EBA RECOVERY PLANNING

COMPARATIVE REPORT ON GOVERNANCE ARRANGEMENTS AND RECOVERY INDICATORS

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EBA EUROPEAN BANKING AUTHORITY

Contents

Executive summary

With the implementation of the Bank Recovery and Resolution Directive (BRRD) in January 2015, recovery planning has become a key aspect of the European banking groups' planning and risk management, and is now embedded in the standard cycle of supervisory activities. As part of its ongoing efforts to provide supervisors and banks with valuable support in effectively taking forward recovery planning activities, the EBA has conducted a third thematic comparative analysis. This follows the peer-group exercise on core business lines and critical functions (published in March 2015) and the comparative report on the approach taken for scenario testing in recovery plans (published in December 2015). This time, the focus of the comparative analysis is on governance arrangements and recovery indicators, both of which are crucial for assessing the credibility of a recovery plan.

In order to be effective, a recovery plan needs clear governance arrangements, both in terms of the processes and procedures that govern its development (who develops the plan), maintenance (who updates the plan), implementation (who applies it when needed) and execution (who makes sure that the plan is applied). Indeed, as a recovery plan is essentially a special case of contingency planning, it is of utmost importance that it is activated in a timely manner. Therefore, institutions should feature an appropriate set of quantitative and qualitative indicators that adequately reflect the size and complexity of the bank and allow a proper and regular monitoring of potential risks. In turn, the breach of indicators should signal a potential threat to the institution's viability and indicate that recovery actions may be required.

In general, clear improvements can be seen across the board on the above aspects in the analysed recovery plans. Nevertheless, several areas where some challenges remain were identified. In terms of governance arrangements related to the development of recovery plans, the comparative analysis demonstrated that sound practices were applied by most banking groups in terms of process description, receiving approval from the highest group management bodies and seeking contributions from a broad array of internal specialist and/or corporate functions. The main area for improvement was the limited involvement of local management in developing and updating the group plan, and—consequently—the need for more detail on the steps taken to ensure the coordination of actions at the group and local levels.

In the area of escalation procedures, most banks strived to integrate their recovery plans into the existing governance arrangements, but, in some cases, further clarifications could be added to avoid any ambiguities and to explain which arrangements should be applied at different stages of deteriorating financial positions. Moreover, while some recovery plans envisaged that competent authorities should be notified only in cases when the institution applies recovery measures, it should be noted that the BRRD requires the notification to be made after the escalation procedure triggered by the breach of recovery indicators. Similar to recovery plan developments, the analysis unveiled that the majority of group plans provided little detail regarding interaction between escalation and monitoring procedures applied at the group and local levels.

Finally, in the area of recovery indicators, almost all institutions in the sample clearly understood the need to have a broad set of metrics regularly monitored in order to flag any potential signs of distress in a timely manner and to incorporate them within their risk management framework. However, many institutions limited their indicators to only two categories (capital and liquidity), whereas the other categories (asset quality, profitability, market-based indicators, and macroeconomic indicators) were only considered as early warning signals (EWS) (which cannot trigger the recovery escalation procedure) or, in a few cases, not considered at all.[1] The calibration of recovery indicators also constituted a challenge for many institutions, particularly in setting thresholds for capital ratios and ensuring consistency with requirements stemming from the Supervisory Review and Evaluation Process (SREP), as well as reflecting capital buffers. Further, more details could have been provided on the dedicated recovery indicator framework of material entities (if included) in order to capture deterioration in the financial position at the local level (which may require the application of recovery options at the entity level).

Coverage and integration of material legal entities has been found to be a challenging task across the majority of plans. Many plans focus on the parent perspective and do not provide sufficient detail on the involvement of local management in the recovery plan's development and implementation, nor on the use of indicators at the local level. This limits the credibility and the effectiveness of the group recovery plan, undermining the overarching objective of identifying measures that may be required to be implemented at the level of the parent undertaking and of each individual subsidiary. In turn, an appropriate coverage of material legal entity would clearly help contribute to a smooth joint decision process between the competent authorities for a group recovery plan.

[1] In these cases, there is no justification provided that would rebut the presumption that the obligatory indicators or categories of indicators included in the EBA Guidelines on the minimum list of qualitative and quantitative recovery indicators are relevant for the given institution.

Introduction

Following the implementation of Directive 2014/59/EU (BRRD) in January 2015, and in accordance with the EBA's role in contributing to effective recovery and resolution planning (Article 25 EU Regulation 1093/2010), the EBA keeps providing insights into the development of recovery planning in the European banking sector, inter alia, through peer-group analysis, thereby promoting better and more consistent practices.

In line with this mandate, the EBA compared the recovery plans of 26 European cross-border banking groups with parent institutions located across 12 European Union (EU) countries, focusing on how institutions have described their governance arrangements to develop and implement the recovery plan and how the framework of recovery indicators has been developed.

Article 5(6) of the BRRD requires institutions to include in their recovery plans 'appropriate conditions and procedures to ensure the timely implementation of recovery actions', while Article 9 of the BRRD mandates institutions to feature a framework of indicators that 'identifies the points at which the actions referred to in the plan may be taken'. To this extent, under its mandate pursuant to Article 9(2), the EBA published its Guidelines on recovery indicators (EBA/GL/2014/06)[2] in July 2014. Further details on governance arrangements are included in EBA/RTS/2014/11 on the content of recovery plans under Article 5(10) of the BRRD.

This report is the third thematic analysis performed by the EBA on recovery planning. It follows the peer-group study on core business lines and critical functions (March 2015),[3] and the benchmarking report on the approach taken in developing scenarios (December 2015).[4] In line with previous reports, the current analysis is not a grading assessment but rather aims to understand how institutions approach the requirements envisaged by the BRRD, the draft regulatory technical standards (RTS) on the content of recovery plans and the EBA Guidelines on recovery indicators. It also considers the credibility and effectiveness of governance arrangements across a sample of European banking groups.

This report aims to support supervisors in their assessment to identify the crucial elements that should be considered by institutions when designing credible governance arrangements and effective indicator frameworks. Moreover, resolution authorities would also benefit from well-structured recovery plans, as the information provided therein is useful in developing resolution plans. In particular, a clear framework for recovery indicators is important in helping to understand when an institution is actually moving from going concern to gone concern.

[2] EBA Guidelines on the minimum list of qualitative and quantitative recovery plan indicators.

[3] EBA report on recovery planning – Comparative report on the approach to determining the critical functions and core business lines in recovery plans.

[4] EBA report on recovery planning – Comparative report on the approach taken on recovery plan scenarios.

1. Approach

1. The sample of recovery plans included in this comparative study was driven by the availability and status of recovery plans at the time the benchmarking analysis was carried out by the EBA staff. The plans included were all submitted during the course of 2015. However, since the date of actual submissions varied across supervisors and (in some Member States) the BRRD was translated only during the course of the year, some degree of heterogeneity can be found in terms of formal compliance with the BRRD and related EBA technical standards, as some plans had been developed before the BRRD's actual entry into force in their respective countries. However, it should be noted that the BRRD was published in the Official Journal in June 2014, and the relevant EBA technical standards had already been published in draft form for consultation during the course of 2013,[5] thus providing for at least a draft common approach. This exercise has nevertheless been conducted in acknowledgment that, for some of the sample's recovery plans, meeting the full BRRD requirements was still a work in progress.

2. The sample consists of the recovery plans of 26 banks with parent institutions located in 12 different EU countries. Both the size of the institutions, as well as the countries, are quite heterogeneous, and therefore the risk of specific size or country bias remains limited.

