



PLAYBOOKS AND DRY RUNS

MAKING BANK RECOVERY PLANS MORE OPERATIONAL

FEBRUARY 2019

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BDO: PROFILE AND POSITIONING

BDO is one of the world's leading auditing and consulting firms.

We are an entrepreneurial network and a professional partner for regional companies and global groups alike.

We aim to provide auditing and consulting services and support of the highest quality. We act with foresight, create added value and proactively approach our clients.

BDO FINANCIAL SERVICES

BDO's strategy is ambitious: To further expand its strong market position in the financial services industry.

Today, BDO's industry specialists provide consulting and auditing services to leading banks, investment managers and insurance companies.

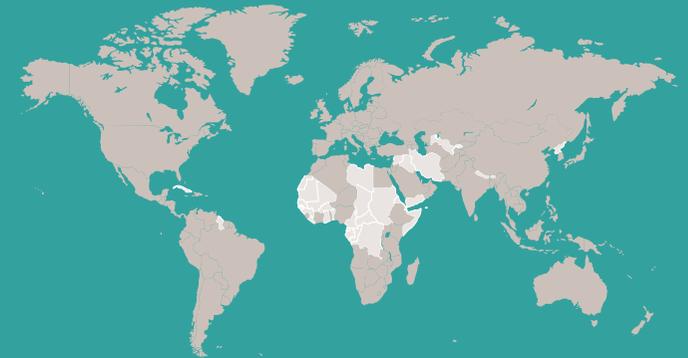
More than 1,000 employees focus on financial services, including auditors, tax consultants, lawyers and other specialists, for example in the fields of compliance, IT, M&A and business valuation.

High quality, strong motivation and independence serve as a benchmark for everything we do.

BDO INTERNATIONAL

US \$ 9.0 billion
2018 REVENUE

162 Countries
1,600 offices
80,087 Staff



MAKING LARGE AND COMPLEX RECOVERY PLANS MORE OPERATIONAL

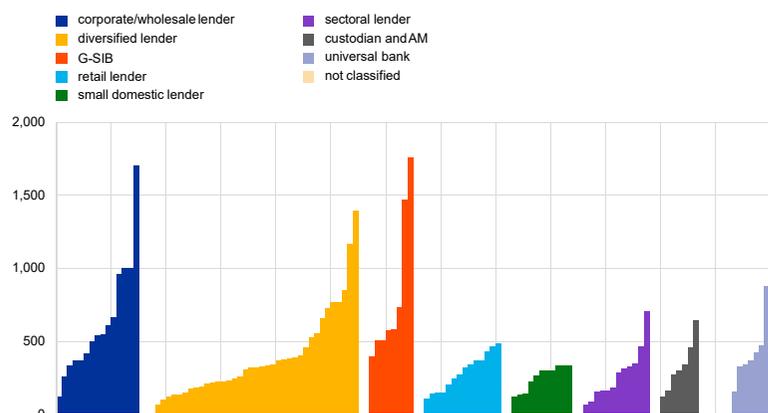
Following three cycles of recovery plan assessments since the Single Supervisory Mechanism (SSM) was established, the European Central Bank (ECB) performed comprehensive benchmarking analyses in order to identify lessons learned and best practices. In a 'Report on Recovery Plans' published on 3 July 2018, the ECB presented its findings, which are highly relevant to significant institutions (SIs). Based on the findings of the report, the ECB's Joint Supervisory Teams submitted **bank-specific feedback letters** to SIs requesting the improvement of the recovery plan's usability thus making them **more operational**.

Recovery plans are useful tools that an institution can employ in order to overcome stress situations, but only if they are properly designed. According to the 2018 ECB

report, the complexity and length of the recovery plans are likely to affect the ability to implement recovery plans quickly and effectively in the event that a stress situation occurs. Therefore, the ECB concludes that the usability of complex recovery plans should be improved. In order to ensure that institutions are able to make appropriate decisions in situations of severe stress, the ECB has identified '**playbooks**' and '**dry runs**' as best practices.

