

20 August 2013

Sent by email to EBA-CP-2013-9@eba.europa.eu

European Banking Authority
Tower 42
25 Old Broad Street
London EC2N 1HQ
United Kingdom

EBA Consultation Paper on Draft Regulatory Technical Standards specifying the range of scenarios to be used in recovery plans (EBA/CP/2013/09)

Dear Sir / Madam

Please find enclosed AFME's response to the Consultation Paper on Draft Regulatory Technical Standards specifying the range of scenarios to be used in recovery plans (EBA/CP/2013/09). Should you have any questions or desire additional information, please do not hesitate to contact us.

Yours faithfully



Oliver Moullin
Director, Resolution and Crisis Management
AFME

Association for Financial Markets in Europe

www.afme.eu

London Office: St. Michael's House, 1 George Yard, London, EC3V 9DH T: +44 (0)20 7743 9300 F: +44 (0)20 7743 9301
Brussels Office: Square de Meeus 38 - 40, 1000 Brussels, Belgium T: +32 (0)2 401 8724 F: +32(2) 401 6868
Company Registration No: 6996678 Registered Office: St. Michael's House, 1 George Yard London EC3V 9DH

Consultation response

EBA Consultation Paper on Draft Regulatory Technical Standards specifying the range of scenarios to be used in recovery plans (EBA/CP/2013/09)

20 August 2013

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on the European Banking Authority (EBA) Consultation Paper (CP) on Draft Regulatory Technical Standards specifying the range of scenarios to be used in recovery plans.

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society. Its pan-European membership allows AFME to draw upon the expertise, diversity of business models, cultures and experiences found within its member firms.¹

AFME has been strongly active on resolution issues for a number of years and has played a leading role in the industry efforts, at European and global level, aimed at achieving effective and credible recovery and resolution frameworks.

AFME is broadly supportive of the draft RTS specifying the range of scenarios to be used in recovery plans. We address the questions raised in the CP below.

Questions

Q01. Have you already drafted financial distress scenarios for the purpose of testing a recovery plan or are you in the process of doing so? If so, are these financial distress scenarios in line with the contents of the draft RTS?

A number of AFME's members have prepared scenarios for testing their recovery plans. In general these scenarios are in line with the draft RTS. As acknowledged in the RTS is it necessary for scenarios to be relevant to the particular group. However, requirements for scenarios should not be set in too great a level of detail as scenarios focused on too specific factors will make the scenarios narrow and therefore less effective.

¹ AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia. AFME is listed on the EU Register of Interest Representatives, registration number 65110063986-76.

We note that the requirement for scenario testing of recovery plans is new to certain jurisdictions where firms are required to produce a local recovery plan (e.g. the U.K). In these cases, the requirement to produce scenarios for testing recovery plans should be assessed against the existing recovery planning framework to see how these are best incorporated with a view to minimising the additional effort and resources to implementing this additional requirement.

Q02. Have you developed group or solo specific scenarios to test the adequacy of the recovery plan?

AFME's members have developed scenarios generally focused on the entire group, but some have included scenarios around specific geographical locations, as relevant to the particular group. This reflects the fact that no one size fits all and the nature of the scenarios should be tailored to the relevant circumstances of the group.

Q03. Do you believe that the draft RTS on the range of scenarios for recovery plans is adequate to ensure that firms test their recovery plans against a range of scenarios for financial distress?

We believe that the draft RTS provides adequate requirements for developing scenarios to test recovery plans. We particularly support the requirement in Article 3(1)(a) for each scenario to be based on events that are most relevant to the institution or group and the emphasis given to this in Article 4(4). This is a very important requirement in order for relevant scenarios to be developed.

In addition, the requirements in Article 4(1) should also to be applied as appropriate to the particular group. We therefore suggest that firms should not necessarily be required to develop separate scenarios for each of a system wide event, an idiosyncratic event and a combination of the two. We suggest that firms should instead, in the event that they do not include separate scenarios for each category, explain why this is not appropriate for the relevant group.

Q04. How many scenarios have you been required to develop to test the adequacy of the recovery plan? Have you included slow or fast moving events?

As use of scenarios necessarily differs from firm to firm depending upon business models and other considerations, members have developed anywhere between one and ten scenarios. Rather than being required to develop different scenarios with slow and fast moving events, it would be better to change the emphasis to ensuring that recovery plans are sufficiently adaptable to enable recovery options to be implemented in a short space of time if required. This issue would therefore be better addressed in the RTS on the assessment of recovery plans than requirements for slow and fast moving scenarios.