3. Recovery planning is a relatively new topic for many institutions and for some supervisors alike, and the plans themselves still remain at very different stages of development. The number of plans included in the sample allows for a reasonable comparative exercise, while at the same time ensuring that only those recovery plans are included in the analysis that were developed on the basis of the EU rules for recovery planning.

4. Governance arrangements and the framework of recovery indicators are crucial to assessing the quality and credibility of recovery plans. In particular, in accordance with Article 4(c) of the RTS on the assessment of recovery plans, the quality of a recovery plan, among other things, can be assessed by the presence of a sufficiently wide range of recovery indicators that are structured in line with the relevant EBA Guidelines. On the other hand, in accordance with Article 5 of the RTS, credibility also relies on the level of integration and consistency of the recovery plan with the general corporate governance and internal processes of the entities, as well as their risk management framework.

5. Thus, this report investigates whether governance arrangements and indicator frameworks support recovery plans that are credible, feasible and of good quality. Accordingly, the analysis is divided into three sections.

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[5] Consultation paper on draft RTS on the content of recovery plans (EBA/CP/2013/01) published on 11 March 2013; Consultation paper on draft RTS on the range of scenarios to be used in recovery plans (EBA/CP/2013/09); and Consultation paper on draft RTS on the assessment of recovery plans (EBA/CP/2013/08) published on 20 May 2013.

6. The first section provides insights into the processes of, as well as into the roles and functions of the persons responsible for, preparing and implementing the recovery plan. It also provides insights into appropriate ownership by the senior and top management and the involvement of the subsidiaries' management in developing the group recovery plan. To this extent, the draft RTS on the content of recovery plans state that the recovery plan should provide details on how it was developed, the process of approval and how it is integrated into the overall corporate governance of the institution.

7. The second section focuses on the escalation processes and their integration into the standard risk management framework. A clear description of the internal escalation procedures should be envisaged, including the role, functions and responsibilities of persons involved at every stage. Moreover, the role of indicators within governance arrangements is also investigated, with a particular focus on the consistency of indicators with already existing risk dashboards (e.g. risk appetite framework). Finally, in the case of a banking group with many entities, the consistency of the governance arrangement at the central and local levels has also been considered.

8. The third section sheds more light on the indicator framework that should help initiate the escalation process. The report looks at how recovery indicators are integrated into the regular risk management framework and whether there is appropriate consistency between the recovery indicators themselves and the EWS (which do not indicate entry into the recovery phase nor require escalation outside the business-as-usual processes). Finally, the analysis will focus on whether the framework of indicators adequately covers all the categories included in the EBA Guidelines on recovery indicators, and will focus on the appropriate calibration of the indicators. It is further analysed whether indicators are provided at the level of individual entities to reflect specific macroeconomic conditions or sectoral issues.

2. Governance – Recovery plan development, update and structure

9. A recovery plan should constitute a very useful and effective tool for any institution in the case of financial distress. However, the plan can be effective only if it is up to date, comprehensive in covering all entities, and when its content is tailor-made for an institution's specificities and fully supported by its senior management. Therefore, it is essential that the document is prepared with the involvement and input of all relevant operational and strategic development departments of an institution, so that all the implications of a potential recovery option or choice of indicators can be assessed. At the same time, it is also crucial that a recovery plan is owned, understood and fully supported by the management of the institution at all relevant levels, including those bodies tasked with taking prompt decisions in crisis situations. Moreover, instead of being a one-off exercise, the recovery plan should constitute a living document that should be subject to regular and, if necessary, ad hoc updates.

10. To this extent, the comparative analysis identified a number of findings among the group recovery plans:

    - More than half of the analysed plans included a clear and sufficiently detailed description of: (i) the recovery plan development process; and (ii) the roles and functions of persons/corporate bodies responsible for developing the recovery plan. However, in one fifth of the plans, the description of either the roles or processes was lacking clarity or was not specified;

    - Almost all recovery plans were approved by the Board of Directors of the parent entity and half of the recovery plans were reviewed by an internal audit function;

    - The vast majority of institutions emphasised consultations and contributions to the development of the recovery plan from various specialists at the group level. In contrast, only approximately one third of plans mentioned the involvement of management from subsidiaries in preparing and updating the group recovery plan, often without providing necessary details on this cooperation;

    - Most banks used the same procedures and allocation of responsibilities for updating the recovery plan that were applied for developing it. The level of detail provided for regular and ad hoc updates varied significantly across institutions, and some banks followed the best practices using results of Dry Run/simulation exercises in order to improve their recovery plans;

    - Most of the analysed recovery plans did not ensure appropriate coverage of material entities and focused mostly on the group perspective, referring to material subsidiaries merely in a description of the group and mapping of entities. Moreover, the structure of group recovery plans and the limited involvement of local management in their development might pose challenges to ensuring the consistency of recovery measures that could be applied at the group level and at the individual subsidiaries level.

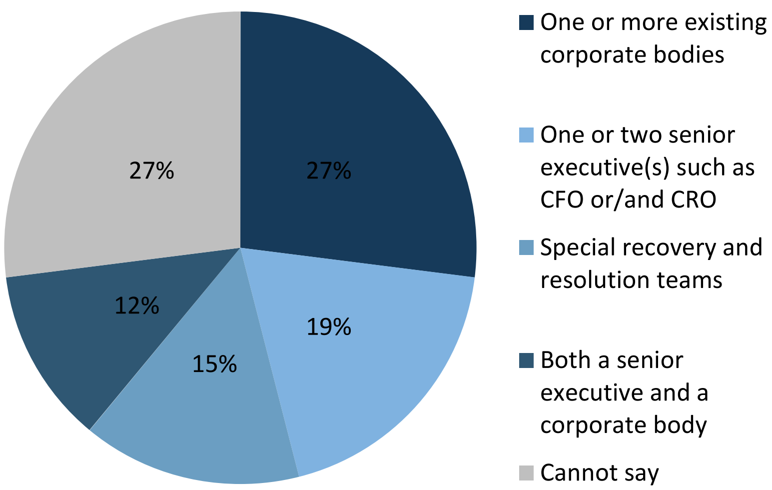
2.1 Recovery plan development

2.1.1 Detailed description of a recovery plan

11. In accordance with Article 5(a)(i) of the draft RTS on the content of recovery plans, the recovery plan should provide a detailed description of how it was developed, including the role and function of persons responsible for preparing, implementing and updating each section of the plan.

12. The comparative analysis of group recovery plans unveiled that more than half of the plans included in the sample provided a clear and sufficiently detailed description of the recovery plan development process, as well as the roles and functions of persons/corporate bodies responsible for developing it. On the other hand, 22% of analysed plans could be improved by adding more detail, whereas 19% of the plans either did not specify respective roles or processes or provided a description that was lacking in clarity. One recovery plan, instead of providing a description of the development process and responsibilities, only included a reference to its internal procedures available on the bank's intranet.

13. Banks implemented a variety of different approaches with regard to executive responsibility/supervision and coordinating the preparation of a recovery plan. Different institutions granted these powers to various executives or corporate bodies, as shown in the chart below.



14. The vast majority of institutions included in the sample emphasised consultations with, and contributions to, the recovery plan development from numerous departments and specialists at the group level (e.g. Risk, Business, Treasury, Strategy, Legal/Compliance, Internal Governance, IT, Communication, International Cooperation, Accounting and Reporting).

2.1.2 Approval of the recovery plan

15. Article 5(b) of the draft RTS on the content of recovery plans stipulates that the recovery plan should describe in detail the policies and procedures governing the approval of the recovery plan, including: (i) whether the recovery plan has been reviewed by an internal audit function, external auditor or risk committee; and (ii) confirmation that the recovery plan has been assessed and approved by the management body[6] of the institution or the EU parent undertaking responsibility for submitting the plan.

