SUPERVISORY AND REGULATORY GUIDELINES: 2022
Recovery Planning
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RECOVERY PLANNING GUIDELINES

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INTRODUCTION

1. The Central Bank of The Bahamas ("the Central Bank") is responsible for the licensing, regulation and supervision of supervised financial institutions ("SFIs") operating in and from within The Bahamas pursuant to the Central Bank of The Bahamas Act, 2020 ("the CBA"), the Bank and Trust Companies Regulation Act, 2020 ("the BTCRA"), and The Bahamas Co-operative Credit Unions Act, 2015 ("the BCCUA").

2. All SFIs are required to adhere to the Central Bank's licensing, regulation and prudential requirements and ongoing supervisory programmes, including periodic onsite inspections and required regulatory reporting. SFIs are also expected to conduct their affairs in conformity with all other Bahamian legal requirements.

PURPOSE

3. The BTCRA and the CBA grant enhanced resolution powers to the Central Bank to address potential bank failures in the financial system. A thorough and detailed recovery plan is a vital component of a strong crisis management process. The recovery plan should produce a high-level plan fully understood and endorsed by senior management and Board of Directors. These Guidelines specifically address a SFIs' responsibility in developing and testing its own recovery plan as part of their risk management framework and should be designed to apply well before a SFI gets into a crisis situation, in effect enabling the SFI to prevent a crisis rather than to respond belatedly to one.

4. The objective of the recovery plan is to enable a SFI to restore itself to financial soundness and compliance with all regulatory requirements in a timely and credible manner following adverse shock affecting a SFI's capital, liquidity or operational capacity. This process is to be commenced at an early stage in the emergence of financial stress.

5. These Guidelines are meant to serve as a general guide to recovery plans. Nothing in this Guideline prevents or limits the Central Bank from taking any course of action, as it deems necessary, for the protection of depositors or the financial system in The Bahamas.

6. The Central Bank endorses the Basel Committee on Banking Supervision ("*Basel Committee*") extensive guidance published on recovery planning.

APPLICABILITY

7. These Guidelines apply to all banks and banks and trust companies incorporated in The Bahamas as well as co-operative credit unions and branches of foreign banks which are licensed or registered by the Central Bank of The Bahamas (collectively referred to as "supervised financial institutions"). These Guidelines do not apply to pure and nominee trust companies, restricted banks and/or trust companies or managed branches[1].

[1] Please refer to the Central Bank's Guidelines for Managed Branches.

8. The Central Bank recognises that some SFIs are subsidiaries of larger groups, and the recovery planning process may be led and/or managed by a foreign parent. Notwithstanding that a foreign parent will likely lead in these instances, the Central Bank expects the management of the local SFI to be aware of how the parent's global recovery process works for the SFI, and how crisis management at the local level fits into the Groups' recovery plan approach. The local recovery plan should include the triggers for seeking capital injections or other support from a recovering bank's Head Office.

9. Local management must understand the SFI's risk profile and be prepared to engage in discussions with the Central Bank as needed. The Central Bank expects SFIs to have relevant documentation and procedures in place to address these matters, as responsibility for compliance with the requirements of these Guideline remains with the SFI.

10. These Guidelines should also be read in conjunction with the following documents:

    (a) Guidelines for the Internal Capital Adequacy Assessment Process ("ICAAP");
    (b) A Guide to the Central Bank's Ladder of Supervisory Intervention;
    (c) Guidelines for the Management of Capital and the Calculation of Capital Adequacy;
    (d) Guidelines for the Management of Operational Risk;
    (e) Guidelines for the Management of Liquidity Risk; and
    (f) Business Continuity Guidelines.

DEFINITION

11. The recovery plan is a formal action plan that sets out measures (including extraordinary measures) to restore a SFI's financial position in response to emerging stress and/or following a crisis. On the crisis continuum, the recovery stage falls between the lesser stress stage and the greater resolution stage. The SFI should adequately develop recovery triggers and identify and analyse recovery options to enhance management's focus on risk governance toward minimising the financial impact of unforeseen events in the future.