Recovery planning continues to be a key concern for the banking industry as well as for supervisors. While the playbooks and dry runs that were developed under the umbrella of the SSM methodology are applicable only to SIs, they may, according to the principle of proportionality, also become relevant to less significant institutions (LSIs).

Size of recovery plans (in number of pages)



Source: ECB, Report on Recovery Plans

RECOVERY PLANNING – AN ELEMENT OF THE EU BANKING UNION

The regulatory requirements on recovery planning are set out in the Banking Recovery and Resolution Directive (BRRD), complemented with both the relevant technical standards in the form of the EU's Commission Delegated Regulation and Guidelines by the European Banking Authority (EBA). The BRRD is applicable EU-wide, but the SSM, together with the Single Resolution Board (SRB), act as the institutional 'pillars' in the Banking Union and are in charge of how BRRD is applied to SIs in recovery as well as resolution.

THE SIZE AND COMPLEXITY OF SUBMITTED RECOVERY PLANS

- ▶ According to the ECB, the lack of usability of some recovery plans can be related to their size, their complexity or the fact that the information is sometimes scattered throughout the document.
- ▶ This may create a challenge for the institution's management to take swift decisions, especially under time pressure.
- ▶ The sheer size of some recovery plans suggests that some plans may be too large to be used in an actual crisis. Based on the data from the standardised reporting templates submitted in 2016, the pages in some plans exceed 1,500 (see graph).
- ▶ In addition, inadequate integration of the recovery plan processes within the institution's organisation may further undermine the usability of the recovery plan.

OVERVIEW OF ASPECTS PRESENTED IN THE ECB'S 'REPORT ON RECOVERY PLANS'

- ▶ **Recovery options:** The ECB has observed that not all SIs adequately comply with the requirements of the BRRD and the relevant Commission Delegated Regulation. The report presents possible improvements to recovery options, including impact and feasibility assessments.
- ▶ **Overall recovery capacity (ORC):** According to the ECB, SIs tend to overstate their ORC. Possible elements that SIs could consider when estimating their ORC are included in the report.
- ▶ **Recovery indicators:** ECB's observation has shown that not all SIs comply with the EBA Guidelines on recovery plan indicators (see the box on the page after next). The report presents examples of good practice, where SIs could select their set of recovery indicators and calibrate capital and liquidity indicators.
- ▶ **Making recovery plans operational:** The report presents best practices for making recovery plans more operational: playbooks and dry runs.

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By highlighting the size of submitted recovery plans, the ECB demonstrates its willingness to shift away from treating recovery planning as a compliance exercise to more practical guidelines, which can be incorporated into the SI's risk management. The **playbook**, also described as a **concise implementation guide**, shall include steps of business process workflows. Multiple visual format examples are included in the ECB report.

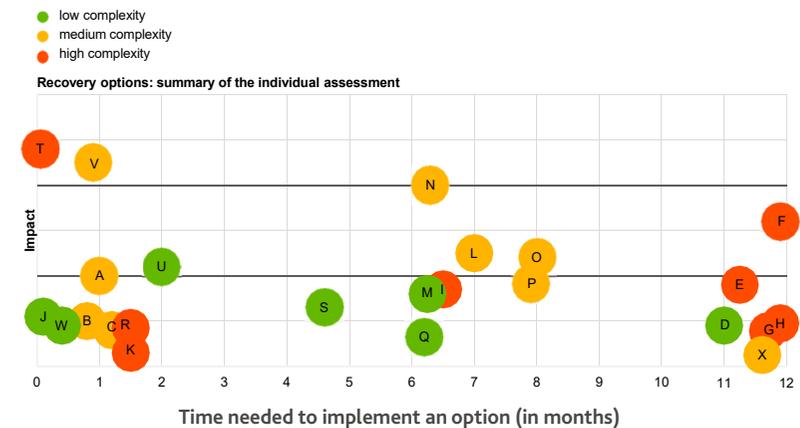
Both the playbook and the recovery plan are to be maintained in a **continuous fashion** with sufficient accessibility and clarity for stakeholders and supervisors.

“The plan and specific options within the plan [shall be] reasonably likely to be implemented quickly and effectively in situations of financial stress and avoiding to the maximum extent possible any significant adverse effect on the financial system, including in scenarios which would lead other institutions to implement recovery plans within the same period.”

