

Handbook on SimEx – Annex A: Showcase example

1. This showcase example offers practical guidance on how the elements of the SimEx handbook could be applied in a scenario where an RA would like to organise a SimEx.
2. **Concept statement:** The RA has established a new procedure related to decision-making for resolution action that has not been assessed or utilised to date. A SimEx is to be carried out with all the relevant stakeholders to assess the efficiency and effectiveness of the procedure and to identify any potential gaps or enhancements that could be made.
3. The **goal** is to test the adequacy and operational soundness of the newly created procedure concerning the execution of a resolution decision. The **scope covers:**
 - Testing whether the procedure identifies the relevant required decisions, roles and responsibilities, including the logical sequence of steps and referring to the entire procedure (which starts when the CA informs the RA of the FOLTF).
 - Testing whether the information needed to successfully take the decisions is correctly identified.
4. The **scope does not cover** the soundness of the platform for sharing documents, as this is to be tested later in a different SimEx.
5. The RA believes the type of exercise that best suits the objective at this stage is a **desktop exercise**. This proposal has in view the fact that the procedure was never previously tested. The RA also considers that, at this time, there is no need to perform the actual actions identified in the procedure but only that participants should discuss and review the mock inputs and outputs as per the decision-making procedure.
6. As part of the initiation phase, the SimEx charter is drafted including the above information.
7. Only one RA is participating in this exercise, in line with its scope and goal. The control team will consist of the same people from the design team. Three people are considered sufficient for the tasks of designing and controlling the SimEx, considering the relative non-complexity of the SimEx.
8. From each functional unit of the RA, the design team expects to have at least two experts present (e.g. legal team, resolution execution experts, communication team).
9. One person from the audit team is asked to act as an integrated observer. The observer will be tasked with checking the following during delivery:
 - i. if there are deviations from the procedure that is being assessed;
 - ii. if there are discussions on decisions that are not captured in the procedure but are needed for achieving the end outcome of the procedure;
 - iii. if there are other specific elements missing (insufficient input, divergent expectations between players), as indicated by players;
 - iv. the cooperation among players;
 - v. if the timings considered in the procedure are sufficient to implement the decision-making process accordingly.

10. The observer will act during the exercise and in the debriefing session afterwards by taking notes of the gaps identified. The observer will also be tasked with helping the control team to draft the first version of the closing report.
11. The **scenario** is for a fictional LSI-type bank, marked for resolution, that fails. The **challenge** is to solve the crisis successfully, focusing on the decision-making process according to the objectives of the SimEx. The RA is tasked with triggering its processes for taking a resolution decision. The first inject is related to the bank failure, which is a generic and non-disputed failure. The temporal dimension of the scenario is **compressed/accelerated**. The simulation is planned for two hours, starting with the communication of the entity's FoLTF and ending when the resolution decision is reached.
12. The failing entity is proposed to be a non-cooperative LSI with a small and medium sized companies-oriented business model. This specific business model was considered to avoid possible complications that are not in the scope of the exercise.
13. In particular, the exercise will apply the sale of business tool accompanied by the write-down or conversion of capital instruments (WDCI) in line with the preferred resolution strategy of the mock resolution plan. The selection of the tool would result from internal discussions on the type of crisis, following the procedure that is to be tested, the situation of the entity and the alternative tools. The SimEx is **linear**, in the sense that no deviation is allowed, regardless of players' output, with a pre-determined path.
14. To prepare for cases in which players, based on the circumstances, conclude that the institution is to undergo liquidation, the control team prepares an inject to intervene in that direction. The controllers will note down to debrief on why the players indicated a liquidation outcome as opposed to the expected resolution action.
15. The scenario includes the following assumptions in the unfolding of the simulation:
 - i. A number of potential credible purchasers are available;
 - ii. Valuation 2 gives a reasonable negative outcome;
 - iii. All funding and liquidity needs will be covered by the purchaser;
 - iv. All of the information required will be available/provided to support the decision-making process; however it is important for players to express their needs or their expectations;
 - v. There are no surprises/injects that would alter the course of the simulation or, additionally, challenge the players.
 - vi. Players are left to take decisions freely, but on the assumption that the bank should be put into resolution.
16. The players are expected to perform their duties as they would in a real crisis and produce mock documents such as a PIA assessment, a resolution decision, etc., following the procedure that is to be tested. Mock documents means that their content is not detailed and, for instance, they can be templates.
17. Regarding the **timeline** (SOT and PMT):
 - The design team prepares an agenda for the SimEx. The design team will need to prepare all documents necessary for the simulation at least one week in advance and send them for the senior manager's approval.

