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11 June 2013

Euroclear response to the European Banking Authority consultations on the Draft Regulatory Technical Standards

- ***on the content of recovery plans (CP/2013/01)***
- ***on the assessment of recovery plans (CP/2013/08)***
- ***specifying the range of scenarios to be used in recovery plans (CP/2013/09)***

The Euroclear group is the world's leading provider of domestic and cross-border settlement and related services for bond, equity, fund and derivative transactions. User owned and user governed, the Euroclear group includes the International Central Securities Depository (ICSD) Euroclear Bank, based in Brussels, as well as the national Central Securities Depositories (CSDs) Euroclear Belgium, Euroclear Finland, Euroclear France, Euroclear Nederland, Euroclear Sweden and Euroclear UK & Ireland. Euroclear Bank is the only credit institution in the Euroclear group.

We are pleased to be given the opportunity to provide our view on the consultations issued by the European Banking Authority (EBA).

This response shares our knowledge and experience on the topic of recovery planning with the EBA. We have combined the responses to several recent EBA consultations in one single document and have chosen to respond only to the questions that were most relevant to us.

Euroclear Bank is a Financial Market Infrastructure ("FMI") which also holds a banking licence. As a consequence we have a strong interest in both the Resolution and Recovery framework for credit institutions, and for the forthcoming regime that will apply to FMIs (and on which the European Commission recently conducted a consultation). It is currently unclear however, which of these two regimes will apply to Euroclear Bank. We believe this should be clarified by the regulators to avoid double regulation for those FMIs which hold a banking licence.



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General comments

- We strongly support the EBA's understanding of the future directive that decisions related to the implementation of recovery measures need to be tailored to the specific situation that may arise and should remain at the discretion of the institution's management body. The draft RTS clearly excludes a mechanical approach to recovery planning.
- We support the content and overall level of detail of the draft Standards. It constitutes a helpful guide for recovery planning purposes.
- However, Article 5 of the future Directive makes clear that the audience for the recovery plans is the management of the company. Therefore, it seems to us that some minor pieces of the proposed content (e.g. description of management information systems), which are well-known to management, are redundant for the purposes of recovery plans and should only appear in the resolution plans, if needed.
- We would also welcome more guidance on how to articulate the group recovery plans vs. those of individual entities (e.g. see our comments to question 2, page 8).
- Any requirements for scenario planning should take into account the difference between the business models of credit institutions. The most relevant scenarios for a Financial Market Infrastructures are unlikely to be similar to the scenarios needed by universal or by retail banks.

Draft regulatory technical standards (RTS) on the content of recovery plans (CP/2013/01)

Q01: Have you already drafted/approved a recovery plan or are you in the process of doing so? Is your recovery plan in line with the contents of the draft RTS?

The CPSS/IOSCO Principles for FMIs already require Euroclear group entities to put in place extensive business continuity planning, aiming at the continuity of CSDs' services in cases of the materialisation of operational or financial risks.

In addition, both Euroclear Bank and the Euroclear group have been required to draft a recovery plan by their home regulator. We believe that the Euroclear local CSDs (which do not have a banking licence) will soon be asked to undertake a similar exercise, inspired by the CPSS/IOSCO work on the appendix to the Financial Stability Board Key Attributes for FMIs and the prospective EU legislative proposal on the FMI recovery regime.

The guidance received for the drafting of the plans is broadly in line with the draft RTS, as it follows the general international guidance; although Euroclear Bank and group plans also reflect the infrastructure profile of the entities and their special legal environment. The competent authorities have indeed agreed that the general framework need to be adapted. Some components of the draft RTS are however, new.



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Q02: Do you believe that the draft RTS on recovery plans is comprehensive and contains sufficient and relevant requirements to enable timely and effective recovery of an institution in the event of financial distress?

Apart from the caveats observed in our general comments above, we believe that the draft RTS is comprehensive. The information to be included in the plans should allow firms to identify measures they could take to ensure they remain viable in the face of a financial distress. However, the recovery plan as such cannot ensure timely and effective recovery, as it rests on the effective implementation of recovery measures. Some constraints to effective implementation that are difficult to alleviate (such as difficult general market conditions) or will take time to be alleviated (as when a change of legislation needs to be foreseen) will undoubtedly remain.

Q03: Please provide your views on the indicators and escalation process as stipulated in the draft RTS under Articles 2(a) and 5(c), and on the other governance arrangements provided for by Article 5.