16. In the sample of group recovery plans, almost all of them were approved by the Board of Directors of the parent entity (both by the Management Board and the Supervisory Board in Member States with a two-tier Board structure or, less frequently, by at least by one of these bodies). In only two recovery plans, the final approval was granted by the Management Committee or the Risk Assessment Committee (in the latter case, responsibility was delegated to this committee by the Board of Directors).

17. Half of the banking groups explicitly mentioned that their recovery plans were reviewed by an internal audit function, and one bank required that the plan was 'endorsed' by the Audit Committee. Only a small fraction of institutions required submission of the recovery plan to external auditors (and one bank specified which selected elements of the recovery plan were being reviewed). One bank made the recovery plan available to an internal audit and to external auditors; however, it did not require that the auditors review it.

2.1.3 Involvement of local management in preparing a group recovery plan

18. In accordance with Article 5(a)(iv) of the draft RTS on the content of recovery plans, 'The information on governance shall include a detailed description of […] how the recovery plan was developed, including […] if the considered entity is part of a group, a description of the measures and arrangements taken within the group to ensure the coordination and consistency of recovery options at the level of the group and of individual subsidiaries'.

19. In this context, it should be noted that 38% of group recovery plans explicitly mentioned the involvement of local management from subsidiaries in preparing and updating the group recovery plan; however, most of them did not provide necessary details on this cooperation. In most cases, the input from local management was limited to selected

[6] Pursuant to Article 2(1)(24) of the BRRD in conjunction with Article 3(1)(7) of CRD IV, the management body refers to an institution's body or bodies which are appointed in accordance with national law, that are empowered to set the institution's strategy, objectives and overall direction, that oversee and monitor management decision-making, and that include the persons who effectively direct the business of the institution.

sections of the group recovery plans (i.e. the following sections in decreasing frequency: indicators, options, scenarios, governance) or the plan mentioned that management from subsidiaries provided local forecasts used in the group recovery plan.

20. 20% of recovery plans included in the sample described organisational aspects on coordination between the group and the subsidiaries in developing and updating recovery plans. It should be mentioned that banking groups applied different organisational solutions in order to coordinate actions between the parent and its subsidiaries, which envisaged, inter alia, (i) including subsidiaries' representatives in the recovery and resolution planning (RRP) working group established at the group level; (ii) participation in the development and review of the group recovery plan based on one-off invitations; (iii) the involvement of local Boards and local Crisis Management Officers from the main subsidiaries in work on recovery indicators, options, scenarios and governance; and (iv) the group recovery plan team relying on a network of RRP correspondents from key subsidiaries. Only two recovery plans explicitly required the local Boards of Directors to approve sections or annexes of the group plans devoted to local entities.

2.2 Recovery plan update

21. Pursuant to Article 5(a)(i-ii) of the draft RTS on the content of recovery plans, 'The recovery plan should include a detailed description of: (i) the role and function of persons responsible for preparing, implementing and updating each section of the plan; and (ii) the identity of the person who has overall responsibility for keeping the recovery plan up to date and a description of the process in case the recovery plan needs to be updated to respond to material changes affecting the institution or group or their environment'.

22. In line with Article 5(2) of the BRRD, competent authorities shall ensure that the institutions update their recovery plans at least annually or after a change to the legal or organisational structure of the institution, its business or its financial situation, which could have a material effect on, or necessitates a change to, the recovery plan. Competent authorities may require institutions to update their recovery plans more frequently. Furthermore, Article 2 of the draft RTS on the content of recovery plans specifies that 'material change' means any change that could impact the ability of an institution, an EU parent undertaking, or one or more of its subsidiaries to implement a recovery plan or implement one or more recovery options contained in the recovery plan.

23. Based on the regulatory requirements, two types of updates for recovery plans could be distinguished: regular (annual) updates and ad hoc updates. The following sub-sections of this report present observations for both types of updates, as well as the best practices contained in the area of reviewing recovery plans on the basis of Dry Run exercises performed by banks to test their governance arrangements.

2.2.1 Regular updates

24. In most cases, the recovery plan is reviewed and updated according to the same processes as it was developed, which implies that the same corporate bodies/executives are involved in the updating process and the same functions are assigned to them. This approach confirms that—in most of the institutions—the recovery plan has become embedded in their standard processes and is now a living document and not a one-off exercise.

25. With regard to the frequency of performing a regular update of the recovery plan, only one institution had a bi-annual update in the recovery plan, whereas all other banks envisaged that a review should be performed at least once per year. Some recovery plans provided more details on timing for updating the various sections of the plan to ensure alignment with other internal procedures.

26. Some institutions proposed a more detailed description of the timing of the regular update—for instance, (i) by specifying how updating different parts of the recovery plan should be aligned with other internal procedures (e.g. approval of the risk appetite framework, annual determination of the bank's business strategy and financial planning); (ii) by providing specific/detailed timing for updating various parts of the plan; and (iii) by ensuring that the parts of the group recovery plan devoted to specific entities are reviewed by local management before they are submitted for group review.

27. Around one fourth of banks included additional details on the regular update of their recovery plans—for instance, by indicating the specific elements that need to be taken into account while reviewing the plan. These elements included, in particular:

- Relevance of scenarios;
- Alignment with risk management framework;
- Keeping recovery options up to date with external and internal developments;
- Alignment with the new regulatory standards;
- Annual changes in banks' strategic and financial planning;
- Feedback received from competent authorities assessing recovery plans.

2.2.2 Ad hoc updates

28. Approximately 20% of recovery plans included specific rules on ad hoc updates by: (i) listing cases that might require immediate revisions of the recovery plan (i.e. providing more details when compared to provisions of the BRRD/draft RTS on the content of the recovery plan); and/or (ii) outlining dedicated procedures for conducting such extraordinary updates. Some examples of the ad hoc events that might require an extraordinary update of the recovery plan included the following internal and external developments:

Internal developments:

- Change in strategy and/or business model;
- Change in legal structure;
- Acquisitions and divestments;
- Change in operational structure;
- Introduction of new metrics for management purposes;
- Changes in relevant management information systems.

External developments:

- Change in (inter)national standards or in the thinking on recovery planning;
- Change in applicable supervisory legislation;
- Change in applicable corporate and/or contractual legislation;
- Introduction/development of new financial instruments;
- Change in financial markets infrastructure or the introduction of new financial markets infrastructure;
- Change in existing central bank facilities or the introduction of new central bank facilities;
- Practical experience with recovery plans elsewhere.

2.2.3 Best practices (Dry Run/simulation exercises)

29. Two banks from the sample conducted a Dry Run/simulation exercise in order to test their recovery plans and remove identified drawbacks in the updated versions of the plans. The simulation exercises were conducted either annually or every two years, and they were aimed at testing governance arrangements and communication procedures included in the recovery plans and identifying areas of improvement, especially in escalation processes included in governance arrangements.

2.3 Structure of the recovery plan

30. Both the BRRD and the draft RTS on the content of recovery plans focus on the content of the recovery plans without imposing detailed requirements on their structure. Recital 3 of the draft RTS on the content of the recovery plan stipulates that 'To facilitate the organisation of the recovery plan, the information requirements should be grouped under five headings, namely (i) a summary of the recovery plan, (ii) a discussion of the governance, (iii) a strategic analysis, (iv) a communication plan, and (v) an analysis of preparatory measures. In order to ensure a consistent approach across institutions and groups, recovery plans should contain at least these five items, but it is not necessary to require recovery plans to be structured in the same order'.

