

Response

Consultation on draft Regulatory Technical Standards on the content of recovery plans under the draft directive establishing a framework for the recovery and resolution of credit institutions and investment firms EBA/CP/2013/01

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Response "Draft RTS on the content of recovery plans"
Registernummer 52646912360-95 of 2013-06-11

On 11 March 2013, the European Banking Authority (EBA) published the Consultation Paper "Draft RTS on the content of recovery plans under the draft directive establishing a framework for the recovery and resolution of credit institutions and investment firms". We are pleased to have the opportunity to provide our response.

I. General Remarks

At international as well as national level, several initiatives have been launched on recovery and resolution planning. The EBA has since published its proposals for possible regulatory and technical standards (RTS) concerning the establishment of recovery plans, although Articles 5 (7) and 7 (4) of the Commission's proposal for a directive establishing a legal framework on recovery and resolution of credit institutions (RRD), which ought to be the legal basis for the draft RTS, have not yet passed the legislative process.

We have concerns about developing RTS at such an early stage before there is a finalised legal framework. Even if it is taken for granted that the finalised legislative text of the RRD contains a mandate for EBA to develop RTS for recovery planning, there are important aspects of the ongoing discussions in the European Parliament and the Council that have to be taken into consideration.

In fact the negotiating position which the Committee on Economic and Monetary Affairs (ECON) approved on 20 June 2013, as well as the Council's latest compromise texts, contain simplified obligations for institutions with regard to the threat its failure can cause for domestic or international financial markets. The upcoming discussion gives reason to assume that this aspect will also become an important point in the trilogue. Such a gradation in content and detail is essential to comply with the principle of proportionality.

Unfortunately, the present draft RTS does not fulfil these requirements. According to Article 1 RTS, it specifies "minimum information" which should be contained in every recovery plan although its requirements are obviously tailored to institutions that are of systemic importance for financial markets (see also Q2).

Additionally, certain aspects are discussed which – if recognised in the finalised regulation – would require changes to the RTS at a later stage.

For example, the Council's latest RRD compromise text contains a waiver for institutions which can be resolved in normal insolvency proceedings without any significant negative impact especially on financial markets or other institutions due to their size, business model etc.

Also, according to the ECON proposal under Article 5 (1a), consideration is being given to the question of whether Member States may delegate the task of drawing up recovery plans to an institutional protection scheme (IPS). Under this proposal, the IPS is permitted to determine the measures to be taken by the institution or the IPS itself in a crisis situation. According to the intent and purpose of the arrangement, these are standard plans which stipulate the early intervention measures to be taken by the IPS for the institution concerned on a binding basis. The present requirements of the RTS could not be directly applied in this case.

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Finally, the RTS evidently assume that, in addition to group recovery plans, recovery plans will also need to be prepared for the individual institutions belonging to the group. This contradicts the status of the discussions both within ECON and the Council. Quite rightly, neither of the compromise texts provides for such a duplication of work any longer. Such individual recovery plans are only considered advisable where an authority of another Member State requests such a plan because the institution there is of significant importance for the financial system.

Overall, the RTS should be consistent with approaches already set out by global standard-setters and national authorities and should provide a useful framework to support the planning process that has already started at national level. Introducing such an RTS can, among other things, help to achieve consistency in authorities' analysis of RRP. Nevertheless, a too detailed level of regulation should be avoided to guarantee complete and comprehensive consideration of possible recovery measures and individual scenario planning that could be found in supervisory dialogue.

II. Response to the questionnaire

Q1: Have you already drafted/approved a recovery plan or are you in the process of doing so? Is your recovery plan in line with the contents of the draft RTS

1. Background

In November 2012, the German Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, "BaFin") and the Bundesbank submitted a draft circular for consultation on the minimum requirements for the establishment of recovery plans (Mindestanforderungen an die Ausgestaltung von Sanierungsplänen, "MaSan"). This circular is intended to supplement and specify in more detail the minimum requirements in regard to the contents of recovery plans which will be introduced with the Act on protection against risks and planning the recovery and resolution of credit institutions and financial groups, which is due to come into force shortly. Institutions and financial groups which BaFin, in consultation with the Bundesbank, has classified as systemically important, will have to observe these requirements in future, when drawing up their plans. The draft circular is currently under discussion in the so-called expert committee for crisis management, which consists of the BaFin and the Bundesbank, with the participation of representatives from institutions, banking associations and members of the accountancy profession. A final version of the circular is expected shortly.

