Solvent wind-down
Gearing up for winding down
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For a number of years, regulators in the US and UK have required some banks to conduct solvent wind-down (SWD) exercises as a part of wider recovery and resolution preparedness. More recently, in the Eurozone the European Central Bank (ECB) and Single Resolution Board (SRB) have begun to request SWD plans on a bank-by-bank basis. At the global level, the Financial Stability Board (FSB) will consult on approaches to SWD in 2019.

Given this increasing scrutiny, Eurozone banks should expect SWD planning to become part of standard recovery and resolution planning (RRP). They should look to the experiences of banks in the UK and US to determine where to focus their attention in order to optimise their approach to SWD exercises and secure the business benefits that SWD analysis can yield.

What is solvent wind-down?

SWD is a regulatory exercise that seeks to ensure that banks are prepared to dissolve some or all of their operations in an orderly way (with a particular focus on investment banking activities) in a situation where neither the continuation of the business nor the restructuring of operations are viable options.

It typically consists of segmenting the trading book into portfolios of positions with similar risk profiles, such as FX exotic derivatives, articulating a disposal strategy for each portfolio and its costs, reporting on the bank’s capital and liquidity positions, articulating of all assumptions in the analysis, and describing the remaining “rump” assets that will persist after the wind-down period.

The SWD exercise gives the regulator and the bank visibility of the costs associated with winding down the bank, an understanding of the maturity and complexity of the trading book, and the funding and liquidity implications of a wind-down.

Challenges and lessons learned

Banks should look to the challenges faced and lessons learned by banks in the UK and US during the first iteration of the SWD exercise to determine where to focus their attention. These include:

- Inconsistent and/or unrealistic assumptions – Inconsistent assumptions between different firms in the group (e.g. exit costs for certain positions) and/or unrealistic assumptions (including those out of line with industry practice or benchmarks) about timescales for unwinding positions may lead to further supervisory scrutiny.

- Database construction and reconciliation breaks – Developing a single SWD database from disparate sources and reconciling data (e.g. between Risk and Finance systems) can be time-consuming and challenging.

- Project management and stakeholder buy-in – As the SWD exercise is a concerted effort requiring inter-departmental coordination, obtaining stakeholder buy-in from the beginning may pose a challenge. Banks should mitigate this risk via a strong “tone from the top”, supported by robust project management and governance arrangements.

- Scalable systems and capabilities – It can prove cost-effective to invest in scalable systems and capabilities upfront (rather than on an incremental basis) to address potentially complex requests in the foreseeable future that require significant enhancement to the database and modelling capabilities.

- Process and controls assurance – Independent testing can provide assurance that SWD planning processes and capabilities are in place and operational.
Optimising solvent wind-down capabilities

While meeting regulatory expectations for the initial SWD exercise will be challenging, banks should look to optimise their SWD capabilities and leverage the benefits building these capabilities can bring. Below, we look at three areas where banks can optimise: integrating their SWD capabilities with wider risk management activities; future-proofing their SWD capabilities in order to reduce the cost of future exercises; and taking advantage of the business benefits that the SWD exercise can bring.

Integration of SWD into wider risk management activities

Banks should view SWD as a part of their wider risk management activities, rather than as an activity in a silo. Integration will enable banks to achieve cost savings by leveraging earlier and ongoing work while also ensuring consistency of reporting to the regulator. Particular areas banks should look to integrate include:

- **Recovery and resolution planning** – SWD is viewed by regulators as one of a group’s recovery options, and firms will be required to demonstrate alignment between the SWD plan and the group RRP Plan.
- **Stress testing** – Regulators may include specific “stress” scenarios to be modelled as part of the SWD analysis. In addition, firms may be required to calculate risk-based losses emanating from credit, market, and operational risks during a market-wide systemic stress period.
- **Booking models** – SWD will require details about a firm’s booking practices, an area of increased scrutiny for many regulators.

Future-proofing SWD capabilities

Over time, regulators are likely to increase the complexity of SWD submissions, leading to additional challenges for banks. In order to anticipate potential future complexities, banks should focus on and plan for the following scenarios:

- **Stress scenario** – If not initially included, banks should expect stress scenarios to be included in later iterations of the exercise.
- **Portfolio segmentation** – Requests may become more granular and prescriptive, requiring a clear articulation of underlying portfolio characteristics.
- **Cost analysis** – More granular cost analysis may be required over time.
- **Capital and liquidity** – More granular reporting may be required at a later stage, including over periods of time outside of the active wind-down period, and an increased frequency of reporting of the liquidity profile and capital positions.
- **Rump analysis** – More detail and granular narratives for rump positions may be required.

Business benefits of SWD analysis

Although SWD exercises typically emanate from a regulatory request, banks which have already had to prepare a SWD plan have seen a number of material benefits:

- **Governance** – SWD playbooks identify and consolidate governance responsibilities, giving the Board and Senior Management sight of granular activity conducted by trading desks which may not be visible through aggregated MI.
- **Data sources** – Reconciliation of different data sources (e.g. Risk, Finance, liquidity, front office, operations) into a centralised database improves the efficiency, versatility, agility and accuracy of the production of regulatory submissions.
- **Business profitability** – Capital and liquidity requirements and operational costs assessed at the individual portfolio levels can allow management to obtain a more holistic risk/return analysis. Moreover, the identification of “rump” positions provides a granular understanding of risk/return related to “sticky” and challenging positions which might require enhanced attention.
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