Polish Bank Association

Warsaw, 7 March 2023

Mr Jose Manuel Campa

Chairperson

European Banking Authority

Dear Mr Chairperson,

The Polish Bank Association (PBA) welcomes the opportunity to contribute to the European Banking Association (EBA) consultation by providing its response to the key aspects of the proposal of guidelines on overall recovery capacity in recovery planning included in the EBA Consultation Paper dated 14 December 2022. Our response is the summary of the response received from the group of Polish commercial banks being members of our Association.

Questions for Consultation

Question 1: Do you have any comments on the general factors to be considered when assessing credibility and feasibility of the recovery options?

As the starting point we would like to express our opinion that the assessment of recovery options' credibility and feasibility is highly dependent on the discretionary interpretation of the person that is assessing the information. This assessment may lead to diverse interpretations and viewpoints; therefore, it is subjective and potentially may create different option, depending the bank preparing the recovery option and competent authority assessing the proposal prepared by bank.

In this context, the assessment of the credibility and feasibility may remain qualitative and institution-specific only, as it befits this kind of assessment that can only be performed while duly considering the

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specific capabilities and organization of every institution. This is the reason why the proposal of a list of credible and feasible recovery option should be openly discussed by the competent authorities with the institution in order to look for the range acceptable both for competent authority and institution.

During the analysis and assessment of recovery options to be used in specific recovery scenarios, the banks use two methods of assessment in line with Regulation 1075, i.e.: the impact assessment (as per Article 10) and feasibility assessment (as per Article 11). The impact assessment involves impact on recovery options and external impact, while the feasibility assessment considers the experience (of executing the recovery option or an equivalent measure), timely execution and impediments (legal, operational, business, reputational or financial ones). Will the draft Guidelines indicate how the assessment of impact should be combined with the assessment of the feasibility to ensure that the best recovery options are selected for a given recovery scenario?

In our opinion the list of general factors is complete. It needs clarification if the same criteria will be used for Overall Recovery Capacity assessment by competent authority. Some recovery options can be assessed as ineffective and resignation from its implementation needs competent authority's acceptance. In this case also it needs clarification if competent authority deciding about ORC adjustment can adjust also the list of implemented recovery options?

<u>Question 2</u>: do you have any comments on the specification of the scenario severity for the purpose of calculating the 'scenario – specific recovery capacity'?

The draft of Guidelines confirms the scope of the scenarios already defined in EBA Guidelines for common procedures and methodologies for the supervisory review and evaluation process (SREP) and supervisory stress testing. We see it as a good option to give additional explanation if scenarios are very severe for the sector and economy, but not for the bank due to high capital adequacy or liquidity. Especially this problem occurs with smaller banks.

<u>Question 3</u>: do you agree with the proposed criteria for the relevant starting point, timeframe in particular (in particular with regard to the 6-month period for the LCR and NSFR) and representative indicators (in particular with regard to the explicit consideration of potential other / substitute indicators – e.g., MREL) for the calculation of the "scenario – specific recovery capacity"?

It is crucial that, whenever the institution adopts additional indicators in stress scenarios, the infringement of such additional indicators shall not be construed as insufficient ORC.

Setting a maximum timeframe for recovering capital and liquidity positions *a-priori* may be difficult solution. Indeed, setting *ex ante* a predefined timeframe may lead to further drag the stress scenario until the predefined timeframe, in case the scenario reaches the NDP in a shorter period, adding further elements to the scenario and going over the reverse logic approach. Vice versa, in case of longer scenarios, the fixed timeframe for the evaluation of ORC could stop before the reaching of the NDP, in particular in case of the 6-months expected for NSFR and LCR. For these reasons, the timeframe for the assessment of the ORC should be more coherently evaluated in accordance with the deployment of the underlying scenario and could vary from different scenarios and different institutions.