2. Preparation of a recovery plan

Parallel to the publication of the above-mentioned draft circular, BaFin called upon those credit institutions and financial groups considered to be domestically systemically important to prepare a recovery plan by the end of 2013. On the basis of the framework outlined above, the preparation process is already underway. The first plans are expected to be finalised shortly following the submission of the final version of the MaSan.

According to the developments currently foreseeable, the MaSan will offer a comprehensive and complete approach for the preparation of recovery plans, which has already drawn upon practical experience to a large degree. In particular, the MaSan are based closely on the Financial Stability Board (FSB) key attributes for recovery planning. This means it is all the more important for the final version of the RTS to take into account the initiatives already existing for the preparation of recovery plans. In particular, it is

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important to avoid duplication of processes at the institutions through further-reaching or deviating planning requirements.

Q2: Do you believe that the draft RTS on recovery plans is comprehensive and contains sufficient and relevant requirements to enable a timely and effective recovery of an institution in the event of financial distress.

The draft RTS on recovery plans should specify the basic contents of a recovery plan to enable a crisis to be overcome at an early stage. Nevertheless, in this connection it ought not to be overlooked that, whilst the recovery planning assumes various scenarios (Article 5 (5)), the specific circumstances which will make it necessary to take recovery measures will hardly be predictable in detail. It would accordingly be detrimental to the objectives pursued with recovery planning if an institution/group could no longer react flexibly to a specific situation.

However, the recovery planning requirements appear in part to be too narrowly defined or too detailed. It would be desirable to have minimum standards which offer the institutions sufficient leeway to develop their own plans tailored to their respective characteristics. Nevertheless, on the basis of Article 6 (3) (c) and (d), it is clear that the contents of the plans as provided for in the RTS instead contain maximum requirements and are primarily directed at institutions which are closely networked with other market participants or provide central services in the financial markets. Accordingly, the proposed principle of proportionality contained in recital 4 also ought to be clearly reflected in Article 1 RTS.

Q03: Please provide your views on the indicators and escalation process as stipulated in the draft RTS under Articles 2 (2) (a) and 5 (c), and on the other governance arrangements provided for in Article 5.

Article 2 (2) (a) (evidently Article 2 (a) is meant here) defines indicators as a set of criteria which determine the point at which an institution should consider and determine which specific recovery options it may need to apply in response to the actual crisis situation that has materialised. According to recital 6, these should not be understood as thresholds which, when overstepped, virtually automatically activate counter-measures laid down in advance, but, rather, the point at which a detailed analysis of the situation of the institution should commence and possible recovery options should be initiated. Under Article 5 (c) (2), the institution is to define the indicators in the plan.

This approach is welcomed. However, in this connection it needs to be taken into account that banks already possess a certain amount of latitude to control regulatory capital ratios or liquidity ratios (e.g. LCR) within the scope of their regular business activities. Furthermore, it must be ensured that an institution is not deemed to be "in need of recovery" as long as the "overstepped" indicators are still at a stage before regulatory authorities need to take early intervention measures or lie below the insolvency threshold. In no event may an institution be deemed to be a "recovery case" solely by virtue of the fact that the instruments provided within the scope of risk management are also provided for in the plan as possible counter-measures.

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Furthermore, recital 9 of the RTS requires banks to test recovery options against specific scenarios. Given that the relevant economic environment in a recovery situation is difficult or virtually impossible to predict, we would see more benefit if generic scenarios were analysed and tested instead of specific scenarios. Generic scenarios would also be more consistent with the definition of "*indicators*" (Article 2 (a)), which requires banks to reassess and determine the reaction to the actual situation.

With respect to the definition of "*material entities*" contained in Article 2 (c) of the draft RTS, it should be made clear that this definition is only meant to be relevant for the purposes of the RTS on the content of recovery plans as set out in Article 2 by "*For the purposes of this Regulation, ...*". However, the definitions provided in Article 2 of this draft RTS should clearly have no impact, reach and/or prejudice on similarly worded definitions used for other regulatory contexts such as ICAAP, for example.

Article 5 (a) (1) and Article 5 (c) (1) (a) stipulate that the "*identification of natural persons*" should be included. However, we have concerns about including the identification (i.e. name and other personal details) of natural persons who have been and/or are involved in recovery planning, and we do not see why this would be required in order to achieve proper governance. In fact, for recovery planning purposes, the role and function of natural persons who are to be involved is the only relevant information that needs to be provided. We therefore propose that the draft provisions be modified so that no personal details of natural persons, but only their role and function, are disclosed.