Article 6(2)(b) BRRD

	Aspects as indicative of good playbooks	Description
1	Clear crisis management governance	Roles, escalation procedures and reaction timelines should be presented in the playbook. For instance, this could be illustrated by flowcharts accompanied by deadlines.
2	Swift and effective decision-making processes	Clearly defined decision-making processes to ensure that decisions can be taken swiftly and effectively during a crisis. Key elements may include: <ul style="list-style-type: none"> ▶ Standard agenda points for the first meeting of the management board in 'crisis mode'. ▶ Standard agenda items for follow-up meetings of the management board if a decision was not or could not be taken in the first meeting. ▶ A summary table for each of the main recovery options: (i) the impact on capital and liquidity, (ii) the expected implementation timeline and (iii) the likely success rate in a stress situation (see adjacent graph with an illustrative example of the selection criteria for recovery options).
3	Key information about the relevant stakeholders	A key contact list including names, functions and contact details for relevant stakeholders. This list may include the staff supporting the management board in managing the crisis, the board members of subsidiaries and the supervisors.
4	Communication	Communication elements in order to ensure that critical communication requirements and strategies are identified, with special focus on immediate requirements that may run in parallel to the information-gathering and decision-making processes (e.g. social media). Internal and external stakeholders, who are relevant from a communications perspective should also be identified. Furthermore, guidance on potential information disclosure requirements should be provided.
5	Quick reference to the recovery plan	An overview of the building blocks of the recovery plan and links to where crucial information in the recovery plan can be found should be included.

Illustrative example of the selection criteria for recovery options (A to X)



Source: ECB, Report on Recovery Plans

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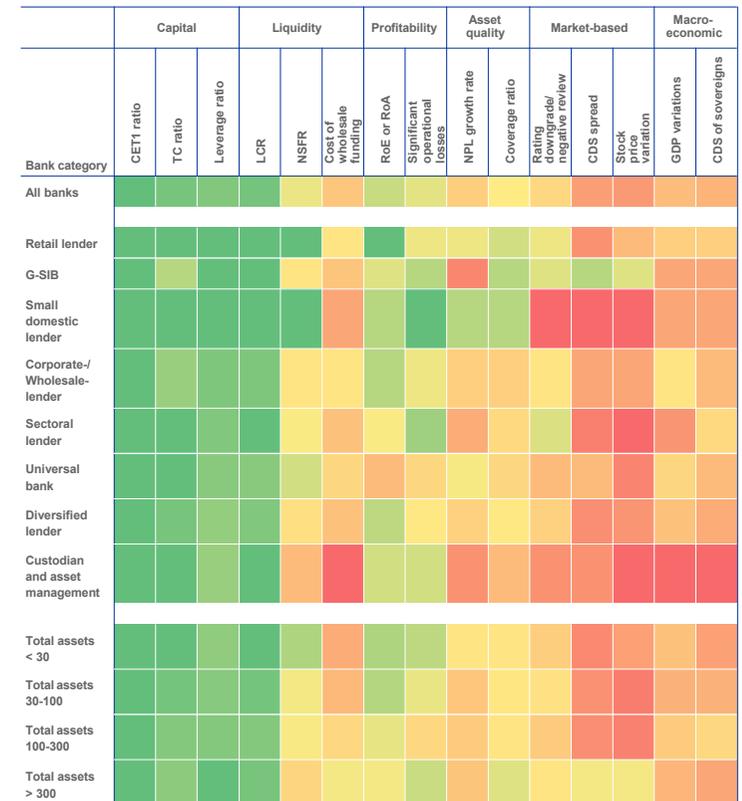
In keeping with existing EU rules and good practice on business continuity management, the ECB report suggests that SIs, in addition to creating and maintaining a playbook (see previous page), undertake **dry runs** where parts of the recovery plan are tested.

A dry run is a **'live' simulation** exercise where the SI tests key parts of its recovery plan under crisis conditions. Its objective is to test whether the selected part(s) of the recovery plan could be implemented in a crisis situation, to train staff and to identify areas for improvement.