OVERVIEW

12. A SFI's recovery planning process should enable it to continue to operate as a going concern, recovering from adverse but non-fatal shocks to restore its capital, liquidity, or operational capacity to an acceptable level. Recovery planning may improve a SFI's understanding of its risks arising from severe but plausible scenarios.

13. The recovery planning process should be integrated with the SFI's strategy, business decision-making, risk management framework, stress testing, internal capital adequacy assessment process (ICAAP), contingency and business continuity planning.

14. The Central Bank requires SFIs to establish and document a recovery plan, which should identify options to restore financial strength and viability when under severe stress and should include:

    (a) credible options to cope with a wide range of scenarios including firm-specific and market-wide stress;
    (b) scenarios that address capital shortfalls and liquidity pressures; and
    (c) processes to ensure timely implementation of recovery options in a range of stress situations.

MAIN FEATURES OF THE RECOVERY PLAN

15. Effective recovery planning makes a SFI more resilient to financial stress. The recovery plan should include both a SFI's risk management framework for monitoring, and recovery options for responding to a range of stress scenarios. These recovery options should help the SFI to restore itself to a stable and sustainable condition. Each aspect of the plan should be underpinned by detailed analysis.

16. At a minimum, the Central Bank expects the following key elements to be contained in the recovery plan:

(a) Executive Summary;
(b) Governance and risk management;
(c) Documentation and data;
(d) Scope;
(e) Critical functions and services;
(f) Scenarios;
(g) Testing;
(h) Triggers and associated early warning indicators;
(i) Restoration points;
(j) Recovery options;
(k) Feasibility, Timing, Impact and Objective;
(l) Communications;
(m) Implementation of framework (including preparatory measures);
(n) Updating; and
(o) Integration with Risk Management Framework.

(a) Executive Summary

(i) The recovery plan should include a high-level summary that provides an overview of the plan and how it will be implemented. This includes the identification of the SFI's critical functions and services, triggers and associated early warning indicators, stress scenarios and recovery options, as well as preparatory measures.

(ii) The executive summary should either contain or include reference to a short checklist of decisions and actions that the senior management team and the Board can use to:

a. Determine whether to invoke the recovery plan;
b. Ascertain the nature of the problem affecting the SFI, its cause, and its impact;
c. Determine the recovery strategy, including recovery actions and communications; and
d. Ensure all actions are subject to effective oversight and coordination.

(iii) Matters which will be considered when reviewing a SFI's recovery plan include:

a. Does the recovery plan contain an executive summary which is succinct and practical in its focus?
b. Does the executive summary cover the listed items above?
c. Would the executive summary be a useful guide for senior management and the Board for use of the recovery plan in a situation where the plan needs to be applied? Is the executive summary easy for a user to access and apply?

d. Does the executive summary contain a checklist of key decisions and actions that senior management and the Board need to make when deciding to invoke the recovery plan; in determining the nature and impact of the problem being addressed; and in applying recovery actions? If not, does a separate document exist which contains such a checklist?

(b) Governance and Risk Management

(i) The SFI's senior management is responsible for:

a. Developing and implementing a recovery plan and maintaining the recovery plan process;

b. Presenting the recovery plan to the Board of Directors for approval once developed and tested (feedback from the Board should be addressed and the recovery plan revised accordingly);

i. For branches of foreign banks, the responsibilities outlined for the Board of Directors of a SFI should be assumed by the Head Office of the local branch. Senior managers at Head Office should ensure that the standards outlined herein are appropriately addressed by the senior management of the local branch.

c. Annual review and testing of the recovery plan; and

d. Identifying the accountable senior executive who will be responsible for the SFI's recovery plan and for acting as the SFI's contact point with the Central Bank on its recovery plan. Those who typically have oversight of the risk management function (CEO, CFO, or CRO) will have ownership of the plan and should ensure that the plan is kept up to date.