Describing indicators under article 5(c)(2) as “reflecting possible vulnerabilities, weaknesses and threats” seems too vague and mild for recovery planning purposes. This entails the risk that such indicators would be activated too soon and too often. The difference between risk indicators or early warning indicators, which are used in the day-to-day risk management or in the business continuity plan, and indicators triggering the escalation process described in the recovery plan should be clear from the definition.

A set of indicators is explicitly mentioned in the RTS including the risk profile of the institution. However, a material degradation of the risk profile can occur independently from the other indicators. Therefore, you may wish to say “*or* risk profile” rather than “*and* risk profile”.

As stated in the general comments, some information required to be provided in the recovery plans relating to governance seems to be redundant. Indeed, the main purpose of a recovery plan should be to support the institution in taking appropriate and timely measures to come out of a crisis without regulatory intervention. Consequently, where institutions already have a strong crisis management structure in place and where such measures are effectively implemented in business continuity (BCP) arrangements and are already well-known to management and staff, a cross-reference to the relevant procedures should be sufficient.

We believe that the description of how management information systems are managed does not belong in a recovery plan. It does not have any value-added for decision-making purposes. Adequate information systems are an overall risk and business management requirement, not limited to recovery planning purposes. It would thus seem better placed in a resolution plan. It should be noted in this respect that the FSB Key Attributes group such “generic” requirements for the recovery and resolution plans together. We also believe questions related to the availability of necessary information should better be answered together



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with the analysis of individual recovery options, as it will be a pre-condition for the effective implementation of such options.

Q04: Please provide your views on the relationship between the governance arrangements provided for by Article 5 and current risk management processes/governance arrangements such as the Internal Capital Adequacy Assessment Process (ICAAP) and the Internal Liquidity Adequacy Assessment Process (ILAAP)

Recovery planning links many areas of an organisation. Work on scenarios used for the determination of economic capital can be leveraged for recovery planning purposes. In terms of governance related to the approval, the close involvement of the Management and the Board in both ICAAP and Recovery Planning also ensure alignment.

A crisis management structure should include clear escalation procedures, and a clear description of responsibilities at different levels within the organisation. Recovery governance should be a logical extension to that structure.

Q05: Please provide your views on the requirements for the description of the institution or group, as stipulated by the strategic analysis in the draft RTS under Article 6(3)

We believe the inclusion of general information on the business does not add value to decision-making. It should be well-known. This is particularly true for smaller institutions, whose business and corporate structure should not need to be exposed in much detail (this could be done in an annex, or in a stand-alone document, to ensure completeness or as a recap to be used, in particular, if the institution or group needs to be resolved, but not in the main body of the recovery plan).

However, the core of the strategic analysis (consisting of the identification of core business lines and critical functions, and of internal and external interconnectedness) is key. These could prove useful where divestment decisions would need to be taken, or alternatively in a resolution context.

With regards to the analysis of interconnectedness, we would like to suggest the following distinctions:

- financial interconnectedness could cover your points 1 and 2;
- operational interconnectedness could include, in addition to common functions, common infrastructure, both hardware and software;
- legal interconnectedness could include the intellectual property rights related to common infrastructures (alternatively, this could be discussed under operational interconnectedness);
- external interconnectedness should include a view of participation in or other types of ties to FMIs.



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Q06: Please provide your views on the requirements for the recovery options, as stipulated by the strategic analysis in the draft RTS under Article 6(4). Does this requirement comprehensively and adequately capture the different categories of recovery options that could be considered?

The list of recovery options is clear, although we wonder whether point (5)(a)(1) is not redundant given the presence of (5)(a)(2) for capital or (5)(a)(3) for liquidity. We would advise to separate the elements related to “reduce risk or leverage” and “restructure business lines” in (5)(a)(4). We would welcome some specific examples of appropriate recovery options related to reducing risk. The distinction between a risk-reducing measure (that would allow a return to business-as-usual and should therefore not be considered a recovery option) and a true recovery option is unclear.

Some guidance on the expected timeframe, within which the described options should be effective in order to be considered for inclusion in the plan, would be useful.

Q07: Please provide your views on the requirements for the communication plan, as stipulated in the draft RTS under Article 7.

While we entirely agree that communication is key in a crisis and support the inclusion of such aspects in the plan, we do not believe preparing *detailed* communication plans *ex ante* would be appropriate, due to the uncertainty surrounding the future potential crisis. Furthermore, the extent to which the institution should communicate will vary depending on the particular circumstances of the crisis. Communication can undermine or restore market confidence, depending on how it is managed and timed. The management should retain discretion in this extremely sensitive matter.