Q04: Please provide your views on the relationship between the governance arrangements provided for by Article 5 and current risk management process/Governance arrangements such as the Internal Capital Adequacy Assessment Process (ICAAP) and the Internal Liquidity Adequacy Assessment Process (ILAAP).

We are of the opinion that the requirements specified in Article 5 and the risk management processes already practised today (ICAAP, ILAAP) are closely correlated, e.g. with regard to the requirements for an emergency concept or to the management information system. Here, care should be taken in general that reference can, but need not necessarily, be made to existing processes in order, where appropriate, to avoid redundant arrangements for certain circumstances.

We strongly advocate that the governance arrangements provided for by Article 5 of the RTS should not prejudice any organisational structure of a credit institution beyond the scope of recovery planning. In particular, given that the tasks related and connected to recovery planning are not identical with risk management in a strict sense and concern also, inter alia, strategic issues in a broader sense, recovery planning should not be mandatorily and/or automatically classified as an extension of the risk management function in its set-up.

We reject the review of recovery plans within the scope of the audit of annual statements as provided for in the alternative in Article 5 (b) (1) RTS. Both under the FSB key attributes and also under the pending RRD, due preparation of the recovery plan lies within the responsibility of the management. Moreover, according to the RRD, it will be the task of the supervisory authority to examine and assess the recovery plan submitted by the institution. It should form its own opinion on any "shortcomings" of the plan. The creation of a further controlling body is therefore not justified.

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Q05: Please provide your views on the requirements for the description of the institution or group as stipulated by the strategic analysis in the draft RTS under Article 6 (3).

Article 6 (1) requires institutions, among other things, to identify their "*critical functions*". This is likely to be impossible for institutions in many cases; particularly in a cross-border context, it would have to be supported by analyses delivered by macroprudential supervisors. For example, the degree of substitutability of an institution's business lines reflects the institution's role in the market infrastructure, for an assessment of which supervisory support would appear appropriate. For comparability and resource efficiency purposes, "*critical functions*" should be made easier to define by providing sufficiently interpretable guidelines and/or examples in the explanatory notes.

The "*mapping*" of core and systemically important business lines called for under Article 6 (3) (b) should be confined to legal persons and branches upwards of a certain size so as to avoid unnecessarily overloading the recovery plan.

With regard to the "*external connectedness*" referred to in Article 3 (b), it should be noted that what is needed is not a "*description*", but rather the identification of contagion risks. Determining how contagion risks can spread within the financial system is likely to go beyond the scope of a recovery plan, however. For instance, direct contagion effects resulting from interbank loans or credit default insurance are difficult to assess. It should also be questioned whether a description of the main counterparties on the assets side and liabilities side of an institution/group would be helpful, given that these counterparties are constantly changing.

Q06: Please provide your views on the requirements for the recovery options, as stipulated by the strategic analysis in the draft RTS under Article 6 (4). Does this requirement comprehensively and adequately capture the different categories of recovery options that could be considered?

We understand Article 6 (4) of the draft RTS to mean that recovery options to be named in the recovery plan should include measures of an extraordinary nature as well as measures which may also serve or be used as normal or standard risk management measures. However, a clear distinction and allocation of recovery options to either category would not be possible and/or achievable, as the classification of a measure as normal/standard or extraordinary may change over time or in the light of the relative economic environment.

With regard to the "*assessment of the effectiveness of recovery options*" called for under Article 6 (5) (d), it should be noted that credit institutions can provide an abstract description of identified recovery options in regard to particularly crisis-sensitive parameters such as capital ratios, risk-bearing capacity, liquidity and earnings both in the current scenario and in a stress scenario. However, because of uncertain market and competition conditions (e.g. when it comes to the planned sale of an investment), it is difficult to say anything definite in advance about the implementability of identified recovery options in the scenario then actually prevailing. The requirements in this respect should therefore be qualified accordingly. For example, the probability of recovery options being implemented could be indicated in simplified form using a three-step scale (high, medium, low).

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Q07: Please provide your views on the requirements for the communication plan, as stipulated in the draft RTS under Article 7.