31. On the other hand, the BRRD and Article 6(3-4) of the draft RTS on the content of recovery plans provide specific requirements for the appropriate coverage of entities in the group recovery plans and the consistency of recovery options at the group level and the material subsidiaries level. In particular, Article 7(1) and (4) of the BRRD requires that the group recovery plan: (i) identifies recovery measures at the level of the EU parent undertaking and each individual subsidiary; (ii) aims to achieve stabilisation of the group as a whole or any institution of the group; and (iii) includes arrangements ensuring coordination and consistency of measures to be taken at the parent/subsidiaries level. Article 6(3-4) of the draft RTS on the content of recovery plans stipulates that a recovery plan must: (i) set out a range of recovery options to maintain or restore viability and the financial position of the entities covered by the plan; and (ii) include a description of entities covered by the plan and provide their mapping to critical functions and core business lines. It appears that both a structure of group recovery plans (including a level of detail for individual entities) and arrangements that govern the plans' development/review have a significant influence on meeting these requirements.

32. In the vast majority of cases (75% of plans included in the sample), the group recovery plan consisted of one document prepared for the whole group. Most plans focused only on the group perspective and referred to subsidiaries merely in the group description or mapping of material entities to critical functions/core business lines. Only one recovery plan included separate sub-sections dedicated to material subsidiaries in the area of recovery options, indicators and governance. 20% of the recovery plans consisted of one central document with integrated annexes devoted to material entities, with cross-references and arrangements aimed at ensuring consistency. One recovery plan was composed of a few separate recovery plans prepared at different sub-consolidation levels with no comprehensive central document encompassing the whole group.

33. With regard to the structure, one recovery plan included an additional Crisis Guide, which constituted a practical manual for bank management and highlighted key processes, decisions and actions to be taken in crisis situations. This Crisis Guide included precise references to appropriate parts of the recovery plan.

34. The insufficient coverage of material entities in group recovery plans constituted one of the main deficiencies identified in the comparative analysis, and should be addressed by the banking groups, so to achieve appropriate coverage of subsidiaries in the group recovery plan, which should aim to identify relevant measures to be implemented both at the level of the parent and at the level of the subsidiaries. In turn, a better coverage of local subsidiaries can help achieve a smoother joint decision process. Moreover, it should be noted that the structure of group recovery plans and the limited involvement of local management in their development might pose challenges to ensuring the consistency of recovery measures that could be applied at the group and individual subsidiaries levels.

3. Governance – Escalation process

35. The credibility and effectiveness of an institution's recovery plan will be determined not only by the recovery measures identified to recover from severe stress, but also by the procedures that govern its escalation and decision-making processes. As a matter of fact, at the time of severe stress, unexpected delay in taking decisions and confusion on who bears the ultimate responsibility could adversely impact otherwise valid recovery options, as they cannot be implemented speedily and effectively.

36. To this extent, the analysis of the plans included in the sample has revealed a number of interesting findings:

   a. The majority of the plans include the activation of one or more dedicated committees or task forces to manage the escalation process and report to the highest bodies of the institution on the development of the crisis; however, these ad hoc structures often overlap with standard governance, so that it is not immediately easy to understand who is involved at each stage of the recovery process;

   b. Only in a few cases were local escalation processes aligned with the group ones and local indicators monitored and supervised at the group level. Indeed, most plans lack detail about the interaction between escalating processes at the central and local levels. Sometimes there is only an exchange of information but no relationship between the escalation and the decision-making processes;

   c. More than half of the plans feature a distinction between recovery indicators and EWS, which are triggered at an early stage and are aimed at monitoring whether, and warning that, a recovery indicator might be breached in the future. In a number of plans, recovery triggers and EWS levels are internally consistent, but they are not aligned with figures from standard risk management processes (e.g. risk appetite framework);

d. Indicators do not usually automatically trigger specific recovery options, but rather prompt the escalation framework where a number of recovery options could then be considered for activation. However, in some plans, the link between the breach of a trigger and the escalation procedure is relatively weak, implying that there is just 'increased monitoring or heightened attention'.

3.1 Escalation and decision-making

37. In accordance with Article 5(c)(i) of the draft RTS on the content of recovery plans, the information on governance arrangements should include the conditions and procedures necessary to ensure the timely implementation of recovery options, including a description of internal escalation and decision-making processes that apply when indicators have been triggered. In turn, this would require the institution to describe:

    a. The role and function of persons involved in the processes, including the presence of any dedicated committee;

    b. The procedures that need to be followed when the escalation process is initiated;

    c. The time frame for the decision recovery options and the information provided to the supervisors on the fact that indicators have been met and the recovery phase is under way.

38. The vast majority of the plans in the sample include—upon the breach of certain indicator thresholds (see below)—the activation of one or more dedicated special committees or task forces to manage the escalation process and report to the highest bodies of the institution (e.g. Board of Directors, CEO) on the development of the crisis. In most plans, the action plan envisaged that managing the crisis situation involves a number of functions and committees within different levels:

    a. A 'Leadership' level, which takes the ultimate decisions about the start of the recovery phase and the activation of dedicated recovery measures, and is usually carried out by the CEO or (less frequently) by the Board of Directors;

    b. A 'Coordination' level, which mainly deals with the overall crisis management process and with the decision-making before it reaches the most critical levels. This can imply the engagement of dedicated or existing committees or top management functions (CFO, CRO, COO);

    c. An 'Operational' level, which involves the actual monitoring of indicators, the practical management of the alert phase and the implementation of any recovery option chosen at the Leadership level.

39. When ad hoc structures are appointed, one of the most compelling challenges is the correct identification of roles and responsibilities and the coordination with existing committees (e.g. ALCO, Group Risk Committee), as the presence of the same members of the senior management can cause overlaps and uncertainty about who is actually in charge at certain phases of the recovery process. Moreover, within task forces or special committees, the plans in the sample show that it is not uncommon to have co-ownerships; however, these might raise issues in case of disagreements.

40. A few cases were identified where there is no formal appointment of a dedicated committee or task force. This is not a shortcoming per se, as sometimes roles and responsibilities are very clear and leverage largely on already existing functions and processes. However, in other cases, the absence of the identification of specific committees simply leads to a high degree of uncertainty about the persons or functions that have the decision-making power to initiate the escalation process, as there is no clear identification on whether either a dedicated committee will be established or the management will decide to leverage on existing procedures. (For example, some plans simply say that, in a distress situation, 'it is highly probable' that some extraordinary committee will be set up to manage the crisis.) In turn, this would raise doubts as to who has the ultimate responsibility to manage the process.

41. While roughly one third of the plans did not identify the specific function or person involved in the decision-making process, some best practices could still be identified when allocating roles and responsibilities. This happened in a very few instances, when each recovery trigger is assigned an owner who is responsible for:

   a. Monitoring its performance through existing reporting processes;

   b. Initiating the escalation to the relevant functions (either the CRO/CFO or the dedicated committee) if the trigger is eventually breached.

42. Quite interestingly, there were a few plans where the escalation and the decision-making process was summarised into different stages and, for each stage, functions and responsibilities have been identified.

   a. Diagnosis/impact assessment, assessing the extent of actual or potential losses;

   b. Activation of the recovery plan, where action is taken and relevant, out of ordinary, procedures are implemented;

   c. Execution of the recovery options, where a decision is taken upon the implementation of one or more recovery measures;

   d. Monitoring of the implementation of options, entailing a dedicated process to check whether the action taken is actually working to restore viability.

43. While, in most of the plans, there was no mention of a definite time frame for the escalation process, there are some cases where certain signposts are envisaged to monitor the process after the beginning of the escalation.

