other analysis they would like to perform.

The proposed EBA template is high-level and serves as a helpful guideline rather than a template. We can see it makes sense for guidance which will be used across countries to be more generic, at the individual country level, more detailed and prescriptive guidance (such as the FSA's CP) may be more useful in ensuring consistency across banks' submissions and a sufficient level of detail is provided.

Confidentiality

The measures proposed in the draft crisis management directive depend greatly on enhanced cross border cooperation and communication amongst regulators, which the templates should facilitate. We strongly support this. But we are concerned that there should be a protocol in place about how regulators share information provided to them by banks as well as proposals for possible action in a time of stress, without exposing the bank itself to the risk that information is inappropriately onwardly

disclosed to other parties not relevant to the supervision of the firm or group as a recovery plan, in the wrong hands, could serve as a blueprint for a hostile take-over

Q.1 *Have you already drafted/approved a recovery plan or are you in the process of doing so? If so, please reply to the following questions referring to your experience*

As a membership organisation representing banks active in London the BBA has not been directly involved in the preparation of recovery plans. But as recovery planning has been a subject of intense interest amongst our members we have facilitated a number of discussions between the UK authorities and banks, both large and small, who are directly involved in preparing recovery plans and so have a thorough understanding of the key issues in their preparation.

Our response is based on this experience of working with all sizes of banks, not just G-SIFIs but also much smaller banks.

Q.2 *Is your recovery plan or would your future recovery plan be in line with the contents of the template and its underlying approach? Please mention the relevant differences, if there are any*

We believe the contents and approach of the template meet our objectives of providing a consistent approach but one which is sufficiently flexible to accommodate the proper degree of proportionality that we expect.

Below we comment on aspects of the template which could be further elaborated on in any eventual regulatory standards in the area of recovery planning, which we believe should be produced soon after the EBA's consideration of the responses to the discussion paper, in order to promote regulatory convergence in national competent authorities' recovery planning requirements.

Summary of plan

Governance

We believe that the summary should explicitly identify the governance process that has been deployed to create the recovery plan (which we would recommend be considered in detail and signed off at board level) and also identify a key member of the management team (who we believe should be a board member) as taking prime responsibility for its production and regular review. It should also identify those individuals who would be involved in executing it were circumstances to demand this.

Recovery option(s)

It may be helpful in the summary to identifying the most credible recovery options and the associated time frame for its implementation, assumptions applied and effectiveness under different scenarios, as well as identify specific impediments to recovery and action that is being taken to overcome them. This emphasises, as we believe it should, that recovery planning is an evolutionary process - the first recovery plan presented by a bank is unlikely to be perfect, although the recovery plans for smaller banks should not be 'over-engineered'. It is unlikely that there most credible recovery options will change materially with the passage of time.

Description of group/institution

We do not think that recovery plans should include information on the mapping of legal, financial and operational structures, intra group financial links or description of critical functions. In addition the template appears to place emphasis on other sorts of isolated analyses, for instance identifying branches/legal entities that "are important for the financial stability of the country in which it operates".

In a recovery planning it is the health of the group that is important and the "triggering" bar should be set at that level. Such jurisdiction-specific/legal entity-centered analysis is more properly undertaken in resolution planning, not in the recovery phase.

Discussion of internal governance

An integration of the early warning signals with the bank's daily and crisis risk management section might be useful. This is because daily capital, liquidity and risk management is designed to manage and mitigate the risk that a bank is exposed to an event that could lead to its failure and the recovery plan will provide an additional layer of measures that a bank can execute to restore the viability of its business. Therefore a recovery plan might include an overview of the integration of the early warning signals with the bank's daily and crisis capital, liquidity and risk management.

In a stress, the Business as Usual governance structure may be modified to a Crisis Management Governance which will be more aligned to the institution's needs when the Recovery Plan is implemented.

Q.3 *Are there legal provisions and/or guidelines in place in your jurisdiction with regard to recovery plans and resolution plans? If so, are there any elements of this template which conflict with those provisions?*

The BBA's response to the FSA's CP11/16 consultation on recovery and resolution planning can be viewed here (insert link). The FSA has recently released its feedback to the consultation paper and

wisely, in our view, delayed implementation of any final rules until after the release of the European Commission's release of its draft Crisis Management Directive (update when necessary). But we anticipate that such rules will indeed be finalised by the FSA in the autumn.

We believe that the draft EBA template is largely in line with the current environment under which UK banks are preparing resolution plans although as we outline in our answer to question 6 we do not think the authorities should set standardised scenarios to which banks should plan as each one will be uniquely susceptible to different stresses.