(ii) SFIs should designate a Recovery Management Team responsible for implementing the applicable sections of the recovery plan for their functional areas. This team may comprise executives and staff normally employed by the SFI in other roles.

(iii) SFIs must ensure that decision-making and escalation processes for the activation of recovery options are in place. In particular, this includes clearly defining the responsibilities of Board members, senior management and business units, and identifying a senior executive[2] responsible for ensuring that the SFI observes recovery planning requirements and that recovery planning is integrated into the SFI's overall governance processes. Management information on early warning indicators and any breach of triggers should be reported promptly to senior management and the Board to enable early detection of severe stresses.

(iv) Escalation and activation procedures are also necessary to evaluate the various recovery options set out in the recovery plan in order to decide which, if any, of the options to activate and to specify how this activation will be implemented.

(v) The Central Bank recognises that senior management may approve some recovery options, while others may require approval of the Board. These decision delegations should be clearly documented in the recovery plan, along with details regarding the decision-making and escalation process.

[2] See 16(b)(iv) below.

(vi) The Board is expected to maintain a close overview of senior management's performance of its responsibilities in relation to the recovery plan in order to satisfy itself that senior management has performed all of its responsibilities effectively. The Board is also expected to clearly understand its own responsibilities in relation to the recovery plan, including the recovery actions entrusted to it. The Board should maintain a comprehensive understanding of the recovery plan and be satisfied that it complies with all regulatory requirements, is comprehensive and is practical and realistic. The Board must ensure that the plan is subject to regular testing and the results of the test is assessed. Occasionally, it would be appropriate for the Board to participate in the testing of the recovery plan, both as active participants and as observers.

(c) Documentation and Data

(i) Recovery plans should be supported by documentation, data, and management information. The plan must be clearly defined and capable of being activated by senior management in a timely and effective manner. Data and management information should identify when triggers are breached or are likely to be breached and should be integrated with other data and internal reporting aspects of the SFI's risk management framework.

(d) Scope

(i) Where SFIs are a part of a group, recovery plans must address recoverability on both a solo basis and a group basis.

(ii) In addition to this, SFIs are required to include scenarios within their recovery plan which will reflect an event where the parent entity experiences a stress situation which would also affect the local SFI. In this case, the SFI will be required to identify recovery options available to them, and also include the recovery options available where the parent entity is not willing or capable of providing capital or liquidity assistance.

(iii) In the case of cross-border groups, the Central Bank may require the submission of a supplementary recovery plan, particularly where no group recovery plan exists, or where the SFI is not adequately covered by the group recovery plan. However, SFIs should ensure that there is group-wide coordination to avoid inconsistent recovery actions in times of crisis.

(e) Critical Functions and Services

(i) For SFIs operating in the Bahamian domestic market, the recovery plan should identify the SFI's core business lines, critical functions and critical services, and the key legal entities and jurisdictions from which these functions and services are provided.

(ii) A critical function includes:

a. payments, clearing, settlement, and custody services;
b. retail deposit-taking;
c. retail lending;
d. specialist lending (e.g. small and medium enterprises, industry sectors, or regions), and;
e. market-making in securities such as government bonds will be recognised as an activity of a SFI, which, if discontinued following the failure of the SFI would cause

significant damage to financial stability or the wider economy, or would be detrimental to the ability of the SFI to meet its obligations to depositors.

(iii) A critical service is one on which critical functions depend. These are likely to include:

a. IT systems;
b. transaction processing;
c. administrative services;
d. trading and asset management;
e. treasury-related services;
f. access to financial market infrastructures;
g. valuation, accounting and cash handling; and
h. ability to maintain customer account to identify, quantify, monitor and manage risks, real estate, legal services, and risk management and compliance functions. These services may be performed in-house, from within a SFI or group, or outsourced to third parties.

