



Single Resolution Mechanism

Resolution planning process

Introduction

Addressing the issue of Too-Big-to-Fail (TBTF) banks has been the overriding aim of financial services policy since the crisis, reflected in the host of regulatory initiatives that lawmakers have proposed in light of this objective. At the core of these efforts lies the goal of making banks 'resolvable' in distress to reduce the risk of having to bail them out with public funds.

A 'resolvable' bank is one that resolution authorities consider could be dealt with in an orderly fashion in the event of its failure, rather than having to provide it with public support to maintain financial stability or ensure the continuity of critical banking services. The EU's response to resolvability was to introduce a cross-border resolution mechanism via the Bank Recovery and Resolution Directive (BRRD), which provides resolution authorities with comprehensive powers and resolution tools to intervene when a bank meets the conditions for resolution, whilst ensuring taxpayers avoid carrying the burden.

To ensure that decisions across participating Member States of the Banking Union are taken effectively and quickly, the EU created the Single Resolution Mechanism (SRM) with a strong centralised decision-making body, the Single Resolution Board (SRB), and the Single Resolution Fund (SRF). The SRM became fully operational, with a complete set of resolution powers, on 1 of January 2016. What resolvability means and how it will be interpreted in detail has therefore been one of the key remaining pieces in the post-crisis regulatory puzzle.

With this guide we provide a comprehensive summary of the resolution planning approach detailed by the SRB.

The SRB sets out a number of aspects of the SRB's approach to resolution planning that had, so far, only been alluded to informally. The SRB further gives some indication of its expectations for banks in areas that we have previously identified as 'resolvability drivers' in our paper *Tackling too-big-to-fail: The resolvability challenge for banks*, particularly with regard to the following:

- **Loss-absorbing capacity** – The document provides the clearest statement the SRB has given so far on its approach to setting a Minimum Requirement for Own Funds and Eligible Liabilities (MREL), making clear that a target of "not less than 8% of total liabilities" will be used as a starting point for the calculation. The SRB stresses that a lower MREL requirement would be "generally unlikely" and following a case-by-case assessment "possibly well above," giving the impression that banks subject to the requirement should generally expect their MREL not to be set at a lower level.
- **Data quality, reporting and valuation capabilities** – The SRB sets out a number of expectations for the capability of data and management information (MI) systems. Banks' MI systems are not only required to provide "timely, up-to-date, accurate and reconcilable information" in order to populate information templates following a regular schedule. In addition, and probably more challenging, they also must be able to deliver information for a number of different issues (e.g. assets and liabilities, resolution planning, covered and uncovered deposits) and perform valuations "at very short notice." The challenges banks face in developing these capabilities are well known, and there is still an open question as to how quickly the SRB will expect banks to converge to the standards it has illustrated here, but the document does appear to emphasise that its expectations in this area are necessarily high.

Single Resolution Mechanism (SRM)

The SRM is the system of bank resolution comprising the Single Resolution Board (SRB) and National Resolution Authorities of the participating Member States of the Banking Union (NRAs).

The SRM's mission is to ensure an orderly resolution of failing banks and banking groups, with minimum impact on the real economy and public finances of the participating Member States of the Banking Union.

Single Resolution Board (SRB)

The SRB is the resolution authority for:

- Banks which are considered significant or in relation to which the ECB has decided to exercise directly all of the relevant supervisory powers;
- Other cross-border groups, where both the parent and at least one subsidiary bank are established in two different participating Member States of the Banking Union.

NRAs are responsible for all other banks and can request the SRB to exercise directly all its powers with regard to banks that are originally within an NRA's remit.

- The SRB, in cooperation with NRAs, focuses on resolution planning and preparation with a forward-looking mind-set, to avoid the potential negative impact of bank failure on the economy and financial stability member states. The SRB is also in charge of the Single Resolution Fund (SRF). The SRF is financed by the banking sector. It has been set up to ensure that financial support is available as a last resort, after private solutions have been ruled out and after the owners and creditors have borne losses.
- The SRF pools significant resources from bank contributions and therefore protects taxpayers more effectively than national

funds. The aggregate target size of the SRF is equal to at least 1% of covered deposits of all banks. The target size of the SRF is dynamic and changes automatically as the amount of covered deposits varies.

The role of the SRB and the NRAs is not limited to crisis situations. Their primary tasks include:

- To draft resolution plans for the banks under their direct responsibility
- To carry out an assessment of the banks' resolvability and to address impediments to resolution
- To set the level for Minimum Requirement of Own Funds and Eligible Liabilities (MREL)
- To take necessary actions following early intervention measures adopted by the European Central Bank (ECB) or the National Competent Authorities (NCA")
- To adopt resolution schemes (placing an entity under resolution, determining the application of resolution tools and determining, where necessary, the use of the SRF to support the resolution action).
- To raise contributions for the SRF and to manage and invest its resources.