***Q.4** What kind of legal implications and/or binding effects does the plan have in your jurisdictions, if any, and what should they be, in your opinion?*

All UK banks will ultimately be required to produce recovery and resolution plans. Some of our larger members have been heavily involved with the FSA's RRP pilot process and will be required to submit them before the summer. At present, apart from disciplinary action, there is no explicit legal sanction in the UK for the non-presentation of a recovery plan, although there is a significant reputational risk with the regulator, which institutions would not be willing to risk as the local regulator can take action against the firm (e.g. increase capital requirements). Recover planning, with the involvement of supervisors, will be an interactive process which we do not believe is amenable to enforcement action, although we recognise that they may impose extra levels of capital upon institutions that they deem more difficult to resolve.

Conversely industry we do believe that that a 'good' RRP should result in a lower G-SIB buffer as an institution will not have as severe a systemic impact if it has a RRP that does not generate material disruption to markets. . Although this is not yet a matter of agreement between the authorities and industry we believe this principle should be adopted in regulatory practice in the future as it will incentivise the production and updating of excellent recovery plans.

***Q.5** Do you believe the draft recovery template to be sufficiently comprehensive and cover all the aspects relevant for the purpose of the recovery plan? If not, please specify what is missing.*

In line with our comments on template in the Overarching Principles section, it is important that a template is not rigidly imposed on all banks. Banks will vary dramatically in the size, structure and complexity. It is important that banks retain some discretion to evolve the template to reflect their management information and analyses.

We also consider that the proposed recovery planning template to comprehensively cover all the key aspects that should be considered in creating a recovery plan.

However we recognise that as different parts of the world engage with recovery and resolution planning with different degrees of enthusiasm and rapidity there is a risk that different national regimes will develop different requirements. Whilst recognising that the EBA is likely to be tasked by the European Parliament with developing a template we also believe that there would be merit in the Financial Stability Board developing and promoting a consistent template for recovery plans, in order to avoid placing undue burdens on banks which will result in the provision of contradictory and inconsistent recovery plans. We hope that the EBA, as we do will see the merit in this and seek to ensure aligned templates are used for internationally active banking groups - these could be tailored in the Crisis management group where necessary to reflect and individual banking group's specificities although our preference is for consistent templates across banks.

Q.6 *Should the recovery plan include scenarios and assumptions as possible points of reference for testing the various recovery options? What role should they play within the recovery plan and with respect to the possibility to consider per se the various triggers and negative impacts?*

We do not believe that making recovery plans scenario based according to scenarios and assumptions prescribed by the authorities would be helpful as it is impossible to tell what the next crisis might be.

In particular the specific examples of financial stress suggested in the template would be largely insignificant. For example, a large exposure analysis related to the default of a single counterparty (or even a group of related counterparties) would suggest that potential losses would be very unlikely to reach a level that would trigger the need for recovery actions. Similarly the suggested analyse of the default of a single entity (including the parent) is problematic, as

- a single default will likely have only limited impact on the group, and
- this type of scenario crosses the line into resolution planning because recovery planning, as we have explained above should in our view be undertaken at a group level

Rather it is important that banks have a set of recovery options – with management determining what the most appropriate action is when a stressed event occurs. Otherwise, we believe, there will be too much focus on scenario making rather than preparing a range of recovery options, which is what actually matters. In addition, introducing specific scenarios would require significant rework of material that had already been completed and approved by Boards and certainly well beyond the periodic refresh of material that has properly been contemplated.

Q.7 *How would/do you identify quantitative and qualitative recovery early warnings and triggers? What are the key metrics you would use to develop early warnings and triggers?*

A described in question 6, we believe recovery planning should not be scenario based, for fear of focusing on the 'last crisis' or tying analysis too closely to events which may never happen. In preference, we see recovery plans as providing a menu of options that can be chosen depending on circumstances prevailing at the time. Nevertheless, we agree that some use of scenarios can help 'bring recovery analysis to life', possibly in connection with reverse stress testing which banks should devise based on their own understanding of their specific vulnerabilities. Where used, scenarios should determine the stressed financial position of the bank and each recovery action would then demonstrate how its financial position could be improved through implementation of the action, thus providing a clear metric on the effectiveness of recovery actions.

A range of quantitative triggers could be contemplated including the proximity of a bank's actual ratios to the minimum regulatory capital and liquidity ratios incorporated into Basel III and forward looking metrics based on stress-testing. Such early warning indicators should be used to identify when the type of stress assessed by the bank may actually be materialising which then provides early warning to prepare for execution of the recovery plan.