44. Notably, one of the areas where there is still some uncertainty is the coordination between procedures and processes at the central (i.e. parent) and the local (i.e. subsidiaries and branches) level. Roughly half of the plans do not contain any reference to what procedures are triggered in the parent company when one or more of the individual entities enter a recovery phase, or what happens at the local level when it is the group that falls into distress. In some other cases, there is just a generic mention of some form of high-level coordination, but the roles and responsibilities are not defined at both central and local levels. In one case, the interaction between local and central procedures seems to take place mostly in the monitoring and reporting of indicators, but then the group functions are then taking over the more central part of the process.

45. Very few cases could be found where a full integration of procedures between the group and the local levels is envisaged. In such instances, the local subsidiaries monitor the main risks that can impact their business model and risk profile, but there is a further level of reporting at a group level, so that there is a double-layer line of defence aimed at promptly identifying any deteriorating situation that could escalate into a severe crisis.

46. Some other plans, although falling short of a full integration of process and procedures, still feature some description of the decision-making process at the local level, although to a different extent:

   a. If the local plan is triggered, this will trigger invocation to the group plan only to the extent that recovery indicators at the group level are also breached;

   b. Sometimes the group governance acts as a backstop—i.e. in the case a local indicator is triggered but the local Board decides to refrain from implementing a specific measure, escalation will be initiated via group governance;

   c. The escalation process at the local level works in a progressive way, with more and more involvement of the central function when the crisis gets more acute.

3.2 Role of indicators in governance arrangements

47. In accordance with Article 9(1) of the BRRD, a recovery plan should include a framework of indicators established by each institution with the aim of identifying the points at which the escalation process should be activated to assess what appropriate actions referred to in the recovery plan may be taken. Moreover, institutions should put in place appropriate arrangements for the regular monitoring of the indicators.

48. Therefore, the establishment and the use of an appropriate set of indicators can be seen as the first prerequisite for a sound governance arrangement: if no signal is provided to the top management of the institution on whether the institution is approaching the recovery phase, no proper decision-making process can be initiated in a timely manner.

49. In line with Article 5(d) of the draft RTS on the content of recovery plans, in addition to the recovery indicators, institutions should also include a description of those relevant benchmarks (EWS) that are used as part of the institution's or group's regular internal risk management process to inform the institution or group about the risk of deterioration of its financial situation and (potentially) of the indicators being triggered. While such EWS do not indicate the actual entry into the recovery phase or require escalation outside the business-as-usual processes, they help ensuring consistency between the institution's regular risk management and the monitoring of the indicators.

50. To this extent, more than half of the plans feature a clear distinction between EWS and recovery indicators, with the latter being capable of triggering the escalation procedures for recovery planning purposes and the former mainly aimed at monitoring and providing the management signals that a recovery indicator might be breached in the future.

51. In other cases, the distinction between EWS and indicators is not stated explicitly but applies in practice. A 'traffic light approach' is used with some indicators featuring three stages of alert beyond business-as-usual (e.g. red, orange and yellow), and others only two stages (e.g. orange and yellow). However, in such a scheme, only the indicators that also envisage a red threshold can activate the escalation process, while the others can only be used for monitoring purposes and have little effect on the recovery process.

52. Therefore, this two-stage approach to indicators often implies that only some of the six categories of indicators included in the EBA Guidelines on recovery indicators (capital liquidity, asset quality, profitability, market and macroeconomic) are featured as such, while the remainder are not 'true' indicators (in the meaning of the BRRD and the RTS) but rather EWS.

53. One of the reasons some institutions have been hesitant to include indicators for all of the categories featured in the EBA Guidelines on recovery indicators is the concern about dealing with a 'false positive' signal—i.e. the breach of a recovery indicator that is actually an outlier and does not reflect a real deterioration of an institution's financial situation. This concern has also led some institutions to envisage that the recovery phase is not triggered by the breach of one only indicator, but by a combination of two or more indicators, in some cases for more than one monitoring interval (e.g. the breach of a combination of indicators for two or three consecutive months or quarters).

54. While the need to avoid the unduly initiation of an extraordinary procedure when the institution is still relatively far from a severe crisis is clearly understandable, it should be noted that the RTS on the content or recovery plan state that 'indicators do not

automatically activate a specific recovery option […] and they should be used to indicate that an escalation process should be started'.

55. Therefore, the very same regulatory framework does not require a procedure that moves an institution into the recovery phase by pure automatism; rather, the breach of a recovery plan indicator requires the appropriate body (either appointed ad hoc or within the standard policies and procedures) to meet and to decide what actions should be taken. For virtually all the plans in the sample used for this analysis, the indicator framework does not automatically activate a specific recovery measure. Rather, specific measures can only be activated by a decision of the appropriate body (CEO, Board of Directors) after an assessment of the situation.

56. Upon breaching a relevant recovery threshold, the competent authority should be promptly warned in order to help the institution manage such a distressful situation in the most efficient way. Virtually all plans in the sample contain a reference to the involvement of supervisors, although there are some differences:

    a. In roughly 80% of the plans, the information to the consolidating supervisor is just part of the recovery process;

    b. In the remaining few cases, it is not completely clear whether supervisors will be warned upon the breaching of an indicator, although the presence (for instance) of the Head of Regulatory Affairs/Head of relationship with supervisors in dedicated committees clearly implies some sort of communication between the institution and its supervisors.

57. Finally, and very much in line with the findings summarised in the previous section, one possible area of uncertainty is the interaction between the indicator framework at the local level (when specified) and the escalation process both at the group and at the local levels. Indeed, only a few plans in the sample provide a clear and codified procedure that could lead from the breach of a recovery indicator at the local level to escalation and decision-making at the group level, while (in most of the cases) it is not clear how EWS and recovery indicators can impact the decision-making process at a more central level.

3.3 Integration into the overall risk management framework

a. Contingency plans

58. Recovery plan arrangements should not be seen as completely detached from the standard risk management framework already in use; rather, there should be an overall consistency between ordinary and extraordinary governance procedures.

59. In roughly three quarters of the plans in the sample, there is full consistency, as recovery plan arrangements seem to be the most extreme phase of contingency funding/liquidity plan and of the contingency capital plan. Therefore, the dedicated recovery governance

framework does not replace or supersede standard contingency plans that are in place to address distressed situations where recovery indicators have not been breached. Rather, the governance arrangements in recovery, in business-as-usual and in contingency are considered as a continuum, where each phase is the continuation of the previous one.

60. However, there are plans where it is stated that there is a general consistency between recovery governance arrangements and business-as-usual procedures, but this could not be verified, as the latter were not described (or attached) in the recovery plan document or because the alignment only referred to some phases of the respective processes. In turn, this might lead to a lack of clarity on which functions are involved in each stage of the process.

61. Finally, in a minority of plans, there was no mention of any consistency with processes already in place, which clearly makes it difficult to consider the recovery plan governance as something integrated within the standard risk management framework. This, in turn, hampers its credibility and feasibility.

b. Risk appetite framework and other risk dashboards

62. Similar to the overall decision-making processes for the recovery phase and their alignment with existing contingency procedures, the set of EWS and recovery indicators should not be seen as a stand-alone tool, but rather as something deeply interlinked with the monitoring and alert process already in place in normal times.

63. In the vast majority of the plans analysed for this report, recovery indicators and triggers are not set in isolation, but are an extension of existing risk dashboards, such as the risk appetite framework (i.e. a set of metrics that should provide comparable measures across the financial institution for senior management and the Board to communicate, understand, and assess the types and levels of risk they are willing to accept).

64. However, it should be noted that, even for best practices, the alignment between the recovery and the risk appetite dashboards could necessarily be only partial, mainly because the metrics in the former are usually more numerous than in the latter. Moreover, other indicators were not included in the risk appetite framework, but they were still monitored at a more operational level.