Q05. Have you used reverse stress testing as a starting point for developing financial distress scenarios?

While firms do perform reverse stress testing in other contexts, our members do not generally consider that reverse stress testing is appropriate in the context of recovery planning.

Q06. What are the additional costs to develop financial distress scenarios in respect to the current practices of reverse stress testing?

Additional management time is the main driver of additional cost in developing financial distress scenarios.

Q07. Do you believe that the events that institutions or groups need to consider and include where relevant are most suitable? If not, what other events ought to be taken into account?

We agree with the proposed events for consideration by groups. These events provide some additional guidance on what events could be used, but we support the requirement for firms only to consider these events and the clarification that this is subject to the general principle that scenarios should be based on events most relevant to the specific institution or group.

Scenarios should ideally be based on existing assumptions that are applied by institutions in their risk assessment, which are typically already agreed with their respective regulators. In this context, we would not support a mandatory list of events to be reflected in the scenarios but rather suggest that institutions should have the flexibility to determine the events most appropriate to be included in their scenario.

Q08. Do you have any general or specific comments on the draft RTS?

As a general comment, too much focus has been put on scenario testing of recovery plans rather than a general assessment of the adequacy of the recovery plan to enable the group to recover from a wide range of potential situations. Scenario testing can form one element of this, but it should not be the main determinant of assessment.

We suggest that it is made clear that the RTS relates to scenarios for testing recovery plans, rather than scenarios upon which recovery plans should be based. This is generally clear in the text of the RTS, but the reference to “use” of scenarios in recovery plans, for example in the title of the RTS, could be misleading.

We note the requirement in Article 3(2) for each scenario to include, where relevant, an assessment of the impact on a number of aspects including available capital and liquidity. It would be helpful to clarify that, we assume, the purpose of this requirement is to test the ability of the recovery plan to recover from such impacts and distinguish the scenario testing in the RTS from other stress testing. In our view, the aspects “profitability” and “reputation” listed under Article 3(2) would be better seen as sub-categories of the aspects of capital, liquidity and business model. Additionally, we suggest excluding the “payment & settlement operations” from the assessment requirements for a recovery scenario as this concern in our view is more appropriate to the resolution of the institution.

Q09. Are the definitions and terminology used in the draft RTS clear?

We are generally supportive of the inclusion of a system wide event and an idiosyncratic event in the range of scenarios. However, we note that the definition of “system wide event” would require the event to risk “having serious negative consequences for the financial system or the real economy”. It is not clear from this definition whether this refers to the global financial system and global real economy, or would include a more limited scope such as the financial system or the real economy in the relevant jurisdictions in which the institution or group operates.

We also note that some scenarios might not have a serious impact upon the entire financial system or real economy, yet form suitable scenarios beyond an idiosyncratic event. For example they might affect just part of the financial system or a particular market. The FSB Guidance on

Recovery Triggers and Stress Scenarios² uses the terminology of “market-wide” scenarios rather than “system wide event”. We regard the FSB terminology as preferable for this reason.

We are also unclear on what is meant by the requirement in Article 4(1)(c) for the combination of system wide and idiosyncratic events to occur “interactively”.

In addition, the level of detail and type of information (qualitative / quantitative) the impact assessments should include is not specifically defined. We believe that each firm should make such determination based on its specific situation. We would further welcome a further specification of the meaning of 'financial distress'.

Q10. Do you agree that, for an institution, the costs of developing financial distress scenarios to test a recovery plan are likely to be proportional to the size/complexity of the firm and so of the costs its failure may create? If not, could you explain why?

In general we agree that the cost of developing scenarios is likely to be proportionate to the complexity of the firm given the need to tailor the scenarios to the specific institution or group. However, there is likely to be a minimum level of costs for developing the minimum three scenarios mandated by the RTS. Therefore the relationship is unlikely to be directly proportionate.

Q11. Do you agree with our analysis of the impact of the proposals in this CP? If not, can you provide any evidence or data that would explain why you disagree or might further inform our analysis of the likely impacts of the proposals?

We have no comments on the impact analysis.

² Financial Stability Board, Recovery and Resolution Planning for Systemically Important Financial Institutions: Guidance on Recovery Triggers and Stress Scenarios, 16 July 2013.