However, should the EBA prefer to set predefined timeframes, banks underline that by limiting the timeframe to 6 months for liquidity and 12 months for capital (or putting more emphasis on it), the number of options would be significantly reduced, and subsequently more focus would be placed on short-term solutions, instead of on long-term viability. Options enhancing the longer time viability often require more drastic measures and tend to require a longer throughput time, especially in distressed markets (e.g., reorganisations like divestments). This concern is more prominent in fast moving, system-wide scenarios than in slow moving scenarios, as in the latter actions will already be taken anticipatively upon breaches of early warnings and limits and thus, before entering in recovery.

Our experience concerning the recovery of some Polish banks in the past indicates that this timeframe is too short. We see many examples where the bank recovery has taken more time. The same experience is visible in the bank resolution made by our authority responsible for resolution. The resolution is made in more severe conditions than the bank recovery – for example some options are used in resolutions which are not used in recovery process - and the resolution authority needs more time than 12 months in order to achieve the situation that bank under resolution fulfils all conditions of sound institution and can be sold effectively to new owner. That is the reason for us to recommend that the 6 or 12 month framework is very good timeframe to assess positive impact of implemented recovery plan on bank but it may be difficult to believe that in this timeframe will be enough in order to successfully implement the plan. As it was mentioned above, limiting the plan to 6 or 12 months will also exclude some options which may be successful but in severe macroeconomic conditions it may be difficult to achieved.

Concerning the starting point we have two remarks. Firstly, we fully agree that the starting point should be the breach of any recovery plan indicator, which will force bank to upload recovery plan. We can add that in Poland according to art. 142 of Polish Banking Law, not only liquidity or capital indicators are triggers for recovery plan. The definition is much broader and for example the risk of the breach of

recovery plan indicator or the financial loss in one year can be the starting point for implementation of recovery plan.

Secondly, banks ask the question which moment should be consider as the starting point. Is it the moment when the Red or Orange level of the capital/liquidity indicator has been exceeded?

More, what approach should bank uses for the stress scenario which provides for the deterioration of both capital and liquidity indicators? Also when the leading recovery indicators in these areas are exceeded at a different time, for instance:

Q1 – LCR

Q3 – TCR

Q4 – CET1?

What point in time should then be considered as the starting point? Would it be one of the following options:

1. The common starting point would be the first instance when any of the recovery indicators listed in point 27 is exceeded, for all ORC (calculated for five indicators listed in point 27: CET1, TCR, LR, LCR, NSFR)? In this case, the starting point = Q1.
2. The starting point for the liquidity indicators (LCR, NSRF) would be the first breach in this area – Q1, similarly as for capital indicators (TCR, CET1, LR): the first breach – Q3.
3. The starting point would be fixed separately for each indicator. For an exceeded indicator, the breach occurring at a specific point in time would be the starting point for the ORC for that indicator. For an indicator that has not been exceeded, the starting point would be the first breach in the considered area: LCR – Q1, NSFR – Q1, TCR – Q3, CET1 – Q4, LR – Q3?

What approach should be taken when an indicator from a different area has been exceeded (e.g. a profitability indicator – as we have included in our national law)? Would such a breach have impact on the definition of the starting point? It would be good to include the answer to these question inn final text of guidance or in accompanying document.

Concerning the paragraph including the representation, it has generated some questions and doubts in our banks.

As it was already expressed above in the part concerning the starting point we are afraid that too many indicators have to be followed and that it would be more relevant for the impacts of the scenarios to be quantified on a limited number of indicators and not on an as large number as proposed. In particular, it is difficult to support the inclusion of the Net Stable Funding Ratio (NSFR) in the list of

'relevant RP indicators' because this is not a short-term risk indicator. It is more a structural question that shall be handled at later stage.

