Freshfields Bruckhaus Deringer

Consultation 12/2012 Draft of Minimum Requirements for the Design of Recovery Plans[1]

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[1] Convenience translation of the German consultation document published by the Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin.

A. Preface

1. This circular provides a flexible, practical framework based on Sec. 25a (1) of the German Banking Act (*Kreditwesengesetz*) for the design of recovery plans by credit institutions that have been identified by the Supervisory Authority as being in Germany systemically relevant.	
2. In October 2011, the Financial Stability Board (“FSB”) issued the “Key Attributes of Effective Resolution Regimes for Financial Institutions" (“FSB Key Attributes”), which the G-20 heads of government and heads of state affirmed as an international standard at their summit in Cannes on November 4, 2011. The objective of the FSB Key Attributes is to allow for the resolution of global financial institutions that are “too big to fail” in an orderly manner without the loss of taxpayers' money, and thus to counter this problem effectively while maintaining stability within the system. A primary method for accomplishing this, among others, consists of designing recovery plans. The requirements set out in this circular for recovery plans are based on the requirements stipulated in the FSB Key Attributes.	

B. Objectives of the Recovery Plan

1. The purpose of the recovery plan is to serve as preparation for coping with crisis situations. The objective of drawing up the recovery plan is to allow the credit institution to identify and review suitable potential courses of action that will strengthen the credit institution’s resilience in future crisis situations.	
2. In the recovery plan, the credit institution describes the potential courses of action that it may take during adverse scenarios in order to ensure or restore financial health and therefore viability without the loss of taxpayers’ money.	Financial health can be ensured or restored, among other things, by improving the institution’s capital situation, risk capacity, liquidity situation, earning power, and/or by reducing risks.

C. Scope of Application

1. The requirements set out in the circular are to be complied with by every systemically relevant credit institution in Germany. The entity under obligation pursuant to this circular is always the superordinate credit institution (hereinafter also “credit institution”). All requirements are to be complied with also with respect to the group of institutions as a whole.	Systemically relevant credit institutions in Germany are identified by the Supervisory Authority.
2. The superordinate credit institution shall prepare a recovery plan for the entire group of institutions that also takes into account key group companies and branches (“group recovery plan”).	In particular, key group companies and branches within the meaning of this circular are those • that make a substantial contribution to the group’s income statement or to refinancing, hold significant shares of the assets or the capital, or are involved in or process key business activities (as defined below in D. II. 2 a) • that undertake key administrative functions • that undertake key risk functions • that could present a danger to the viability of the group in the event of a crisis • that cannot be disposed of, or that cannot be liquidated without triggering a significant risk to the group as a whole, or • that are systemically relevant or potentially endanger the system within their jurisdiction
3. Where the credit institution is a subsidiary of a foreign credit institution and the foreign credit institution prepares a group recovery plan, the recovery plan by the German subsidiary should dovetail consistently with the group recovery plan produced by the foreign credit institution.	The German subsidiary’s recovery plan is viewed as dovetailing consistently with the foreign credit institution’s group recovery plan when the two recovery plans do not contradict one another.

	This is the case in particular where the structure as well as the assumptions and potential courses of action underlying the recovery plans are compatible with one another.
4. The design of the recovery plan depends on the size, complexity, and interconnectedness of the credit institution or the group of institutions as well as on the nature, scope, and complexity of the business model and the resultant, accompanying risk (principle of proportionality).	

D. Overall Responsibility of Management and Internal Process

1. Irrespective of any internal arrangements concerning areas of responsibility, all managing directors within the meaning of Sec. 1 (2) of the German Banking Act (*Geschäftsleiter*) are responsible for the preparation, implementation, and updating of the recovery plan as well as for its execution during crisis situations. The managing directors of the superordinate credit institution in a group of institutions are responsible for the preparation, implementation, and updating of a group recovery plan as well as for its execution during crisis situations.	"Implementation" refers to the integration of the contents of the recovery plan into the business processes as well as the credit institution's risk management and risk controlling processes. This also includes the monitoring of the recovery indicators and the anchoring of the escalation process (D 3.3).
2. The credit institution shall stipulate responsibilities and an internal process for the preparation, implementation, and updating of the recovery plan as well as for its execution during crisis situations, and shall maintain for this purpose adequate human resources as well as technical and organizational resources pursuant to section 7.2 of the General Part (*AT*) of the Minimum Requirements for Risk Management (*MaRisk*). This is to include all of the necessary organizational units, in particular management, the committees that play a significant role in the assessment of the risks of the bank as a whole, the relevant business units and, within the limits of their duties, the units responsible for treasury, risk controlling, compliance, and internal audits.	