We would prefer to characterise possible triggers as early warning signals (rather than hard triggers) that will catalyse further discussion. We believe the latitude that our preferred approach of viewing quantitative metrics as triggers for discussion, rather than triggers for action is particularly relevant to G-SIBs. In the sensitive process of ensuring a bank does not tip into resolution there will need to be an element of informed judgement involved, particularly of the bank's recovery plan, which it should remain the responsibility of a management team appointed by the shareholders to implement.

But we believe that there should be a difference between the early warning signals (EWS) used by the bank and those used by the authorities. The authorities should have the ability to closely monitor a bank's liquidity position and be able to assess it in the context of current market conditions and the liquidity positions of its peer group.

But the EWS used by the bank should be the responsibility of the bank's management and defined by them – for instance based on their own internal risk appetite statement, ILAA or ICAAP coverage ratios. These EWS would identify the point at which remedial action would be contemplated and ensure that the CEO and CFO are very engaged in discussions / decisions around liquidity and capital management. This reflects our belief that the quality of the overall daily risk and crisis

management process and the level at which it takes place in the bank is more significant than the monitoring of specific metrics.

Q.8 *What kind of corporate governance arrangements have you adopted or would you adopt for recovery planning? Please comment on differences to the template.*

We believe it is important that the recovery plan is aligned with the bank's risk management processes and other supervisory requirement, including stress testing and the preparation of its pillar 2 processes for capital and liquidity planning.

The recovery plan itself should be approved by the bank's board (not at a lower level) and reviewed annually, unless a more frequent update is warranted because of changes in the bank's circumstances, for instance a large acquisition or disposal.

Otherwise we agree with the template proposals that the governance process should explain how early warning signs would trigger escalation of the recovery plan and describe the associated communication plan that would seek to avoid unhelpful reputational impacts in the market and how it would be activated.

Q.9 *How do/would you ensure the consistency between your group recovery plan and recovery plans drafted by your main entities? For this purpose, are you aware of any obstacles in the current legal framework?*

We firmly believe that recovery planning should be carried out on a top down basis group-wide, coordinated by bank's head office in consultation with the home state regulator and that host state regulators should resist the desire to require local entities to produce their own recovery and resolution plans, either for banks established in another member state or in a third country.

Consideration of, and comment on, the group-wide recovery plan by a host supervisor should be managed by the home supervisor through the CMG. In the event that a host supervisor does not feel that a group recovery plan effectively addresses a particular recovery risk to an entity that they supervise, this comment should be fed back to the group via the CMG and should not be the subject of local discussion.

Q.10 *What range of recovery measures do you think should be envisaged in the template?*

The circumstances being experienced by the bank during the period of stress will determine which recovery option the bank will deploy. This decision should be taken by the bank's senior

management, who will notify the supervisor of the reasons for its choice. At the recovery stage we do not believe it is appropriate for the supervisor to have powers to direct which measures to adopt.

The range of different recovery measures that could be adopted is likely to include:

- Product yield management through pricing changes
- Property sale/sale and leaseback
- Withdrawal from or disposal of businesses
- Reduction of operating costs via organisational (re) design/outourcing optimisation
- Limitations on RWA growth/acquisitions
- Reduction of risk weighted asset
- Reduction of liquidity requirements by assignment of loans, securitisation of assets,
- Utilisation of central bank facilities
- Issuing more capital
- Restructuring of liabilities
- Reduction/elimination of distributions, such as dividends and discretionary remuneration to preserve capital
- Building liquid asset buffers

But as business models evolve other options may emerge, so we would counsel against the template specifying a range of measures. Rather these should be determined by the Board.

***Q.11** Have you got any remarks or concerns related to the confidential nature of the information provided in the recovery plan? If so, please elaborate.*

The information contained in recovery plans will be highly commercially sensitive for the bank and potentially provide a 'take-over blueprint'. Authorities should ensure that access to data is strictly controlled and confidentiality is maintained, paying particular attention to the integrity of information that flows between jurisdictions. Recovery plans should not be shared until they are in their full and final form and even then not beyond the bank's Cross-Border Stability Group. The home regulator should discuss the proposed sharing of a bank's Recovery Plan with the bank in the first instance and where appropriate consider the bank's requests for redactions. Information shared in this way should be subject to suitable confidentiality constraints, imposed on each regulator who receives the recovery plan (or part thereof) and agreed with the bank so they should not be shared with jurisdictions where there is a risk that the data will be available through Freedom of Information requests, or otherwise protected from such requests.

Particular care will be needed for elements relating to any proposed M&A activity or potential closure of operations, and even then disclosure of such information by the home regulator may not be appropriate.

Given the sensitive nature of the information contained in RRP, very careful consideration needs to be given to confidentiality and the mechanism by which necessary or relevant details are shared amongst regulators and communicated to the wider market. Strong safeguards need to be put in place to restrict access to these plans. The home regulator could also make a decision on information it considers should not be disclosed to other regulators for instance a bank's internal capital guidance level.