It is also difficult to support the inclusion of the Minimum Requirement for Own Funds and Eligible Liabilities (MREL) to the list of 'relevant RP indicators. In our view MREL is treated in similar way as a capital buffer. A temporary breach of the MREL requirement alone can not be always seen as a sign of increased risk or financial weakness that should trigger the activation of the recovery plan. The capital elements of MREL are already captured by existing recovery plan indicators on capital ratio like Total Capital Ratio. The breach of the MREL requirements can be managed by the relevant authority according to the power delivered in the BRR Directive, for example for application of (M-MDA). Upon notification of a breach, the relevant bank is already required to inform the authorities on the actions and timeline to restore the level of MREL eligible resources, including, where relevant, a funding plan.

Additionally, the recovery plan should present nominal values considered in the calculation of relevant indicators (numerator and denominator), so that competent authority could properly analyze and challenge (if necessary) the reported indicator. For that reason, we have some doubts about extending the scope of the document – apart from operational problems, such a change might affect the transparency of presented information. Are banks going to receive a template form to report the required information? Do the above-mentioned recommendations apply to all recovery indicators, or rather to the five indicators recognized in ORC (listed in point 27)? Should banks present detailed calculations at each stage of the documented process (i.e. indicators before the application of measures, impact of measures on the indicators, indicators after the application of measures)?

<u>Question 4</u>: do you have any comments on the general steps to be followed for the determination of the ORC?

Step 1

Banks ask the question: which measures should be recognized in ORC calculations? Should it be the recovery measures stipulated in recovery plans (including measures covered both by the recovery plan and contingency plans) or rather measures included only in contingency plans? In this context, should the measures recognized in ORC calculations enable the exit from the Red (recovery plan) level down to the Orange (contingency plan) level? Or rather, should they enable the exit from Red to Yellow (alert level), if not to Green (no breach of recovery plan measures)?

Step 2

We would like to inform that in Poland banks need the decision of competent authority to exclude option from implementation under particular situation. Base situation is that all options should be implemented. In this situation banks ask the question concerning options which should be analyzed in this step - ones before competent authority decision or ones after its decision?

We would like to express our opinion that the potential constraining factor related to reputational effects is questionable. We are convinced that any effective and credible recovery action will be considered positively. Selling several subsidiaries is part of the constraints and the strategy adopted, yet the likelihood of numerous and massive disposals happening simultaneously is quite remote as, very often, just a few decisive actions are sufficient to cure even quite severe crises.

Reputational risk would result essentially from the crisis situation and the lack of any action made by the bank and the competent authority. The entry in recovery itself and the implementation of recovery actions may well be the visible sign of a crisis situation to the public, but it is the evidence that the situation is well known by the competent authority and it is "manageable" by the authority.
Going to the conclusion, we understand that application of limited options of recovery may generate more increased reputational effects than the application of more option by the bank and competent authority.

Step 3

In this point banks in Poland ask for clarification because the proposed text in not understandable.

Question 5: do you have any comments on the determination of the ORC as a range between the lowest and the highest "scenario – specific recovery capacity" both in terms of capital and liquidity?

Banks ask the question why would ORC calculations need to recognize ORC values from different scenarios, i.e. with completely different input data (arising from unique conditions that shaped the specific scenario). In their opinion, also ORC would apply to various periods of time (because each scenario can have a different starting point).

Question 6: do you have any comments on the scope of the assessment of the "scenario-specific recovery capacity" by the competent authorities?

In our opinion, the ORC should be analysed in relation to the business model and to the diversity of options available, and not only in relation to other institutions. The comparison of the recovery plans

of different banks may not be the best option. Bigger variety may be more successful solution than coping the same options by all banks.

Moreover, banking groups have different business models and different organizational structures, some of which facilitate the implementation of options, while some others render the same type of options less easy to sufficiently implement them. Thus, these characteristics can hardly be taken into account in the calibration of the haircuts, if it is made by reference to a peer group.

We believe that no one is better placed than institutions themselves to determine the 'feasibility' of recovery options, as we also doubt how a peer group/cross-institutional analysis could tell if the implementation of recovery options is feasible. The authorities' assessment should essentially be a consistency and plausibility check.