65. It is important that where metrics in the risk appetite framework and in the recovery plan are the same, there should be overall consistency between the relevant values. Most notably, the risk appetite framework limit and the recovery indicator trigger should be aligned.

66. However, in some plans, the alignment of indicators and the relative triggers with the risk appetite framework is incomplete, as:

a. No evidence is provided that the values within the risk appetite framework are consistent with the recovery indicator threshold, because the former are lacking;

b. The whole risk appetite framework is under review, so a full alignment should be expected in the near future;

c. Recovery triggers and EWS levels are internally consistent, but they are not consistent with the levels set for risk appetite purposes.

c. Monitoring

67. Having in place a dedicated framework of recovery indicators and procedures to manage the escalation and the decision-making process is not enough if no monitoring process is established for indicators and EWS.

68. In most of the plans, recovery indicators and EWS are monitored on a regular basis by a central function (e.g. Group Risk Control, or Group Capital Management for capital and profitability indicators and group Liquidity Risk or group Treasury for liquidity metrics). Some best practices could be identified in a few cases where the frequency of monitoring and the function responsible for reporting were indicated for each recovery indicator and EWS within each category.

69. In most of the cases, recovery indicators are part of the standard risk dashboards (see above), and they are monitored and discussed in regular risk management or liquidity committees (e.g. group risk committee, asset and liability committee). However, since the overlap between recovery and 'standard' indicators is not always complete, there might be the need for additional reporting for the larger set of recovery indicators and EWS.

70. Roughly half of the plans explicitly envisage a dedicated reporting of recovery indicators and signals (in addition to the standard reporting framework), but only a minority of them explicitly envisages that, in the case of severe changes with regard to indicator values (even when they do not approach relevant thresholds set for EWS or indicators), these changes have to be analysed and reported to the decision-making body.

71. An appropriate monitoring of indicators also implies a relevant communication to the competent authorities when any threshold has been breached, in order to properly coordinate actions and procedures. While the supervisor is informed in most plans, the notification often happens only when the recovery phase has been initiated rather than upon the trigger of an indicator, whereas the Article 5 (c) of EBA RTS on the content of recovery plans requires that information should be provided on when and how the relevant competent authorities will be informed

4. Recovery indicators

72. Section 3.2 has already demonstrated the crucial role of recovery plan indicators for the plan's governance arrangements. Article 9 of the BRRD specifically requires recovery plans to include indicator frameworks that identify the points at which appropriate recovery actions may be taken. The EBA's Guidelines on recovery plan indicators provides further details regarding recovery plan indicators' scope, calibration and more general features of the indicator framework.

73. A relevant and appropriate recovery indicator framework is key to allow effective implementation of the recovery plan. Sufficient indicator scope and adequacy of calibration levels allow timely implementation of recovery measures and the governance procedures described in the previous section.

74. While findings on the indicator frameworks across the sample vary, there are certain issues observed in a large number of plans examined. These are:

   - The scope of indicators used is too narrow in almost all plans. The minimum list of indicators as per the EBA Guidelines is often only very partially covered, thereby potentially compromising the institution's ability to appropriately identify recovery situations;
   - Inconsistency of the calibration of trigger levels with capital and liquidity requirements is observed in many cases, which could hamper timely implementation of the recovery plan;
   - There is lack of coverage of individual entities as part of the indicator framework.

75. In the sections that follow, key aspects observed with respect to the scope, calibration and general construction of the recovery indicator frameworks observed in the present sample of plans will be discussed in more detail.

4.1 Scope of recovery indicators

Recovery indicators used

76. The scope of the recovery indicator framework should be such that it adequately captures and identifies the key vulnerabilities faced by an institution. An appropriate scope of indicators is crucial to capture a broad range of developments and enable the bank to monitor all relevant areas.

77. Recognising the fact that institutions are faced with very different risks as a result of varying structures, activities, and business and funding models—and therefore the indicators that must be monitored by each institution may vary—a minimum list of categories and indicators to be included in all recovery plans has been specified in the EBA Guidelines on recovery indicators.

78. The EBA Guidelines specify six categories to be covered by the indicator framework, with the first four categories being mandatory while the last two may be excluded in cases where the institution justifies that they are not relevant (rebuttable presumption): (i) capital indicators, (ii) liquidity indicators, (iii) profitability indicators, (iv) asset quality indicators, (v) market-based indicators and (vi) macroeconomic indicators.

79. From the sample of reviewed plans, it is clear that the most frequently included indicator types are capital and liquidity indicators. Figure 1 provides an indication of the use of various capital and liquidity indicators in the reviewed plans. Incorporated in more than 90% of the indicator frameworks, the Common Equity Tier 1 (CET1) ratio is the most frequently used indicator and will also be discussed in more detail in section 4.2.2.

Figure 1 – Inclusion of capital indicators in the indicator framework (% of the 26 plans)

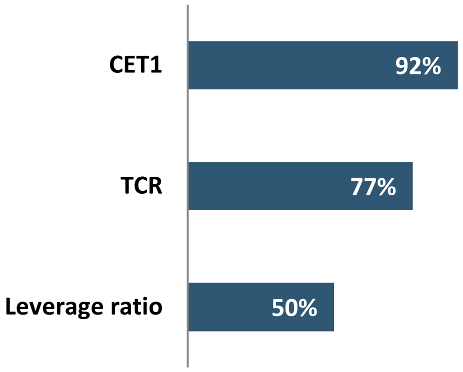
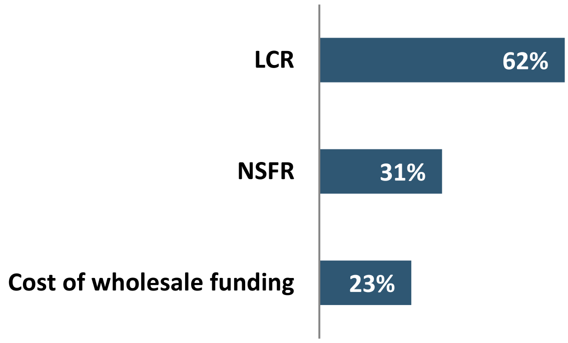


Figure 2 – Inclusion of liquidity indicators in the indicator framework (% of the 26 plans)



80. While from the above it looks as if capital indicators are better covered than liquidity indicators, it needs to be noted that, for instance, the cost of the wholesale funding indicator is observed to be more frequently replaced by a different indicator the bank deems more appropriate for its funding model.

81. However, inclusion in the indicator framework does not always imply that a clear identification of the threshold level is possible. In terms of how many plans include an actual quantitative trigger level, the share of plans decreases to around 70% in the case of the CET1 ratio and the TCR ratio, and to around 50% in the case of the LCR, for example.

82. Coverage of profitability and asset quality indicators is weaker in the plans reviewed. The growth rate of gross Non Performing Loans NPLs is included in less than one third of the sampled plans, while RoE features in even fewer plans. However, these indicators are also more frequently replaced by other indicators that an institution deems more appropriate for its business model and structure. Nevertheless, replacements were only observed in a few cases.

83. Market-based and macroeconomic indicators are included in less than one third of the plans. This is partly driven by the fact that several plans include these indicators only as EWS.

84. The latter practice is also generally observed for other indicator types. Often, when indicators are not included as part of the actual recovery indicator framework, they are included as part of EWS.

Rebuttable presumptions

85. For each category of the recovery indicator framework, the EBA Guidelines spell out specific indicators that should be included, unless the institution justifies that those indicators are not relevant to its legal structure, risk profile, size and/or complexity (i.e. rebuttable presumption).