Q.12 *Should the plan include a ranking among the various recovery measures, differentiating between them with regard to possible scenarios and assumptions and taking into account the expected impact of each measure?*

We do not believe that it is appropriate to rank different recovery options differentiating between different scenarios and impact. In our view this would introduce an expectation and focus by banks and regulators on a small number of possible solutions to a period of severe financial stress which ignores the experience of real life that problems can emerge for a whole range of often unexpected, reasons.

The Recovery Plan is a menu of options available to the Firm. Through the execution governance, decisions will be made, taking into consideration the circumstances at the time, about which options to implement. The use of a ranking may require a firm to make very subjective/ superficial assessment for the sake of assigning a ranking and would not provide any value. If anything, banks could classify actions into those that have a significant franchise value/ viability impact and those that do not.

A ranking process would focus attention and on the merits and demerits of different recovery options rather than developing and refining them as risk scenarios evolve, which we believe is more important.

Q.13 *How would you assess the credibility of a recovery plan? Please comment on your experience*

Having had no direct experience of the implementation of a recovery plan it is difficult for the BBA to answer this question directly. In our view for any recovery plan to be credible the board must be able to determine that it could, if invoked, have a meaningful impact on capital and liquidity metrics enabling them to be restored to supervisory minima in a way that reassures, rather than unsettles

the wholesale markets perception of the bank, within a reasonably short period of time say six months.

Q.14 *What kind of information arrangements have you put in place to ensure that the right information is available within a short time frame for decision-making in a stress situation?*

Larger member banks, particularly those which have the FSA as their home state regulator, already provide significant amounts of information to their supervisor.

We believe that it is important that existing management and regulatory reporting information is incorporated into any new supervisor specified recovery information requirements – although we do not believe that there is any need at all for any such requirements in the first place, given that recovery planning is firmly the domain of the board and senior management which will already have in place appropriate information systems.

Looking forward there may be a case for limited amounts of extra information in relation to resolution planning although we would encourage EBA to build on the already extensive regulatory reporting that our members undertake. Any extra reporting requirements for instance in relation to inter bank or netted derivative exposures should be introduced over a reasonable timeframe and after comprehensive consultation with industry in recognition of the significant IT resources that such incremental reporting would require.

We are aware that the FSB has a work stream examining possible initiatives in relation to g-SIB data architecture in order that it may better understand the build-up of risks in the global financial system. Any future resolution reporting that EBA may propose should be based on the FSB's ultimate proposals, to avoid unnecessary and expensive duplication.

Q.15 *How frequent should interactions/iterations between the supervisor and the financial institution be? What role should the supervisor play?*

Banking crises cannot be prevented without an effective working relationship between banks and their regulators and supervisors, which allows for an in-depth knowledge of the bank by the regulator/supervisor. The frequency and intensity of interaction with a bank should depend on the risk it poses to the financial system and range from close and continuous for the most systemically important banks to infrequent, but at least annual for smaller banks pursuing a simpler business model.

Considering the synergies between the daily risk, capital, and liquidity management we suggest supervisors to avoid, when possible, duplicative work to bank's management and supervisor's themselves, instead of incorporating a new review process.

Q.16 *The implementation of a recovery plan is likely to structurally modify the financial institution and its sources of revenues. Should a forward looking business plan, assuming the implementation of the recovery options, also be part of the recovery plan?*

We support a forward looking view of a bank's capital and liquidity positions which are an important component of a bank's ICAAP and (in the UK) ILAA and which cannot be prepared without reference to a medium term – three to five year – business plan. But regulators should resist the urge to over-analyse these business plans, which during the recovery phase remain the sole responsibility of the bank's management and board; their focus should be on ensuring that the results of the business planning process are properly incorporated in the recovery planning process.

Q.17 *Please provide views on the impact, including your costs and benefits analysis, of the issues involved in the preparation of a recovery plan?*

We have no comment to offer on this question but anecdotally note that our largest members which are part of the FSA's pilot RRP group have established large project teams in order to complete their submissions.

Q.18 *Have you made, or do you plan, changes in the organisation to facilitate successful implementation of the recovery plan in the future?*

The most systemically important banks in the UK are expected to be faced with a requirement to ring fence their retail banking operations which is likely to be introduced by the UK government's forthcoming draft legislation responding to the Independent Commission on Banking's final report. This is likely to result in significant changes to their organisational structure meaning it is difficult to identify the relative roles of RRPs and ring fencing in driving structural change.

Our smaller member banks, however, do not report that they are contemplating organisational change as a result of the RRP work they are currently undertaking.

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