- The players will be announced two weeks ahead of the SimEx, considering it is a relatively simple exercise, and they will receive the rules of play and supporting materials one week before the SimEx.
 - After the simulation, the control team will launch a survey to all participants for one week and then the control team will have two weeks to prepare the closing report.
18. The **environment** is physical, which is the most efficient format considering the small number of participants and specific limited amount of time.
 19. The players will not have to produce detailed elements during this simulation. They will simply mimic by producing documents that are marked in the manuals and national handbook with a title that should be indicative of the content (e.g. PIA assessment), and acting to adopt and pass through the processes and steps necessary to adopt the various decisions in a sequential way, to adopt the final decision on resolution.
 20. The design team prepares the mock bank materials, a brief description of the bank and its resolution plan, together with some financials and simplified valuation reports – Annex A.1.
 21. If players request additional information for taking a decision or producing their output, controllers and observers will note this as points to be re-checked in the procedure being tested. The controllers will direct the players to consider that the requested information has been obtained.
 22. The RA decided that there is no need for an external consultant. The three persons from the drafting team (and the control team, subsequently) can manage the planning and preparation phases as well as the delivery and the closing stages.
 23. For this SimEx, no specific tools or platforms need to be used. The distribution of related documents will be done via the RAs' encrypted email.
 24. The participants' onboarding session will take place just before the actual exercise. This is because it is considered a low complexity exercise, with no technical tools involved and no expectations of information analysis or in-depth documentation production.
 25. The participants will have time to ask questions in this onboarding session so that any uncertainties or concerns can be addressed.
 26. The RoP (rules of play) are:
 - a. The controllers transmit the FoLTF to the RA and the RA starts the exercise of testing the procedure to implement the decision-making process.
 - b. The simulation will continue with each player receiving the information in sequence. Each player will be asked to indicate if the information received is what they expected, what they will do with it (e.g. any internal preparation) and to whom they will send their output.
 - c. If several people receive a piece of information at the same time, they will take turns to take the floor and indicate their process.
 - d. Each player is asked to indicate the amount of time they think they will need to process the information, from input to output, in a real scenario.
 27. The control team is ready to intervene in case the simulation goes into too many details or becomes blocked because of missing links or pieces of information. The control team prepared a mock valuation report in advance, to be delivered at any player's request.
 28. The design team proposes that feedback will be gathered via three methods:

- a. An observer that takes notes, in particular identifying gaps related to the documentation to follow during the exercise (manuals, national handbooks, etc.)
 - b. A debriefing session immediately after the exercise (hot debrief)
 - c. A survey that will be sent to all participants the day after the exercise.
29. The feedback should capture the following aspects:
- i. If the procedure is adequately identifying all parties involved in adopting the decisions in the decision-making process, their required input and generated output?
 - ii. Are there potential ways of streamlining the procedure?
 - iii. Are there any observations in relation to how the procedure would run in a real case?
 - iv. How well was the simulation conducted and are there any areas of the SimEx that could be improved?
30. The participants hold the closing meeting after the conclusion of the exercise, where they are invited to share preliminary views. The control team and the observer are taking notes on the debrief and intervene to ask for clarifications if needed. The aim of the meeting is to refine the conclusions, the identified gaps and clarify certain aspects of the final report to be drafted.
31. The control team and the observers draft a closing report identifying the lessons learned and action items. The report is then circulated to all participants to obtain their feedback. After participants provide their comments, the control team finalises the closing report.

Annex A.1 – Bank descriptive materials

Bank Name: Mock Continental Capital



Business Model: SME-oriented / **Total Assets:** EUR 12 billion

Capital Ratio: 13.5% / Solvency Requirement: 12.5% / Liquidity Regulatory Requirements: Fully met before the crisis

Simplified Balance Sheet

Loans	EUR 8 billion	Deposits:	EUR 7 billion
Securities:	EUR 2 billion	Borrowings	EUR 3 billion
Cash:	EUR 1 billion	Other Liabilities	EUR 1 billion
Other Assets	EUR 1 billion	Shareholders' Equity:	EUR 1 billion

Resolution Plan for Mock Continental Bank

1. **Preferred resolution strategy:** Sale of Business
2. **Communication:** Communicate with all relevant stakeholders, including the competent authority, deposit guarantee scheme, financial market infrastructure, stock market authority, ministry, the EBA, the SRB, competition authority, and insurance supervisory authority.
3. **Operational Continuity:** Ensure the continuity of critical functions and services during the resolution process.
4. **Legal and Tax Considerations:** Address all legal and tax aspects related to the sale of business and winding down certain operations.

Annex A.2 – Mock valuation used as inject to start the simulation

Valuation Report: Continental Bank



Purpose of the report

The purpose of the report is to provide an independent valuation pursuant to Article 36 of the BRRD.

The valuation included in this report is to inform the choice of resolution action to be adopted in respect of Continental Bank and other decisions on the implementation of resolution tools (Valuation 2).

In considering the basis for our valuation work, we have regard to the requirements of Article 26 of the BRRD and the EBA Handbook on Valuation.

As required by the BRRD, this report tries to provide a fair, prudent, and realistic economic valuation of the assets and liabilities of Continental Bank. The resulting valuation may depart from going concern and accounting valuations, including in cases where these have been correctly applied.

Overview:

Continental Bank, a retail-oriented financial institution, has faced a severe financial crisis.

Financial Impact:

The recent financial crisis has severely impacted Continental Bank, resulting in substantial losses. These losses have nearly eradicated the bank's equity, leaving it with minimal remaining capital. The exact nature of the losses is not detailed, but the impact is clear: the bank's equity has been almost entirely wiped out, jeopardising its financial stability and future operations.

The crisis has resulted in substantial losses, nearly wiping out the bank's equity. Shareholders' equity has been reduced to EUR 0.1 billion.

Conclusion:

Continental Bank faces a critical situation, with its equity nearly depleted.