The information required for execution during crisis situations is to be kept available at all times. The Supervisory Authority reserves the right to make standardized inquiries with the credit institution regarding the relevant information.	The information described is also required by the Supervisory Authority so as to stay informed during crisis situations.
3. The credit institution shall review and update the recovery plan annually. Furthermore, an update is to be performed immediately if events arise where the assumptions underlying the recovery plan change substantially.	
4. The credit institution shall have the recovery plan audited and evaluated annually by the auditor of the annual financial statements.	

E. Elements of the Recovery Plan

1. Summary

The recovery plan shall contain a summary that includes the following content at minimum: a. Key findings/results of the recovery plan b. Changes since the last update, and c. Organizational and procedural adjustments required for the feasibility of the recovery plan, including a timeline	With regard to the changes since the last update, the following should be addressed in particular: • Purchases/sales of significant business units or companies • Significant changes in internal and external interconnectedness • Changes to the adverse scenarios and underlying premises • Changes in potential courses of action • Obstacles overcome/newly added obstacles

2. Strategic Analysis	
The strategic analysis shall include a depiction of the corporate structure, the business activities, and the interconnectedness of the credit institution and the group of institutions.	One of the purposes of the strategic analysis is the evaluation of the feasibility of the general and specific courses of action in the recovery plan. The other is to lay the groundwork for the preparation of the resolution plan by the resolution authorities.

2.1 Corporate Structure	
The credit institution shall present its corporate structure via a detailed description of the organizational structure in the recovery plan.	In particular, the organizational structure is to be depicted by means of an organizational chart, which shall indicate at minimum the key group companies and branches.

2.2 Business Activities	
1. The credit institution shall provide a brief overview of the business model in the recovery plan. When so doing, the credit institution shall identify the key business activities and concentrations of earnings and risk. Furthermore, the key markets in which the credit institution or its key group companies and branches play a significant role, either currently or in the future, are to be presented. In this regard, the market is to be defined both substantively as well as geographically.	**Key business activities** within the meaning of this circular are those that may have a significant impact on the institution's or group's net assets, financial position, and results of operations. This also includes business activities that, in the opinion of the credit institution or group, might result in a considerable loss of income/profits, considerable losses, or a considerable loss in franchise value in the event of a disruption to the credit institution or group.
2. The credit institution shall also identify in the recovery plan systemically relevant business activities and shall explain this classification in a comprehensible manner.	**Systemically relevant business activities** are specific business activities the termination or disorderly resolution of which could have a considerable negative impact on other companies in the financial sector, on financial markets, or on the general confidence of depositors and other market participants in the functionality of the financial system in Germany or in the relevant CMG member states.

	The business activity does not necessarily need to be undertaken in Germany or the relevant CMG member states; it is sufficient when it has an impact in Germany or a CMG member state. For example, criteria for systemic relevance might be: size, lack of substitutability, services offered (market power), interconnectedness or financial market infrastructures ("FMIs") (in particular clearing, settlement, custodial functions).
3. The credit institution shall assign the key business activities and the systemically relevant business activities to the individual legal entities and branches ("mapping").	

2.3 Interconnectedness	
1. The credit institution shall identify the **internal interconnectedness within the group** of the key group companies and branches. This is to include the economic, legal, organizational, and operational interconnections within the group.	Internal **interconnectedness** within the group refers to the reciprocal dependency of individual affiliated companies and branches among one another and in relation to the parent company as well as, in reverse, the dependency of the parent company on individual affiliated companies and branches in terms of the economic, legal, and organizational and operational aspects. **Economic Interconnectedness:** Economic interconnectedness includes in particular intra-group receivables and liabilities (including derivatives) as well as the intra-group provision of collateral (e.g. guarantees, surety bonds, letters of comfort), sources of refinancing, and liquidity and capital allocation/flows within the group. These also include, for example, relationships with special purpose entities within the meaning of section 2.2, subsection 2 of the General Part of the MaRisk (including the explanation).

	The description of the liquidity and capital allocation/flows in the group should also address how control by the individual affiliated companies and branches or by the parent company is structured (centralized or decentralized control). The difference between the support provided when the situation is normal and during crisis situations should be indicated in each case. **Legal Interconnectedness:** Legal interconnectedness includes in particular the description of inter-company agreements and dependency pursuant to tax law. **Organizational and Operational Interconnectedness**: In particular, the description of the organizational and operational interconnectedness should include a depiction of the key services performed by an affiliated company and/or branch for other affiliated companies and/or branch. Examples of these includes information technology ("IT") or central functions such as financial, liquidity, and capital management, payment processing, auditing, risk controlling, legal services, human resources, or certain back-office functions.
2. The credit institution shall also identify its key **external interconnections**. In particular, this includes an identification of a. the key contracting party on both the active and passive sides, and b. the key payment processing services, clearing, settlement, custodial aspects, and other services that are performed for third parties or performed by third parties for the credit institution (outsourcing).	The objective of the analysis of external interconnectedness is to determine how the risk of contagion could spread throughout the financial system. This includes on the one hand external contagion via the credit institution undergoing the crisis and, on the other hand, the contagion of the credit institution via the other contracting party undergoing the crisis. Other conceivable external interconnections include, for example, guarantees provided implicitly ("implicit support").