Q08: Please provide your views on the requirements for preparatory measures, as stipulated in the draft RTS under Article 8, providing in particular your views on the question what types of preparatory arrangements or measures could or should be taken into account in the recovery plan.

We believe that no type of preparatory measure should be imposed in the draft RTS. Indeed, it may be the case, in a future iteration of the exercise, that all possible measures will have been taken. Moreover, preparatory measures should be derived from the specific situation of each entity or group.

We believe that this chapter should rather focus on advising institutions on identifying necessary preparatory measures (with criteria for selecting measures that truly bring added value in a recovery scenario), giving examples of possible measures.



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Draft regulatory technical standards on the assessment of recovery plans (CP/2013/08)

Q01: If your recovery plan has already been assessed by a competent authority, what are your general comments to this RTS on the basis of your experience? In particular, which elements do you suggest to add to the assessment criteria specified in this RTS?

Our recovery plan has not yet been formally assessed. Any comments provided therefore are based on our own judgement only.

Q02: Do you think that the elements which shall be subject to assessment according to Article 3 are comprehensive? Do you think that some of the elements should be amended? Do you think that some additional elements should be added?

We think that the relevant points are well covered. We however wonder whether the draft RTS may require information that is not already listed in article 6 of the Directive [RRD], though we understand that the specific point is essential from a recovery planning perspective (art 3.1(c)) on when an institution may apply for the use of central bank facilities. We wonder whether this requirement would not belong to the RTS on recovery plans instead of the RTS on the assessment of such plans).

It seems to us that the identification of impediments to the implementation of recovery measures (art 3.2(c)) should be described together with the detailed analysis of these recovery measures, rather than with the scenarios used to test the plan.

Q03: Do you think that the elements which shall be subject to assessment according to Article 4 are comprehensive? Do you think that some of the elements should be amended? Do you think that some additional elements should be added?

We agree that the clarity, relevance, comprehensiveness and internal consistency of the Plan are the main aspects to be looked at to assess the quality of the Plan.

Q04: Do you think that the elements which shall be subject to assessment according to Article 5 are comprehensive? Do you think that some of the elements should be amended? Do you think that some additional elements should be added?

We generally support the points mentioned in article 5. However, we would like to share comments with regards to three points:

- The role of testing by using scenarios should not be overestimated, in particular where it concerns the "verification" of recovery options. Scenarios are defined with a view to identifying situations where the institution or group may need to take recovery options. They are calibrated by definition in such a way that these options would allow the institution or group to overcome financial distress. Using scenarios rigidly to test whether options are adequate boils down to some sort of circular reasoning. We do agree however, that scenarios are useful as a means to assess whether the identified recovery options address relevant impacts, and whether the magnitude of



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these options seems appropriate. They are also useful to design adequate recovery triggers.

- The systemic impacts related to the implementation of recovery options cannot easily be identified by any single institution (especially in respect of interactions with "recovery actions of other institutions"). We therefore wonder whether, instead of making this part of the assessment of the 'credibility' of the recovery plan, it would not belong under a separate caption, to the extent possible under the Directive. We clearly see an active role for regulators in this respect, as only they have a view of the recovery plans drafted by different banks. They thus have the tools to ensure potential systemic impacts are well understood.

Q05: Could you describe what key elements the competent authority should assess when reviewing the matters stipulated in Art 5(3) a-d?

The elements listed cover adequately the aspects on which authorities should focus.

Draft regulatory technical standards specifying the range of scenarios to be used in recovery plans (CP/2013/09)

We support the content and overall level of detail of the draft RTS. We agree that standards related to recovery scenarios (or options) should not be unduly prescriptive, as it would defeat the purpose of the recovery planning exercise. Indeed, a recovery plan needs, by definition, to be tailor-made for each institution or group and to appropriately reflect its specificities. This is of particular importance for Euroclear Bank and for the Euroclear group. The most relevant scenarios for Euroclear Bank or other Euroclear CSDs, or for other Financial Market Infrastructures, are unlikely to be similar to the scenarios worked out by universal or by retail banks.

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 content of the draft RTS?

We have drafted financial distress scenarios applicable to Euroclear Bank and to the other Euroclear entities. In line with the expectations of our regulator, we have done this in the early stages of the recovery planning process. These scenarios were thus identified before recovery options had been explored; testing of the recovery options by means of the scenarios was done at a later stage.