86. A very mixed picture emerges with respect to the provision of rebuttable presumptions relating to the incomplete indicator frameworks described in the previous section. In over half of the 26 recovery plans reviewed, no reasoning at all for the non-inclusion of specific indicators is provided. Just over 10% of the plans included partial reasoning—i.e. reasoning for some of the indicators that had not been included. For one plan, rebuttable presumptions were not needed, as the indicator framework covered all indicators envisaged by the EBA Guidelines, while indeed around a quarter of the plans provided presumptions for the recovery indicators they had not included.

4.2 Calibration of recovery indicators

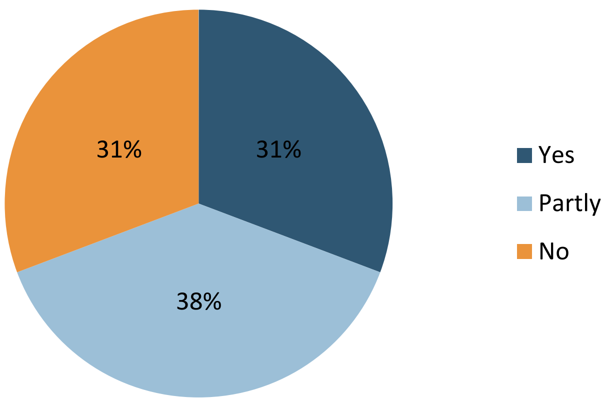
4.2.1 Explanation provided for the calibration of recovery indicators

87. Recovery plans should include an explanation as to how the recovery plan indicators have been calibrated.[7] Demonstration of the rationale behind the specified trigger levels, inter alia, allows an understanding and assessment of the calibration's appropriateness and whether the recovery indicators' threshold levels are set in such a way as to allow sufficient time to act in a crisis situation.

[7] See paragraph 17 of the EBA Guidelines on the minimum list of qualitative and quantitative recovery plan indicators.

88. From the sample of reviewed recovery plans, evidence on the explanation of the chosen calibration is mixed. More than 30% of the plans lack an explanation on the recovery indicators' calibration. For the reminder of plans in the sample, an explanation is provided, albeit to very different extents.

Figure 3 – Calibration of recovery indicators: Explanations included?



89. In almost 40% of the sample's plans, the description provided seems insufficient or limited. While the shortcomings identified vary across plans, some issues were identified repeatedly. In many cases, one observes a fairly detailed discussion around the calibration levels of capital, and often liquidity, indicators; however, this is missing for other quantitative indicators such as asset quality and profitability. Also frequently observed as part of this sub-group of recovery plans was too general a description of the rationale behind the trigger calibration. Often, there is simply a mere mentioning of regulatory requirements and historical events as the basis for trigger calibration as an overall explanation for all recovery indicators.

4.2.2 Consistency of capital indicator triggers with capital requirements

90. In order to ensure sufficient distance from the breach of capital requirements, threshold levels for recovery plan capital indicators should be chosen at an appropriate distance above Pillar 1 and Pillar 2 requirements.[8] This will ensure that the institution has sufficient time to act on its capital levels in order to not breach regulatory capital requirements, while—at the same time—allowing the institution to make use of its capital buffers in times of stress.

91. The lack of adequate distance of capital indicators from banking groups' capital requirements has been one of the key observations during the analysis. Comparing the threshold levels established for the CET1 ratio with institutions' 2015 SREP requirements, it is apparent that, in many plans, these are not consistent.

[8] See paragraph 25 of the EBA Guidelines on the minimum list of qualitative and quantitative recovery plan indicators.

92. Over half of the plans set the CET1 threshold below the CET1 regulatory requirement (P1 + P2) or just at par with the CET1 requirement.[9] A little under one third of the plans include CET1 trigger levels above the regulatory requirement.

93. Inter alia, this highlights the timing disconnect that exists between the joint decisions and the development, frequency and extent of updates of recovery plans. Institutions develop their plans and calibrate their trigger levels based on capital requirements that, in some cases, soon become outdated; therefore, it will often be difficult for banks to calibrate the appropriate capital trigger levels. This, in turn, links back to the timing of the updates of the recovery plans discussed in section 2, as there could be a need for the plans' governance sections to reflect the timing of the capital joint decisions in their description of ad hoc recovery plan updates.

94. While recognising this timing issue, however, several plans also specify indicator thresholds in ways that would still lead to either inconsistent or unclear trigger levels, regardless of the timing. For example, of all the plans reviewed, only over 70% refer to concrete CET1 figures as recovery plan thresholds. In around 10% of the plans, the CET1 trigger level is not expressed as an exact numerical figure, but rather in relative terms to the SREP requirement. Thus, it is not always immediately clear what the actual threshold is. For the reminder of the plans, determination of the actual trigger level is unclear, there is no CET1 recovery indicator, or the trigger level is defined as a relative change of the CET1 ratio.

95. Furthermore, in very few plans, the trigger level was explicitly stated to be set 'at the regulatory minimum', which implies calibration inconsistencies regardless of the timing of the joint decision versus the recovery plan's development. This contradicts the aim of the recovery indicator framework, which is to allow the bank ample time to act and return to financial viability; it also demonstrates that confusion remains with respect to appropriate trigger calibration.

96. Looking in more detail at those cases where the trigger levels sit above the requirement, a heterogeneous picture emerges. The average distance between CET1 requirements and recovery thresholds is just over two percentage points, with distances as little as 0.3 percentage points and a large as four percentage points.[10]

97. In some plans, a more conservative approach has been taken and capital buffers have been included in the calculation of recovery triggers. Thus, threshold levels are set at levels above capital buffers (and P1 plus P2).

[9] For some of the plans that see trigger levels below requirements, it should also be noted that the triggers refer to fully loaded ratios. Therefore, the relative distance to the capital requirements might be somewhat understated. Distinction between fully loaded ratios and phased-in ratios has not been made in all the recovery plans reviewed.

[10] Again, here one needs to bear in mind the timing difference between the capital decisions and recovery plan development.

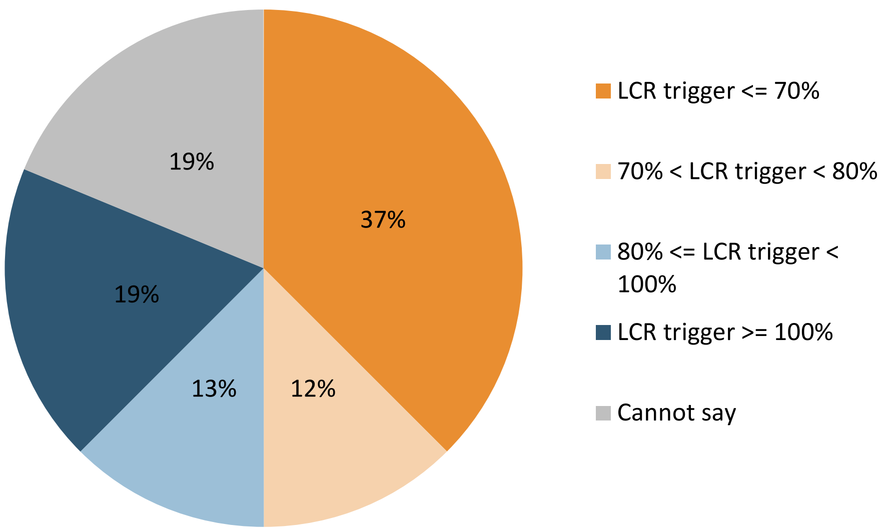
4.2.3 Consistency of liquidity indicator triggers with regulatory requirements

98. Around two thirds of the plans in the sample include the Liquidity Coverage Ratio (LCR) as a direct recovery indicator. Similar to what has been described above on CET1 thresholds, the LCR trigger levels observed also vary substantially in relation to the regulatory minimum of 70% in place as of 2016.