	Best practice principles	Description
1	Clear ownership	Dry runs require the support and active participation of the institution's management body.
2	Defined scope and objective	A dry run's scope and objective should be clearly defined and communicated in advance to the management body. It is recommended that an initial dry run's scope should not be too broad, e.g. only containing a test on whether the escalation or decision-making procedures work effectively.
3	Proper preparation	Adequate preparation ensures that the assumptions underpinning the dry run's simulation are sufficiently detailed. The preparation itself will most likely require input from specialists in each business area.
4	Prior awareness and clear communication	Communication aspects are essential in order to avoid rumours that could cause market reactions. Everyone involved in a dry run should be informed in advance. If a real-life scenario includes notifying the competent authority of an indicator being breached (see adjacent graph), this communication should be tested as well.
5	Realistic, stressed timelines during the exercise	In order to create a realistic test environment, it is important to set realistic and stressed timelines that fit the scope of the dry run.
6	Independent observers	Independent observers should be present during the dry run to make the assessment of the outcome more objective.
7	Timely follow-up	Institutions should initiate specific follow-up actions to address any deficiencies identified by the dry run and incorporate the related improvements into their updated recovery plans.
8	Time allowed for integration into the regular update process	In the decision-making of when the dry run will take place, the time needed to incorporate the findings from the dry run into the regular recovery plan update process should be considered.
9	Regular recurrence	Dry runs should be carried out on a regular basis, e.g. annually. Institutions may define a road map for the topics of future dry runs.
10	Timely communication of the outcome to the supervisor	The supervisor should be informed of the outcome of the dry run. The key information should be included in the recovery plan itself, e.g. in the form of a concise appendix.

Recovery indicator framework

- ▶ An institution's recovery indicator framework should be in line with its business model, strategy, risk profile, size and complexity. According to the EBA Guidelines (EBA-GL-2015-02), a minimum of 15 indicators should be applied, of which ten are part of the four mandatory categories that banks are expected to use, unless they can justify that an indicator would not be of relevance to them or could be replaced by an indicator of higher relevance.
- ▶ Based on the recovery plan data from the standardised reporting templates submitted by SIs in 2017, the ECB prepared a 'heatmap', with dark green indicating full usage by all banks in the category and dark red indicating no usage. Other colours indicate various intermediate levels of usage (see graph below).



Source: ECB, Report on Recovery Plans

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- ▶ The BDO Financial Services teams across member firms have a strong understanding of recovery planning and bank resolution. We support a broad range of (European and non-European) significant and non-significant institutions as well as relevant supervisory and resolution authorities.
- ▶ Our services in relation to **recovery plans** encompass:
 - Preparing recovery plans and regular recovery plan update processes;
 - Advising the preparation of recovery playbooks, ensuring that all aspects of 'good practice' are considered;
 - Advising the preparation and performance of dry runs, including the role of an independent observer and ensuring that best practices are met;
 - Advising on responses to the supervisor.
- ▶ The services related to **resolutions** include:
 - Assisting institutions on the preparation of information for resolution authorities;
 - Assisting relevant stakeholders on their decision-making;
 - Assessing and challenging resolution options, based on our deep expertise of distressed portfolios in various asset classes;
 - Regular or ad-hoc monitoring of the development of implemented asset management vehicles ('bad banks').
- ▶ Further services of our **restructuring & special situations** advisory include:
 - Advising on options with regard to distressed assets and portfolios, including disposals;
 - Preparing fairness opinions, business valuations and valuations of financial and non-financial assets, including performing and non-performing loans (single ticket and portfolios);
 - Advising in relation to State Aid (including 'Private Investor Tests');
 - Assisting programme management and supporting project office functions.

“Going forward, the ECB’s main focus when assessing recovery plans will be on ensuring that they can fulfil their purpose of enhancing the resilience of banks. Having operational and effective recovery plans in place is crucial for enhancing the European crisis management framework and, thus, is a priority for supervisors.”

ECB, Report on Recovery Plans, 3 July 2018

FOR MORE INFORMATION ON **RECOVERY PLANS** CONTACT OUR GLOBAL FS CORPORATE FINANCE (CFFS) TEAM

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