Responsibility for preparing resolution plans / process

- The SRB's Internal Resolution Teams (IRTs) are directly responsible for preparing resolution plans in cooperation with NRAs
- The SRB establishes Resolution Colleges for banks with subsidiaries or significant branches in non-participating Member States.
- The IRT is responsible for the preparation of resolution plans (for banks without subsidiaries or significant branches in non-participating Member States) before entering into the formal adoption process. This involves consulting the ECB, obtaining approval from the SRB and then communicating the outcome to the bank.
- If over €5 billion of the SRF is to be used for a bank then the resolution scheme prepared by the SRB and IRT is deemed to be adopted unless, within 3 hours after submission of the draft scheme, at least one member of the Plenary Session calls a meeting in which a decision will be taken.
- Once the SRB has adopted a resolution scheme it sends it to the European Commission (EC). If the EC endorses the scheme, it enters into force. Otherwise the SRB has to modify it accordingly before entering into force.
- Alternatively the EC can propose to the Council of European Union to object to the scheme because there is no public interest. If the Council agrees that no public interest exists, then the bank will be wound up in an orderly manner.
- The SRB monitors the execution of the resolution scheme by the relevant NRAs at the national level and can directly address executive orders to the bank under resolution if an NRA does not comply with the scheme.

Resolution Objectives of BRRD

- To ensure the continuity of critical functions
- To avoid significant adverse effects on financial stability, in particular by preventing contagion
- To protect public funds by minimising reliance on extraordinary public financial support
- To protect depositors covered by the Deposit Guarantee Scheme Directive (DGSD) and investors covered by the Investor Compensation Scheme Directive (ICSD)

Resolution Plan definition and purpose

A resolution plan is a comprehensive document which details the characteristics of a bank and describes the preferred resolution strategy for that bank including which resolution tools are to be applied. It concludes with a resolvability assessment of the bank.

The purpose of resolution planning is to:

- Gain comprehensive understanding of a bank
- Identify and address any impediments to a bank's resolvability, and to be prepared for its resolution, if needed.

Resolution planning requires a considerable amount of data and analysis from banks themselves, to enable them to provide the necessary information to their respective NRA for the preparation of their corresponding resolution plan.

Resolution tools

If a bank meets the relevant conditions, the SRB places the bank under resolution. This is achieved by the adoption of a resolution scheme, which determines what resolution tools are to be applied to the bank and, if necessary, whether the SRF is to be used to support the resolution action. Before any resolution action is taken, the capital instruments of the bank must be written down or converted. The resolution tools are:

- **Sale of business tool** (the sale of business tool allows for the total or partial disposal of the entity's business)
- **Bridge institution tool** (part or all of the entity is transferred to a temporary entity, which is wholly or partially owned by one or more public authorities)
- **Asset separation tool** (assets, rights or liabilities can be transferred to an asset management vehicle, which is wholly or partially owned by one or more public authorities)
- **Bail-in tool** (equity and debt can be written down or converted, placing the burden on shareholders and creditors rather than taxpayers)

Resolution Planning Process

The resolution planning process is reflected in the following steps:

1. Recovery plan (& Strategic business analysis)

A Bank's Recovery Plan is the starting point of the resolution planning process. The Recovery Plan is drawn by the bank and it details measures the bank will take to restore its financial position. It contains a summary of material changes to the bank and a strategic analysis to identify core business lines and critical functions.

A detailed overview of the bank is produced based on data templates banks are required to fill out. The overview describes the bank's structure, financial position, business model, critical functions, core business lines, internal and external interdependencies and critical systems and infrastructures.

In the context of recovery planning, the bank must identify the legal entities and branches which:

- Substantially contribute to profit or funding, or hold an important share of assets, liabilities or capital of the bank;
- Perform key commercial activities;
- Centrally perform key operational, risk or administrative functions;
- Bear substantial risks that in a worst case scenario could jeopardise the viability of the bank;
- Could not be disposed of or liquidated without likely triggering a major risk for the bank; or
- Are important for the financial stability of at least one of the Members States it operates in.

2. Preferred resolution strategy

Next, it is assessed whether, in case of a bank's failure, the resolution objectives are best achieved by winding up the bank under normal insolvency proceedings or resolving it. If it is the latter, the preferred resolution strategy is developed, including the use of appropriate resolution tools and powers.

3. Financial and operational continuity in resolution

When the resolution strategy has been determined, the financial and operational prerequisites to ensuring continuity in resolution so as to achieve the resolution objectives are assessed.