(iv) It is important that SFIs focus on recovery options that would help to preserve the continuity of critical functions and services, while recognising and avoiding recovery options that might threaten the continuity of critical functions and services (e.g. the sale or closure of a group entity that provides all or part of a critical function, or provides critical services on which the continuity of a critical function may depend).

(f) Scenarios

(i) Scenario testing is important for demonstrating that the recovery plan is suitable for use in a range of different types of stress situations. Testing should be used to improve the consistency of the elements of the recovery plan (i.e. governance, indicators, recovery options, etc.). SFIs should conduct scenario testing to ensure that the recovery plan is viable.

(ii) The SFI should develop a range of both firm-specific and market-wide, plausible but severe scenarios that accurately reflect the bank's specific vulnerabilities based on its business activities. These scenarios should include a wide range of stress events designed to negatively affect the SFI's critical functions and services, thus preparing the SFI in the event of a future occurrence. Each SFI can select its own set of scenarios, but the scenarios should be sufficiently severe in impact on capital and liquidity as to provide meaningful and realistic testing of a range of recovery options. SFIs should note that the scenario need not contain a detailed narrative, but rather should focus on the impact the scenario would have on their capital and liquidity. The scenarios should also cover both fast-moving (e.g. adverse capital and liquidity events occurring over a period of days and weeks) and slow-moving (e.g. adverse capital and liquidity events occurring over several months) financial crises and should include, but not be limited to, the scenarios used by a SFI for its stress testing. A rationale as to why the particular scenario was selected should also be included. Additionally, SFIs should include an estimated time of recovery from each scenario and list the potential disruption issues within the critical business lines. Every Bahamian recovery plan should include a scenario contemplating a catastrophic hurricane striking New Providence.

(iii) SFIs should then analyse the potential impact of scenarios on their:

a. profitability;
b. capital and liquidity;

c. credit rating and cost of raising funding;
d. external counterparties;
e. operational capacity;
f. material legal entities;
g. core business lines;
h. critical functions and critical services; and
i. group-wide position.

A recovery plan's operational capacity may incorporate by reference, each SFI's business continuity plan. Additionally, SFIs should ensure that for each scenario, the particular recovery options it would apply in the scenario as set out in section 16(j) of these Guidelines.

(iv) SFI's recovery plan should include a description of the scenario (including a brief discussion on cause and nature of economic and financial shocks), the impact on the SFI's balance sheet, income statement, cash flows, capital, liquidity, etc. SFI's should also adjust accordingly for the financial contributions of the recovery options.

(v) SFIs should also include detail about the design and planning of the scenario used to report on how the exercise unfolded, and lessons learnt for the development of the recovery plan.

(g) Testing

(i) Testing is a key element in the credibility of a recovery plan while educating stakeholders on their role during a recovery scenario. Recovery plan testing is an annual process beginning with:

a. Strategy and plan;
b. Test of design;
c. Preparation;
d. Execution of test;
e. Test evaluation, and;
f. Revision of plan and strategy (if needed).

(ii) SFIs should leverage existing testing framework, align testing framework with governance, and involve all the lines of defense.

(iii) SFIs should also create a concise implementation guide covering the procedures for activating each recovery option, and should perform tests of their recovery plan. The Central Bank recognises that not all recovery options can be fully tested, but a SFI should confirm as far as feasible that its recovery options could be activated.

(iv) The results of any stress testing conducted should be included in the recovery plan. Moreover, where revisions are made to the plan, this should be submitted to the Central Bank.

(v) Based on the identified shortcomings and recommendations, a SFI should improve the relevant parts of its recovery plan and identify preparatory measures to improve the recoverability of the firm, where relevant. The exercise should be conducted with sufficient time before submission to reflect lessons learnt in the recovery plan and remediate identified deficiencies.

