POSITION PAPER

ESBG response to the European Banking Authority consultation on draft Guidelines on the overall recovery capacity in recovery planning

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ESBG

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?

Paragraph. 19a) and e): it is not clear enough and we kindly ask the EBA to specify the requirements regarding an impact assessment of the recovery option on the financial system (e.g. qualitative, quantitative and if quantitative which impact parameters) and also how to measure the impact on the risk profile.

Question 2. Do you have any comments on the specification of the scenario severity for the purpose of calculating the 'scenario-specific recovery capacity'?

1. Not clear whether breaching the near-default point refers to TSCR and TSLRR or alternatively either TSCR or TSLRR.
2. If the severity of scenarios requires breaching the minimum requirement seen as near-default point, does this mean that this is the failing-or-likely-to-fail (FOLTF) point declared by the supervisor/NRA leading to resolution proceedings?
3. Not clear how does the early intervention buffer according to Article 27(1) BRRD triggering notification of the SRB and start of valuation 1 fit into the near-default point.

Question 3. Do you agree with the proposed criteria for the relevant starting point, timeframe (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 'scenario-specific recovery capacity'?

In our view the timeframe for NSFR is too short as NSFR is a long-term liquidity metric.

Question 4. Do you have any comments on the general steps to be followed for the determination of the ORC?

1. Lacking level playing field: although a harmonized FOLTF point setting may appear as level playing field, in fact it is not. High capital/liquidity levels as starting points for the scenario calculations influence recovery capacities.
    a. High reported capital/liquidity ratios of banks increase the starting point for the scenario calculation.

b. The necessity to decrease from high capital/liquidity starting point to FOLTF point assumes more impact on economies and markets, hence, more severe impact on banks' financials, capital and liquidity ratios compared to banks with lower starting points.
c. This leads to **more severe haircuts on recovery options**, hence, lower ORC for banks compared to banks with a lower starting point of capital/liquidity ratios.
d. This is a clear disadvantage for banks with high or increasing capital/liquidity ratios.
e. The starting point for the scenario calculations should be decoupled.

2. The sum of ORC related to indicators assumes that the ratio impacts per recovery measure are summed up.
    a. This leads to an aggregated ORC which does not properly reflect a correctly calculated summing up of measure impacts based on summed up nominator divided by summed up denominator.
    b. Therefore a mathematically correct methodology should be used. E.g.: The total amount of combined RWA reducing and capital increasing measures may result in a different recovery ratio impact (= ORC) per bank depending on the usage of RWA reductions (denominator reduction may have significant impact on the ratio).
    c. For a proper peer group comparison of the ORC the scenario starting points, the failing or likely-to-fail points and the total ORC impact methodology should be harmonized.
3. The following illustrative example shall demonstrate the shortcomings described in points 1 and 2 of this question:

Illustrative example of diverging "aggregated ORC" vs. mathematically correct "calculated ORC":

	Bank A	Bank B	Bank C	Bank D (= C)	Bank E (= C)	
Capitalisation level:	low	medium	high	high	high	
Impact of options:	Capital + RWA	Capital + RWA	Capital + RWA	Only on capital	Only on RWA	**Results and comments**
Starting point:						
CET1 capital	120	200	300	300	300	Bank A reports the lowest CET1 capital, Bank C, D, E the highest.
RWA	1,000	1,500	2,000	2,000	2,000	Bank A reports the lowest RWAs, Bank C, D, E the highest.
CET1 ratio	12.0%	13.3%	15.0%	15.0%	15.0%	Bank A provides the lowest capitalisation, Banks C, D, E the highest.
Scenario impact:						
CET1 capital	-70	-125	-200	-200	-200	We assume that all banks have the same failing or likely-to-fail point of 5%, therefore, the scenario impact has to be the lowest for Bank A and the highest for Bank C, D, E. **The range of scenario impact is huge, from -70 to -200!! Lacking level playing field.**
Scenario A:						
CET1 capital	50	75	100	100	100	
RWA	1,000	1,500	2,000	2,000	2,000	
CET1 ratio	5.0%	5.0%	5.0%	5.0%	5.0%	The capitalisation after scenario impact is equal at 5% for all banks, which is their failing or likely-to-fail point.
Option 1:						
CET1 capital	30	45	60	60	0	Option 1 is a CET1 capital enhancing measure.
RWA	0	0	0	0	-750	[For illustration purposes of Bank E]
ORC	3.00%	3.00%	3.00%	3.00%	3.00%	The ORC of option 1 is +3%p for all banks.
Option 2:						
CET1 capital	0	0	0	60	0	[For illustration purposes of Bank D]
RWA	-375	-563	-750	0	-750	Option 2 is a RWA reducing measure.
ORC	3.00%	3.00%	3.00%	3.00%	3.00%	The ORC of option 2 is +3%p for all banks.
Option 1 and Option 2:						
CET1 capital	**30**	**45**	**60**	**120**	**0**	Option 1 and option 2 in total provide both, capital and RWA impacts.
RWA	**-375**	**-563**	**-750**	**0**	**-1,500**	
Aggregated ORC	**6.00%**	**6.00%**	**6.00%**	**6.00%**	**6.00%**	The aggregated ORC is equal for all banks A-E, **however, it provides an incorrect impact on the recovered capital ratios**.
Recovered CET1 ratio	**11.00%**	**11.00%**	**11.00%**	**11.00%**	**11.00%**	
Mathematically correct calculation methodology:						
Calculated ORC	**7.80%**	**7.80%**	**7.80%**	**6.00%**	**15.00%**	1. Calculated ORCs diverge from aggregated ORCs because calculated ORCs reflect the mathematically **correct calculation** of an option bundle in case of RWA impacts (change of denominator). 2. For the Banks C, D and E (all equal starting points and scenario impacts) the **calculated ORCs diverge because options provide different RWA impacts (different changes of denominator)**. 3. Only in case there is no RWA impact of options the aggregated ORC equals the calculated ORC as shown by Bank D!!
Recovered CET1 ratio	**12.80%**	**12.80%**	**12.80%**	**11.00%**	**20.00%**	**The recovered CET1 ratio reflects the correct impact of all recovery options and shows different values for Bank C, D and E, which is due to different RWA impacts.**
Divergence of recovered CET1 ratio based on calculated vs. aggregated ORC	***1.80%***	***1.80%***	***1.80%***	***0.00%***	***9.00%***	***Based on aggregated ORC calculations the recovered capital ratios are undervalued.***

Question 5. Do you have any comments on the definition of the ORC as a range between the lowest and the highest 'scenario-specific recovery capacity' both in terms of capital and liquidity?

Question 6. Do you have any comments on the scope of the assessment of the 'scenario-specific recovery capacity' by the competent authorities?

Question 7. Do you have any comments on the proposed ORC score?

It is in our opinion not realistic to fulfil all the buffers included into the recovery indicator levels in such a short period after such severe crisis (going below TSCR or TSLRR). Therefore, we propose the following scores:

a. Satisfactory - in cases where the ‘relevant RP indicators’ of the institutions after the inclusion of the ‘adjusted ORC’ would fail to be above the thresholds defined in line with the “Guidelines on Recovery Indicators”, but they would still be equal to or higher than institutions’ capital including leverage and liquidity regulatory requirements referred to in paragraph 21 adding all applicable regulatory buffers;
b. Adequate with potential room for improvement - in cases where the ‘relevant RP indicators’ of the institutions after the inclusion of the ‘adjusted ORC’ would meet the institutions’ capital (including leverage) and liquidity regulatory requirements referred to in paragraph 21 but would fail to meet all applicable regulatory buffers.

Question 8. 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?

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