3. Potential Courses of Action for Recovery	
In the recovery plan, the credit institution shall present (in relation to itself, key affiliated companies and branches and/or the group of institutions as a whole) the potential courses of action that it can take to ensure or restore financial health and therefore viability without the loss of taxpayers' money should adverse scenarios arise.	

3.1 General Overview of all Potential Courses of Action	
1. Initially, the credit institution shall present all available courses of action and specify the obstacles as well as potential solutions for overcoming those obstacles.	For example, measures in the following categories may be considered as potential courses of action: • Recapitalization • Measures to preserve capital such as suspending dividend payments • Measures to ensure that the credit institution has sufficient access to potential sources of refinancing (including for example an evaluation of the assets available to serve as collateral) • Liquidity measures, for example by transferring liquidity within the group in order to ensure that the credit institution and the affiliated companies continue as a going concern and that liabilities coming due can be paid • Reduction of risk-weighted assets (in particular the sale of equity stakes, business units, or other assets) • Measures for the restructuring or voluntary reorganization of liabilities
2. In particular, the credit institution shall, on its own initiative, analyze the impact (impact analysis) and the feasibility and/or the risk associated with execution (feasibility analysis) for each potential course of action.	

a. **Impact Analysis**: An analysis of the impact (financial, operational, and external, among other things) is to be performed for each potential course of action. The assumptions and measurement standards underlying the impact analysis are to be described in the recovery plan (in particular measurement of assets, assumptions concerning the possibility of the sale of assets and concerning the behaviour of other market participants).	The description of the financial and operational impact of each of the specific potential courses of action is to include the following aspects in particular: • Impact on the capital (organized by type of capital: core capital, additional core capital, supplementary capital) • Impact on liquidity (organized by time to maturity) • Impact on earnings • Impact on the risk profile of the credit institution or the group • Impact on continuation as a going concern (operational impact) The description of the external impact is to include the following aspects in particular: • Impact of the specific potential courses of action on the continuation of systemically relevant business activities of the credit institution or the group (including services for third parties) • Impact of the execution of specific potential courses of action on other market participants, creditors, and shareholders.
b. **Feasibility Analysis:** In the feasibility analysis, the credit institution shall, on its own initiative, perform an evaluation of the chances of accomplishing the particular course of action, taking into consideration the following aspects at minimum: ba. Evaluation of the prospects for success of the potential courses of action	

bb. Identification of the obstacles that could limit or preclude the feasibility of the potential course of action (in particular economic, legal, and operational obstacles or risks such as reputation risks including the risk of a rating downgrade) and presentation of how such obstacles could be overcome. When preparing this analysis, the credit institution should take into consideration any past experiences taking action during crisis situations.	
c. Furthermore, the analysis should also provide the timeline for the particular course of action.	
3. Taking into account the impact of potential courses of action on the credit institution, the credit institution shall stipulate high-level responsibilities and an internal process for the execution of each potential course of action.	The following should be identified in particular: • Which people (their hierarchy level should be specified) or committees are responsible for the decision and who is to execute the decision. • What other steps are to be taken after the decision about executing the course of action.

3.2 Stress Test	
1. When preparing the recovery plan and every update, the credit institution shall perform a stress test that reflects the nature, scope, complexity, and the risk profile of its business activities.	
2. The credit institution shall develop various adverse scenarios for the stress test. At minimum, these shall take into consideration the following criteria, whereby the time factor, i.e. developments that occur both suddenly as well as gradually, is to be taken into account:	

a. Adverse scenarios for the company and/or specific to the group b. Adverse scenarios for the whole market, and c. A combination of adverse scenarios for the company and/or specific to the group as well as for the whole market The adverse scenarios must reproduce the relevant, significant risks facing the credit institution and/or the group and present in detail the assumptions that have been used. All of the adverse scenarios must be sufficiently serious enough to potentially have a considerable detrimental impact on the credit institution and/or the group. The German Federal Financial Services Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*) reserves the right to stipulate specific adverse scenarios to the individual institutions.	
3. The impact of adverse scenarios on the credit institution and/or the group is to be examined in connection with the stress test; in particular this is to include the impact on capital, risk capacity, liquidity, earning power, risk profile, and continuation as a going concern. Furthermore, the key business activities or systemically relevant business activities that might undergo a crisis during such adverse scenarios are also to be identified.	

