The voice of banking
& financial services

Recovery and Resolution Planning: *Making the Key Attributes Requirements Operational*

A response by the British Bankers' Association

Introduction

The British Bankers' Association ("BBA") is the leading association for UK banking and financial services representing members on the full range of UK and international banking issues. It has more than 200 banking members that are active in the UK, which are headquartered in 50 countries and have operations in 180 countries worldwide. All the major banking groups in the UK are members of our association as are large international EU banks, US and Canadian banks operating in the UK and a range of other banks from the Middle East, Africa, South America and Asia, including China, In The integrated nature of banking means that our members are engaged in activities ranging widely across the financial spectrum from deposit taking and other more conventional forms of retail and commercial banking to products and services as diverse as trade and project finance, primary and secondary securities trading, insurance, investment banking and wealth management. Twenty eight of the banks classified as G-SIFIs are BBA members and so are impacted by the FSB's consultation on operationalising key elements of recovery and resolution planning[1] to which the BBA is pleased to respond.

Guidance on Recovery Triggers and Stress Scenarios (Annex 1)

1. Does Annex 1 appropriately identify key emerging practices regarding recovery triggers and stress scenarios? What additional triggers of an institution-specific or general nature may be useful?

We support the FSB's general approach to the activation of recovery plans and stress testing and in particular the emphasis on the institution itself being responsible for the design of a small range of stress scenarios against to inform recovery planning. We do not support regulator defined stress tests as they may not result in banks examining the particular points of failure to which they are susceptible although recognise that there may be merit in the FSB coming up with a consistent set of realistic, but not over conservative, assumptions, for instance about oil prices or short term interest rates, to ensure that banks' individual scenarios are being run based on a common set of inputs.

This confirms our view of recovery planning as being the domain of the management of the institution itself, but with increasing degrees of interaction with the supervisor and as the situation worsens, with the resolution authority. Until the point of non-viability is reached management should be making the decision about how to run their business in the interests of all of the institutions stakeholders. The range of market based metrics described in Annex 1 is comprehensive and support the proposition that they should be aligned with the institutions risk appetite. Additional institution-specific metrics should only be included on a case-by-case basis.

However we are not comfortable with the use of the word 'triggers' which implies a degree of automaticity. Our view is that the triggers should be an indicator that a bank has crossed a boundary to a different weaker position and that management should be on a heightened level of readiness to

[1] http://www.financialstabilityboard.org/publications/r_121102.pdf

take action in an escalated way. The governance process should explain how an escalation plan would be invoked were the emerging stress to be judged significant enough by the Board.

In the sensitive process of ensuring a g-SIFI does not tip into resolution there will always be an element of informed judgement required. For this reason in the rest of our response to this consultation we have used the word 'metric' in place of the word trigger, to emphasise this important distinction, although such metrics could still act as 'review points'.

Additional metrics of a general nature such as the Liquidity Coverage Ratio and the leverage ratio could also be considered as prompts to management to heightened engagement with emerging stresses.

2. Are there certain quantitative recovery triggers that are likely to be more effective than others across different types of financial institutions?

The use and value of quantitative metrics in recovering planning will vary by type of institution and the contextual circumstances. We are sure that GSIFI managers will be reviewing the set of metrics they use regularly to ensure they remain fit for purpose, but that they should have as their foundation the regulating drivers to which the institution is subject and which should be the subject of regular discussion between the institution and its supervisor.

Quantitative indicators that indicate the ability of the institution to tap the capital and funding markets, such as credit rating, senior credit and credit default swap spreads and performance of the institution's CETI in the seconding markets are likely to be these of most use in recovery planning.

3. What kind of qualitative recovery triggers are likely to be most helpful to decision makers within the banking group?

Other qualitative metrics that could be considered might include equity price movements, underlying depositor behaviour, increasing rejection of the bank's name in the broker market, likely public announcements with negative implications or other reputational or operational events, particularly in relation to a subsidiary that as a consequence risks sending the whole institution or group unto resolution unless a recovery plan is out in place.

4. How can financial institutions achieve the goal of early and effective internal triggers, while avoiding negative market reaction to recovery actions taken?

It is important that the recovery plan and its trigger framework enable the G-SIFI to identify the need to take action before the market does. The metric escalation governance and escalation process must also be supported by a realistic communication plan that seeks to avoid unhelpful reputational impacts in the markets that may exacerbate the situation, and that remedial action is implemented fully and without delay.

It is absolutely vital however that the recovery programme and its associated metrics should be treated as highly confidential by all those party to the information therein and that neither the bank nor any of the authorities with access to it should disclose it in any way.

5. Are there certain triggers that are more suitable as early warning indicators for pre-emptive recovery actions versus trigger events that are more suitable for particular recovery actions?

Pre-emptive action should be distinguished from the execution of recovery actions and is all part of good risk management.