99. Just looking at the 16 plans that include this indicator in their trigger framework, almost 40%of these plans include an LCR threshold below the 2016 regulatory requirement of 70%.

100. For a little over 10% of the plans that include the LCR as a recovery indicator, thresholds are slightly above 70%, while for around one third of the plans, the trigger level is above 80%. For almost 20%, the actual trigger level cannot be determined for the LCR.

Figure 4 – LCR trigger levels (for the 16 recovery plans featuring the LCR as a recovery indicator)



4.2.4 Calibration of other recovery indicators

101. Due to very heterogeneous use of the type of indicators and the way in which these are used across the reviewed plans (qualitative versus quantitative), it is somewhat difficult to find a meaningful sample for an analysis of the threshold levels used for other indicators.

102. For non-performing loans, different threshold approaches have been observed, including percentage variations in the non-performing loan ratios as well as specified triggers for the actual ratios.

103. In terms of the RoE, these have, inter alia, been set as low as 0% and as high as 10% in some cases or as relative positioning across peers.

104. Market indicators have also, in some cases, been found to be calibrated in relative terms (for example, an institution’s CDS spread relative to peers). This may not be the most

effective indicator in times of a systemic crisis, as the whole market is likely to experience a deterioration (i.e. and increase in spreads) and therefore the indicator is likely to become meaningless.

4.2.5 Use of the traffic light approach

105. A progressive metric is envisaged for quantitative recovery indicators by the EBA Guidelines on the minimum list of qualitative and quantitative recovery plan indicators[11] in order to signal to the institution's management that these indicators might potentially be breached.

106. The idea of a traffic light approach is present in each of the 26 recovery plans reviewed. The extent of its development and presentation, however, varies across plans and indeed countries.

107. A complete traffic light system, showing progressive metrics for all quantitative indicators and enabling an efficient signalling throughout, is observed in only around half of the plans. For many plans, the approaches used have been very different and, in many cases, the completeness of the traffic light system is doubtful—the idea is there but the actual development is still very tentative.

108. Some of the varying approaches observed, inter alia, most frequently include that only few of the recovery indicators were included in the traffic light system or recovery indicators were categorised in such a way that only some were qualified as 'hard' recovery indicators and, therefore, the progressive metrics had varying implications for different indicator types. Another approach observed was that the traffic light approach was based on an aggregate score—i.e. various indicators took different severity categories (colours) and then, from this, an average level of severity (colour) was derived. Yet another feature observed was that the progressive metrics were established within recovery indicators and within EWS, rather than established across the two indicator categories.

4.3 Indicators at the individual level

109. Indicator frameworks for individual entities that have been defined as material by the recovery plan has been found missing or deficient in the vast majority of recovery plans looked at as part of this report. While around one third of the plans do mention the monitoring of individual entities in the context of the group recovery plan in at least some form or the other, this monitoring does not present an adequate indicator framework in the majority of plans.

[11] See paragraph 16 of the EBA Guidelines on the minimum list of qualitative and quantitative recovery plan indicators.

110. Out of the total 26 recovery plans assessed, there is only one plan that includes a complete indicator framework for all material entities as part of the group recovery plan. For more than 40% of the assessed recovery plans, group recovery plans do not consider indicators at the individual level. Around one third of the plans cover only a very limited number of indicators for individual entities (in most cases, only the main capital and liquidity indicators), only indicators for a limited number of entities, or both. Another small group of plans has been found to cover a reasonable number of indicators at the individual level but—albeit aligned with the group plan framework—this is done as part of annexed individual plans. Yet another practice observed is to only include some EWS for individual entities.

111. In most cases, the indicators included at the individual level do not seem to be sufficiently relevant to the specific entities. While some plans include, for example, GDP variations for specific countries, other cases show that individual indicator frameworks are rather a replication of a group generic indicator framework. For less than one fifth of the plans, there is an indicator framework at the individual level and these plans have therefore been assessed as at least partially relevant for the specific entity.[12]

[12] The latter group of plans include recovery plans with insufficient or partial coverage of individual entities in the indicator framework.

5. Conclusions

112. In order to have a feasible and credible recovery plan, sound governance arrangements and an appropriate framework of recovery indicators are crucial. Ultimately, a recovery plan is a special form of a contingency plan, so responsibilities and procedures should be clear and streamlined because, in an emergency situation, it is of utmost importance that decisions and actions are taken as fast as possible. Therefore, responsibilities should be clear, both in terms of ownership and development of the plan and in terms of the tasks to be executed at any stage of the plan, while indicators should clearly signal when actions should be taken.

113. A recovery plan that fails to provide enough information on the key actors involved in the development process and on the framework of indicator matrices that drive the activation of the plan itself is hardly credible and might not be implemented in a timely manner. Hence, valuable time may be lost in identifying recovery actions needed to prevent the institution from failing.

114. The analysis conducted for this report shows that, in the vast majority of cases, institutions have well understood the importance of developing sound governance arrangements for recovery purposes, and that indicators are important to promote timely activation of the plan when institutions are in distress. Looking at things in perspective, and noting that recovery planning is a relatively new topic for many institutions, it appears clear that a lot of effort has been made to take into account the broader notions for governance and indicator sections, such as developing traffic light systems within the indicator frameworks or integrating recovery escalation procedures with ordinary escalation procedures.

115. Taking into account that some good progress has already been made, the comparative analysis highlights some areas for improvement and the specific issues within the broad building blocks that might need further developments. These developments, in turn, would enhance the effectiveness of the governance arrangements and indicator frameworks.

116. With respect to governance, the main areas of improvement can be grouped into three main categories:

    a. <u>Overlap with existing governance arrangements</u>: The majority of the recovery plans included activation of one or more dedicated committees to manage the escalation process and, in most plans, there is a continuum between ad hoc arrangements and the existing governance mechanisms. However, these ad hoc structures and processes sometimes overlap with standard governance arrangements, so that—in these cases—it is not immediately clear who is involved at each stage of the recovery phase;

b. Involvement of subsidiaries in developing group recovery plans: While more than one third of analysed recovery plans mentioned the involvement of management from subsidiaries in developing and updating the group plan, often they failed to provide necessary details on the extent of this cooperation;

c. Alignment between group and local procedures: Only in a few cases, local escalation processes were aligned with the group ones and indicators were monitored and supervised mostly at group level. The majority of plans lacked details about the interaction between escalating processes at the central and the local levels. Sometimes, there is only an exchange of information but no relationship between escalation and the decision-making processes.

117. With regard to recovery indicators, the three main areas for improvement highlighted are the following:

a. Scope of indicators covered: In a large number of plans, capital and liquidity indicators take the prominent role, while the other four categories are often not at all or not sufficiently included. This hampers appropriate monitoring of the banking group's situation and the signaling of a recovery situation;

b. Calibration of indicators: Capital and liquidity indicators are set at too low levels in the majority of plans. This hinders timely activation of the relevant escalation procedures and recovery options if needed;

c. Recovery indicators for material entities: The majority of the plans in the sample provide only little details for indicators at the level of individual subsidiaries.

118. Therefore, one important area where governance and indicator arrangements could make recovery plans more effective seems to be the coverage of material entities. The BRRD envisages that the plan should cover the whole banking group and ensure consistency of recovery measures that can be applied at the group level and for individual subsidiaries. Indeed, the analysis shows that group recovery plans included in the sample were developed mostly from the parent perspective and did not provided sufficient details on the involvement of local management in the recovery plan development and its implementation, as well as the use of indicators at the local level. Therefore, one of the challenges that institutions are likely to face in the coming future is to cater for a wider coverage of entities when it comes to governance arrangements and indicators; in turn, this would greatly improve the effectiveness and the credibility of group recovery plans.

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