Some clarification is needed as well concerning if will the draft Guidelines specify in detail the impact of ORC assessment for banks. The second question concerns follow- up. Will the proposed "adjusted ORC" be recommended for implementation in the bank, under the regulatory approval of the Recovery Plan?

Question 7: **do you have any comments on the proposed ORC score?**

It would be good if competent authorities are transparent *vis-à-vis* all quantitative and qualitative adjustments they make in assessing the ORC. In particular, such adjustments should be explicitly disclosed to the institutions with sufficient level of detail in order to be concrete and allow them to understand the *rationale,* while avoiding any misinterpretations.

In case the proposed ORC score would eventually be implemented, the calculation and haircuts underlying the ORC adjustment should be adequately justified on a case-by-case basis, allowing banks to properly understand the haircuts applied or to replicate the calculations.

This calibration should not rely on an ORC comparison between banking groups because there will most likely still be significant yet justified variations across banks. The variety, substitutability, and extent of the recovery options by category, type of business, geographic dispersion are key elements in the appreciation of the capacity of a given banking group to recover from a deep crisis. As such, it should be also taken into account by the ORC score.

Concerning the Assessment of ORC and the application of result banks ask questions if the competent authority will calculate the "adjusted ORC" and provide the result to the bank or will the bank receive guidelines on how to adjust ORC calculations on its own?

In area of ORC score banks do not fully understand the criteria for assigning the "adjusted ORC" rating. It would be reasonable to explain them in more detail. For instance, the "satisfactory" rating is assigned when the measures recognized in "adjusted ORC" ensure that the bank's relevant recovery indicators stay above the limits set in line with "Recovery Indicator Guidelines". Does the above-mentioned limit mean the Red level set as the sum of the regulatory limit and the additional room? Another question concerns 'Adequate with potential room for improvement' rating. Is it assigned when – after the application of "adjusted ORC" measures – the Bank's recovery ratios would not exceed the Red level (in line with "Recovery Indicator Guidelines") but they should still be equal to or higher than regulatory requirements for capital indicators (such as gearing and liquidity ratios), as referred to in section 21, including all applicable regulatory buffers? Does it mean that the indicator would be below the Red level, but still above the regulatory limit? For example: LCR at 102% (vs. the regulatory limit set at 100% and the Bank's Red limit set at 105%)? If such LCR fell below the minimum regulatory limit (100%), would it be assigned a "Weak" rating?

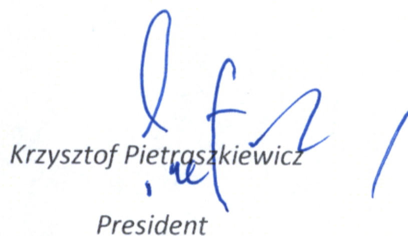
<u>Question 8</u>: do you have any comments on the possibility to identify areas of improvement or material deficiencies related to the competent authorities' assessment of the ORC?

The suggested standardisation might lead to increased complexity, delivering incomparable outcomes derived from individual scenarios of breached individual recovery indicators different from bank to bank. We believe that standardisation of the supervisory assessment approach is welcome, though such assessment should remain a case-by-case exercise particularly for large banking groups. In particular, the initial situation of the institution and the severity of scenarios that potentially affect the ability to recover, given the extremely deteriorated environment in which the institution would theoretically operate, should be taken into account, as well as the number, variety, and availability of recovery options.

I would like to thank for the possibility to comment the draft of the guidance and I hope the comments and questions delivered in our letter will be useful for preparation of final guidelines for banks and the competent authorities. I am convinced that the best result can be achieved in the close cooperation

between banks and competent authorities because in these specific circumstances the options have to be feasible, well prepared and adequately implemented in order to maintain the stability and reputation of banking sector and the bank in trouble.

Yours sincerely,



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