Pre-emptive actions should reduce the likelihood that the G-SIFI may need to execute its recovery plan by, for example, reducing exposures to certain risks or asset classes in advance.
Pre-emptive action should be determined based on the G-SIFI's existing BaU monitoring of early warning indicators and risk metrics within the context of its risk appetite framework, and the performance of its stress testing and reverse stress testing processes.

6. Are there any other issues in relation to the implementation of the Key Attributes requirements for recovery planning that it would be helpful for the FSB to clarify in further guidance?

There is no need for further guidance or clarification at this stage although as recovery planning practice develops and experience is gained there may be the opportunity for further dialogue between institutions, their regulators and the FSB.

Guidance on Developing Resolution Strategies and Operational Resolution Plans (Annex 2)

7. Does Annex 2 adequately capture the key elements of a resolution strategy and operational resolution plan? If not, what aspects are missing or need to be changed?

Annex 2 identifies and addresses the key elements of resolution strategy and operational resolution planning and we support the assertion that these two documents must be maintained as living documents in particular identifying changes in relationships with third party service providers or essential services provided by, for instance, payments systems.

We also believe that an overall strategy for provision of liquidity in resolution is a particularly important element. In addition, we believe a clear timeline and process plan is needed to set out the detailed activities required to operationalise the plan.

8. What are potential obstacles to the effective implementation of either the 'multiple point of entry' (MPE) or 'single point of entry' (SPE) approaches that could arise from national legal frameworks (e.g., insolvency law)? How could they be addressed?

Annex 2 is very welcome as it seeks to identify a *modus operandii* for either the SPE or MPE approach based on COAGs. We firmly believe however that the efficacy of resolution, using either methodology will be as dependent on the relationships built up in Crisis Management Groups (CMG) as on the application of a methodology.

We note that the Annex introduces the possibility of a hybrid SPE/MPE approach which we would see as overly complicating and which could anyway be viewed as an MPE as there would be more than one resolution approach being invoked.

9. What are the implications of the MPE and SPE approaches for the way financial institutions are structured, and what are the likely benefits and costs of any consequential changes in structure?

Home and host supervisors should do all in their power to agree that either an SPE or MPE resolution strategy would be deployed in the event of resolution. This will enable better planning by both the G-SIFI and the authorities whilst recognising the need to maintain the flexibility needed to respond to changing circumstances.

Such decisions may also impact corporate structure or the provision of parental guarantees to support debt issued by local subsidiaries. For instance a holding or top level operating company which sits above all branches and subsidiaries which in turn benefit from the down streaming of debt issued at the group holding company level may bring diversification benefits in normal times and make resolution more straightforward, as it would only be applied by one resolution authority. A concomitant requirement however would be a greater degree of trust and understanding between home and host authorities.

Contrastingly a MPE approach would be a pragmatic response to the legal structure of many G-SIFIs which operate in different jurisdictions by way of locally established subsidiaries, rather than branches.

Deploying an MPE approach, ideally simultaneously as the Annex notes, will still place a strong burden on the home state regulator as it attempts to hold the ring. Whilst recognising that an MPE approach is more likely for many G-SIFIs BBA members are concerned that despite an internationally coherent approach there is an increasing trend for local or regional initiatives to be designed and implemented with the objective of protecting individual jurisdictions from the risks and costs of financial crisis. The adoption of an MPE approach could risk the creation of sub-optimally fragmented pools of capital and liquidity, which will impair the group wide operating model of G-SIFI which should again be able to contribute to optimising the pricing and distribution of investment capital and to playing their part once again in facilitating the free flow of capital within the context of a stable global financial system. This should be avoided.

10. Does the Guidance adequately draw out the key commonalities and differences between the MPE and SPE approaches to resolution?

Yes the annex very effectively identifies the commonalities and differences between SPE and MPE approaches to resolution and many members are already familiar with the information that they require as a result of the work they already been have been doing with a number of resolution authorities. As soon as the CMG, in conjunction with the G-SIFI, have identified the most likely approach to be taken, institutions that are not already doing so will be able to prepare and present the required information about group structures, location of capital and loss absorbing capacity and interdependencies.

The amount of work required to present this information in a useable way to resolution authorities should not be under-estimated which is why it is important to all participants in a potential resolution that the fundamental, presumptive approach, SPE or MPE is identified clearly and is not changed without very good reason.

We do think however that the preconditions for an SPE approach could be elaborated somewhat to mirror the very helpful MPE indicators. For instance it may be that an SPE approach would be indicated where:

- There is a centralised corporate governance approach established at eth top of the G-SIFI with a global control infrastructure
- Intra-group funding is provided on market terms, supported by capital market-like covenants so it of a predominantly arms-length nature
- There is a preponderance of shared operational services between critical functions with strong global support of those support services, rather than an independent infrastructure for each critical function.