The requirements laid down in Article 7 RTS for the elaboration of a "*disclosure plan*" for each option for action ought to be the subject of critical examination. It has always been acknowledged that the recovery of institutions is most likely to be successful when undertaken at the earliest possible stage behind "closed doors" and, where appropriate, with the involvement of a few of the major creditors. On this basis, the instrument of recovery planning applies at an even earlier point in time, while the institution still has enough options in order to manoeuvre itself out of the crisis by its own efforts. Such a recovery can nevertheless only succeed if it is carried out as "noiselessly" as possible. However, there is the risk in the case of credit institutions quoted on the stock exchange that the triggering of a (recovery) indicator and also the decision to implement a recovery option may also entail disclosure duties under the pertinent provisions. Accordingly, from a regulatory perspective, the disclosure duties ought to be appropriately restricted.

It would, furthermore, need to be clarified that in the case of any external communication relating to a specific recovery measure taken, the recovery plan is not to be announced. Otherwise this would thwart due compliance with the obligation for institutions, laid down both in Article 76 RRD and also at national level, to handle recovery planning confidentially.

Q08: Please provide your views on the requirements for preparatory measures, as stipulated in the draft RTS under Article 8, providing in particular your views on the question what types of preparatory arrangements or measures could or should be taken into account in the analysis of the recovery plan.

It is right that an institution should obtain an overview of the options available. However, since the specific circumstances which might make it necessary to take recovery measures can hardly be predicted in detail, an institution/financial group must still be in a position to react flexibly to a given situation, notwithstanding the recovery plan. It is doubtful whether it is actually necessary, as provided for in Article 8 a), to stipulate specific preparatory measures as recovery options. It is up to the individual institution to decide which measures are expedient in this respect.

Q09: Do you agree that some of the costs of preparing recovery plan are already incurred by the requirements of having a proper risk management framework?

We are unable to identify any synergy effects, reflected as profit or loss, between risk management and recovery planning. The two instruments cover different areas. Whilst it is true that, ultimately, data can be generated from risk management for the preparation of the recovery plans, the preparation of the recovery plan nevertheless entails additional expenses. This means that it is all the more important for the risk management processes in place to be made useable to the widest extent possible for the preparation of the plan, so as to avoid unnecessary (duplication of) expenses. This applies, for instance, to the areas of business and risk strategy, risk ratios, scenario observations and emergency plans. For example, the options under Article 8 need not be fundamentally re-drafted, but can be based on existing measures relating to equity capital or liquidity management (e.g. RWA reduction measures for the stabilisation of capital ratios in an economic downturn, emergency plans related to risk-bearing capacity

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or liquidity or the action plans deriving from stress tests). The complexity of the requirements for the implementation and maintenance of recovery and resolution plans would be significantly reduced in this way. Institutions could best profit from the new requirements if the instruments for implementing their requirements could be optimally networked with instruments already existing (e.g. in the area of risk management).

Q10: Could you indicate whether all the main drivers of costs and benefits have been identified? Are there any other costs or benefits missing? If yes, could you specify which ones?

This question cannot be definitively answered at the present time. A considerable cost factor lies in the fact that institutions will need to provide staff capacities on a scale which cannot be currently quantified. Upwards of a certain size of an institution it is, moreover, to be assumed that external support will be required, upon which it is also hardly possible to place a figure at the present time. First findings from those institutions which, at national level, are obliged to prepare recovery plans show that preparation of the plans entails extremely high costs.

Q11: Do you agree that, for an institution, the costs of producing a recovery plan are likely to be proportional to the size/complexity of the firm and so of the cost its failure may create? If not, could you explain why?

Whether the RTS takes adequate account of the principle of proportionality is ultimately also a question in practice of which requirements the national supervisory authorities will stipulate in individual cases for the purpose of implementing the RTS. The RTS contain a high degree of detail. As already explained, the question of whether a plan is to be prepared and, if so, in what scope, should depend on the threat which may emanate from an institution in a crisis situation (in regard to the parameters, see above under General Remarks). The RTS ought therefore to be formulated as minimum standards or basic principles which allow the institutions sufficient leeway to develop plans tailored to their own circumstances.

Q12: Do you agree with our analysis of the impact of the proposals in this CP? If not, can you provide any evidence or data that would explain why you disagree or might further inform our analysis of the likely impact of the proposals?

As soon as the EBA provides a reliable analysis of the possible effects of the RTS for the purpose of consultation, we shall be pleased to give our detailed response.