4. Information and communication plan

This step describes the operational arrangements and procedures required to provide resolution authorities with all necessary information and the arrangements regarding management information systems, which will ensure timely, up-to-date and accurate information, together with the communication strategy and plan for resolution.

5. Conclusion of the resolvability assessment

In this step, it is assessed whether impediments exist to the winding up under normal insolvency proceedings or the resolution of a bank. Where winding up or resolution is not possible, appropriate measures to address such impediments are identified. Furthermore, the level of MREL is determined.

6. Opinion of the bank in relation to the resolution plan

The bank is entitled to provide its opinion in relation to the resolution plan. The bank's opinion forms part of the resolution plan. The resolution plan is reviewed and, where necessary, updated at least annually and after any material changes relating to the bank.

Key elements of resolution plan

- the critical functions and most important core business lines of the bank, as well as the main internal and external interdependencies
- the preferred resolution strategy
- the material aspects of the implementation plan for financial restructuring and for business restructuring
- the main sources of funding and liquidity identified to enable the implementation of the preferred resolution strategy and the main actions to be taken to maintain operational continuity
- the adequacy of the communication and information plans
- the impediments to resolution, as well as the measures to remedy these
- the assessment of the liabilities that qualify as MREL
- the summary of the opinion of the bank regarding the resolution plan

The IRT assesses whether the material legal entities identified by the bank are indeed material in the context of resolution planning.

In general IRTs are allowed to draft simplified resolution plans for banks containing at least:

- General information about the bank
- Relevant communication provisions
- Identification of legal and practical impediments to the application of normal insolvency proceedings
- Conclusion of the resolvability assessment and measures to address or remove impediments to the application of normal insolvency proceedings
- Position of the bank itself

The IRT may require the bank to provide:

- An analysis of the operational consequences of a resolution strategy or
- A description of the processes and arrangements necessary to effectively provide information in resolution.

Valuation in the context of resolution planning

Valuation in Resolution is key. The bank's management information systems must be able to provide timely, up to date, accurate and reconcilable information in order to determine:

- Whether the conditions for the write down or conversion of capital instruments or for resolution are met
- The marketability of assets and liabilities (even if this requires exceptions from accounting and prudential rules)
- Whether shareholders and creditors would have received better treatment if the bank had entered into normal insolvency proceedings

How can Deloitte help you:

Our experienced team of regulatory compliance experts can support your organisation in addressing the technical and regulatory challenges through:

- Reviewing your organisation's Recovery plans and Resolution templates to assess completeness and quality of information
- Assessing the quality of documentation required as part of the strategic business analysis
- Performing Group, Company, Business and Product Valuations and implementing processes to ensure that your organisation's Senior Management and Regulators can accurately assess the "no creditor worse off" (NCWO) requirement at any given point in time
- Assessing your liabilities that qualify as MREL and help your Bank develop a Funding strategy in line with the new regulatory requirements
- Analysing your organisation's Group structure and assessing your Critical Economic Functions to ensure Operational Continuity
- Designing, developing and implementing the processes and infrastructure necessary to effectively collect and store management information required by the SRB or the NCA for the preparation of Resolution Planning

Contacts

If you require any further information on any of the issues mentioned in this material and on how Deloitte can help you address the challenges ahead, please do not hesitate to contact



Alexis Agathocleous

Financial Services Leader
alagathocleous@deloitte.com
Direct line: +357 25 868710



Nikos S. Kyriakides

Financial Advisory Services Leader
nkyriakides@deloitte.com
Direct line +357 25 868601



Clea Evagorou

Senior Manager | Risk Advisory
clevagorou@deloitte.com
Direct line: +357 22 360600

Deloitte.

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. Please see www.deloitte.com/about for a more detailed description of DTTL and its member firms.

Deloitte Limited is the Cyprus member firm of DTTL. Deloitte Cyprus is among the nation's leading professional services firms, providing audit, tax, consulting and financial advisory services through over 600 people in Nicosia, Limassol and Larnaca. For more information, please visit the Cyprus firm's website at www.deloitte.com/cy.

Deloitte provides audit, consulting, financial advisory, risk management, tax and related services to public and private clients spanning multiple industries. With a globally connected network of member firms in more than 150 countries, Deloitte brings world-class capabilities and high-quality service to clients, delivering the insights they need to address their most complex business challenges. Deloitte's more than 244,000 professionals are committed to making an impact that matters.

This communication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively, the "Deloitte Network") is, by means of this communication, rendering professional advice or services. Before making any decision or taking action that may affect your finances or your business, you should consult a qualified professional adviser. No entity in the Deloitte Network should be responsible for any loss whatsoever sustained by any person who relies on this communication.

Deloitte Limited is a private company registered in Cyprus (Reg. No. 162812).
Offices: Nicosia, Limassol, Larnaca.