11. Does the Guidance adequately accommodate the needs and perspectives of host authorities that are not members of the CMGs for G-SIFIs, especially in those jurisdictions where a G-SIFI may be systemic?

Yes. It is important that non-CMG host authorities are kept informed of the resolution strategy that a CMG would deploy in a way that reassures them that the impact of a particular approach would not be deleterious to them or their economies. Open communication will be a key element in this process but should be sufficiently bounded to ensure that the views of such hosts are given appropriate sway without their being able to undermine the CMG's approach, unless this is based on an error of understanding about the role of a particular G-SIFI in that host country's economy.

12. Are there any additional issues in relation to the development of resolution strategies and plans that it would be helpful for the FSB to clarify in further guidance?

No, we have not identified any as a result of our consideration of annex 2 but do expect other issues to emerge as both G-SIFIs and the authorities gain more experience of resolution planning for large, complex, internationally active groups.

In particular we support the FSB's encouragement of cross-border cooperation amongst resolution authorities. We would strongly support measures that would prevent a host resolution authority from taking own initiative actions without prior consultation, even where it believes that the home resolution authority may act in a way that would not promote the host state's financial stability. We strongly believe that host states should only take action where they have consulted with the home resolution authority so that a group wide resolution strategy can be implemented, avoiding the initiation of separate resolution proceedings for branches in host states. To this end we have concerns with FSB Key Attribute 7.3 which recommends that host resolution authorities should have ultimate resolution power over branches of foreign banks and we would appreciate confirmation from the FSB that it still believes that this should remain the case.

Our members would find it helpful for the information that would be needed immediately by a resolution authority to be identified clearly in advance in order that GSIFI understands what is required of them and can plan in advance to be able to provide it.

Guidance on Identification of Critical Functions and Critical Shared Services (Annex 3)

13. Is the two-part definition of ‘critical’ and the distinction between ‘critical functions’ and ‘critical shared services’ a useful taxonomy?

We support this two-part definition as taking forward the debate on criticality. Heretofore our feeling is that some resolution authorities had sought to add to the number and type of critical functions resulting in the need for G-SIFIs to present enormous amounts of both static and dynamic data. In our experience the greater the amount of data that is required in the first place the harder it is to extract and understand the information it is conveying and in order to make good, executable resolution decisions.

14. Is the framework for determining ‘critical functions’ appropriate? If not, what aspects are missing or need to be changed?

Yes we believe it is helpful, although the three-step process seems to somewhat academically focused in its approach. Our view is that critical functions will be self evident, so we would resist a full scale microeconomic analysis which we do not believe would be necessary and which our members would not wish to fund. There will inevitably be a degree of difference of business, organisational and service models between different G-SIFIs and this should be recognised.

15. Do the five broad categories of activities outlined in the Appendix - that is, deposit taking, lending, payments, clearing and settlement, wholesale activities and capital market activities - cover all relevant and potentially critical G-SIFI activities? What additional categories of activities should be added?

Yes we think that the five categories are suitably broad and cover critical G-SIFI activities, capturing the important functions that banks fulfill for society. We would resist the addition of further categories which, unless a strong case is made, would require the further provision of data by our members and analysis by the authorities with perhaps little if any increase in the ability to resolve G-SIFIs effectively.

We do however we suggest splitting the ‘payments, clearing and settlement’ category as it seems to encompass too broad a range of activities.

16. Is the framework flexible enough to cover the different types of business undertaken by G-SIFIs?

Yes we believe the categories are suitably flexible to capture the range of business models deployed by G-SIFIs and commend the FSB for the approach it has taken.

17. Is the framework flexible enough to take account of the external environment in which failure is occurring, for example, an idiosyncratic event or in the context of more severe distress in the financial system?

Yes although as we note above an overly academically robust analysis of criticality may slow down the ability of resolution authorities to react to changing external circumstances. There is a need to balance rigor (and the costs it implies to both resolution authorities and banks) with practicality to produce an analysis that is fit for purpose but not over engineered.

18. Is the definition and framework for determining ‘critical shared services’ appropriate? If not, what aspects are missing or need to be changed?

Yes we believe it is appropriate although, as mentioned before, as the authorities and G-SIFIs work together to identify areas of criticality within their businesses further elucidation may be required.

But we suggest an amendment be made to 3.1 definition that states “for one or more business units or legal entities of the group” to replace this with “for one or more critical functions, business units or legal entities of the group”. We believe it is important to recognise the critical shared services that are often provided to one or more critical functions in resolution planning.

19. Are there any other issues in relation to the identification of critical functions and critical shared services that it would be helpful for the FSB to clarify in further guidance?

No.

BBA responsible executive

Simon Hills
+44 (0)207 216 8861
simon.hills@bba.org.uk