The financial distress scenarios are broadly in line with the draft RTS. They cover both idiosyncratic and systemic events; some scenarios (or some impacts) are unfolding over a longer time period, while others are far more immediate. The scenarios also aim at covering the complete range of relevant impacts (capital, liquidity, profits & losses). However, we have not



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purposefully included any scenario that would be both systemic and idiosyncratic. With regard to the impacts, not all dimensions listed by the EBA have been taken into account.

We wish to highlight a purpose of recovery scenarios other than that of testing recovery options. From a decision-making perspective, the identification of scenarios and potential impacts are a helpful guide to choosing appropriate recovery options in a crisis.

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

We have developed both group and solo scenarios for all entities within the group. We have tried to maintain consistency across the group. This facilitates the identification of appropriate recovery options, either at the local or at the group level.

However, we would welcome some more guidance from the EBA on the group vs. entity dimension. In this respect, we have encountered the following questions:

- When scenarios are applied to the group, should the impact be calibrated similarly for all entities (e.g. identical LGDs)? The conclusion may be that this particular scenario would only materially impact one entity; this may not satisfy the need of a local supervisor, who would like to see a similar scenario impacting the local entity.
- Should we look at scenarios where one or several group entities are in resolution, and how the rest of the group would cope with that? This is at the crossroads between recovery and resolution planning.

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 of financial distress?

We agree that both idiosyncratic and systemic scenarios should be worked out. However, we fail to see what the identification of a scenario that would both be systemic and idiosyncratic would bring, the more so as these events are likely to be uncorrelated (e.g. a failure of a systemically important counterparty and an operational error).

The more complex the scenario, the more difficult it is to exploit for decision-making purposes, as the grouping of different impacts is not intuitive. We have experienced that it was sometimes useful to disentangle potential impacts of diverse events that might occur simultaneously or be causally related (e.g. potential liquidity impacts related to a loss of confidence that might have been the result of a major credit loss). This made the scenarios and their impacts more intuitive for management and eased the mapping of scenarios and recovery options.

Q04: How many scenarios have you been required to develop to test the adequacy of the recovery plan?

We have been asked to develop six scenarios, although this resulted in several scenarios leading to similar impacts (e.g. major credit loss or major operational loss). While this analysis is useful in order to force institutions to



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think about possible scenarios, having different scenarios with similar impacts does not add value to the Plan itself.

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

Q06: What are the additional costs to develop financial distress scenarios in respect to the current practice of reverse stress-testing?

The identification and selection of scenarios was akin to reverse stress-testing. In the context of our business continuity work, we develop several financial distress scenarios each year. These scenarios have been used as the basis for the recovery plan scenarios wherever possible and meaningful. Other stress-tests were also used as a basis for recovery plan scenarios. However, the calibration of the BCP and stress testing scenarios had to be adapted to the purpose of the recovery plan.

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?

The scenarios that we have considered in the Plan are all related to one or several events listed in the RTS.

However, the definition of scenarios is complicated by the fact that the identified events can be the consequences of one another. For example, a severe outflow of liquidity can result from damage to the institutions' reputation, which, in turn, can be the consequence of a major loss. If this can plausibly be the case, should we look at these elements as separate scenarios? Should they be brought together into one single scenario? In particular, the reputational event is difficult to analyse on its own (eg, a false rumour?). As discussed earlier, presenting separate analyses is most appropriate for the purpose of decision-making. But it remains useful to identify the potential interactions between scenarios.

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

We would like to make a few additional comments on the list of impacts to be considered (art 3(2)). While capital, liquidity and profitability impacts are straightforward, it is not the case for the others:

- Can any of the identified scenarios lead to business model impacts? Are changes to the business model not the result of management decisions? While we can see how they could be the consequence of recovery options, we fail to see how they could flow directly from scenarios.
- Whether the impact on payment and settlement operations should be captured under a broader caption "operational impacts"?
- How should we qualify or quantify "reputation" impacts? Can such impacts not be the result of *any* financial distress scenario?

We would also welcome some guidance on how the impacts need to be expressed. Do they need to be quantified? How precisely does that need to



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be? Should it be the result of a deterministic exercise based on scenario inputs, or rather an approximate assessment of the magnitude of potential impacts related to the scenarios?

More generally, some guidance on the level of detail needed in the description of scenarios would be very useful.

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

Yes.

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