3.3 Recovery Indicators and Escalation Process	
1. The credit institution shall, on its own initiative, stipulate indicators ("recovery indicators") that allow it to promptly institute suitable courses of action in order to ensure or restore financial health and therefore viability without the loss of taxpayers' money.	The recovery indicators are not intended to be associated with any kind of automatic action such that a particular course of action is inevitably and immediately undertaken. Rather, the purpose of the recovery indicators is to determine the point in time at which the credit institution initiates the process to prepare a decision regarding the execution of potential courses of action. The recovery indicators must provide the credit institution with sufficient lead time for the decision as to whether and what potential course or courses of action are to be executed. The recovery indicators must trigger the alarm early enough for the credit institution to still be in a position to overcome the emerging crisis situation on its own and therefore to intervene in particular at a point in time before the Supervisory Authority can take steps.
2. The credit institution shall define an escalation and notification process that ensures that management is promptly and comprehensively brought in on the decisions. The decisions made in this context are to be documented. The supervisory body of the credit institution is also to be brought in as appropriate. In such cases, the Supervisory Authority is also to be notified promptly and in detail.	
3. In particular, the recovery indicators should relate to the capital situation, risk capacity, liquidity situation, and the earnings situation as well as the risk profile, but to external events and adverse scenarios as well.	The recovery indicators should be both quantitative and qualitative in nature. Assessments by employees (so-called "expert calls") may also be taken into consideration as qualitative recovery indicators.
4. Over and above the obligation set out in 3.3, subsection 2, the credit institution shall inform the Supervisory Authority semi-annually about the status of the recovery indicators during the last quarter/six months. At the same time, the supervisory body of the credit institution shall be informed.	

3.4 Specific Potential Courses of Action	
1. The credit institution shall determine the effective and suitable potential courses of action for all adverse scenarios underlying the stress test and describe these in the recovery plan. The description of these specific potential courses of action must include the steps required in order to ensure or restore financial health and therefore viability without the loss of taxpayers' money.	In this section, the effectiveness and feasibility of the generally available courses of action described in D. 3.1 are examined as they relate to individual adverse scenarios ("specific potential courses of action"). While all courses of action available to the institution are to be described and assessed in D. 3.1 in detail with no relation to any particular scenario, in this section it is required that the potential courses of action be presented in detail **as they relate to individual adverse scenarios** and analyzed with regard to their feasibility and impact.
2. The credit institution shall, on its own initiative, analyze the effectiveness and suitability of the specific potential courses of action for each adverse scenario while identifying potential obstacles and developing solutions for overcoming such obstacles. When doing so, the credit institution shall, on its own initiative, analyze the impact (impact analysis) and the feasibility or, as applicable, the risk associated with execution (feasibility analysis) of each specific potential course of action for each adverse scenario and shall establish a timeline for executing the potential courses of action.	The impact and feasibility analyses within the meaning of this circular are described in section E. 3.1.2 a and b.

3.5 Assuring Continuation as a Going Concern	
1. The credit institution shall stipulate how continuation as a going concern can be ensured via the execution of each specific potential course of action.	The following are be taken into consideration among others: • Assurance of functionality of internal processes (in particular IT systems, supplier contracts, HR processes, services contracts (SLAs) • Preservation of access (for the institution and, as applicable, for third parties) to financial market infrastructures (clearing, settlement, payment processing, overview of requirements for providing collateral)
2. In the event the specific potential course of action provides for the severance of a unit from the group, the institution shall stipulate how the severed unit can continue as a going concern even without the support of the group and how the group can continue as a going concern without the severed unit.	

3.6 Communications	
1. The credit institution shall prepare a detailed internal and external communications plan that relates to the execution of each of the general, potential courses of action indicated. The communications plan is to include the following aspects at minimum: a. Internal communications (with managers in charge, employees, employee representatives, etc.) b. External communications - with the regulatory authorities and - with the owners and the public (customers, investors, financial market participants, etc.)	The temporary setup of other facilities or functions as needed, for example call centres, should also be taken into consideration in particular in connection with external communications.

3.7 Information Management	
The credit institution shall ensure that the required information for the execution of each potential course of action is available in an adverse scenario at short notice.	

F. Taking Actions Identified as Necessary	
1. The credit institution shall institute the steps necessary to overcome the obstacles and/or to address the detected need for improvement on the basis of the strategic analysis and the obstacles identified.	This includes measures such as: • The early preparation of decisions by governing bodies (executive board, supervisory board) required in order to be able to promptly execute specific potential courses of action (e.g. capital increases) • The early provision of sufficient human resources as well as technical and organizational resources • The remedy of identified weak points in the processes, management models, and organizational structures; necessary training measures for all or specific employees
2. Taking into account the organizational units in charge, the credit institution shall set out any further steps, including a timeline.	