(vi) Every *three years,* the SFI should conduct live simulation type exercises based on a selected scenario to test the recovery plan in its entirety. This is a useful way to test the effectiveness of the recovery plan in a "live" situation. This simulation should involve the participation of the Board and senior management team. SFIs should use the findings of these exercises to improve their plans and demonstrate how the arrangements set out would work in practice. The results from the simulation should be incorporated into the next update of their recovery plan.

(h) Triggers and Associated Early Warning Indicators

(i) An effective trigger framework, linked to associated early warning indicators, maximises the chance that the SFI is alerted to an oncoming stress with sufficient notice to evaluate and potentially implement any necessary recovery options. The trigger(s) in relation to particular financial indicators should be used as a prompt to consider the situation and whether it is appropriate to take any actions; for example it might require the convening of a senior decision-making recovery management team. Some triggers – such as defined breaches of capital ratio and liquidity ratio minimum tolerances in a SFI's Risk Appetite Statement, or breaches in upper limits on NPL ratios, might cause the recovery plan to be activated and specific recovery options implemented.

(ii) Trigger points in recovery planning enable SFIs to restore financial strength and viability before conditions are met for recovery measures to be implemented by the Central Bank[3]. SFIs should develop a set of early warning quantitative and qualitative indicators and triggers to indicate when recovery options might need to be activated[4]. The trigger framework should provide sufficient early warning to allow corrective action to be taken and identify a set of pre-defined criteria that enable the SFI to monitor, escalate, and activate the appropriate range of responses for an emerging stress event.

(iii) Triggers for a recovery plan would typically include:

a. Capital ratios;
b. Liquidity ratios;
c. NPL ratios;
d. Profitability ratios; and
e. Credit ratings (if relevant), (such that triggers are set in alignment with tolerance levels in the Risk Appetite Statement.)

(iv) The triggers should all be set at levels well before any breach of regulatory requirements has occurred.

(v) Early warning indicators (''EWIs'') should be developed in connection with all triggers for the recovery plan and are used to signal negative trends and should alert the SFI to emerging signs of distress. Indicators should be forward-looking to allow time to initiate action prior to a potential breach of an identified trigger and for recovery options to be implemented. It is relatively common for a recovery plan to contain a range of early warning indicators in relation to capital, liquidity, asset quality and profitability, with the early warning indicators being

[3] Refer to the Central Bank's Ladder of Supervisory Intervention, Stage 2 Intervention.
[4] SFIs should always include a broader range of indicators than regulatory capital and liquidity ratios.

selected for their predictive quality in identifying future potential breaches in recovery plan triggers.

(vi) SFIs must indicate the selection criteria for recovery options, how the trigger points were determined and provide an analysis that demonstrates that trigger points would be breached early enough for recovery to be effective. It is also important to note that early warning indicators should be linked to triggers.

(vii) Some indicative examples of EWIs include:

Capital

a. Early-stage deterioration in capital ratios;
b. Capital ratios falling below target levels in the Risk Appetite Statement or in ICAAP;
c. Rapid growth in lending;
d. Increase in the proportion of higher-risk lending;
e. Increase in risk appetite;
f. Adverse movement in risk environment;
g. Deterioration in risk management quality; and
h. Increase in risk-preferment activity.

Liquidity

a. Early-stage deterioration in liquidity ratios;
b. Reduced reinvestment of maturing deposits;
c. Shortening of average maturity of funding;
d. Acceleration in withdrawal of deposits;
e. Increase in risk premium on funding costs;
f. Adverse movements in asset/liability maturity mismatch; and
g. Reduced cash flows from loan portfolio.

Asset Quality

a. Early-stage deterioration in asset quality indicators;
b. Increase in unemployment and underemployment;
c. Lengthening in loans past due;
d. Increase in requests from borrowers for loan restructuring due to stress;
e. Increase in interest rates; and
f. Decline in asset prices relevant to collateral values.

Profitability

a. Increase in operating expenses;
b. Reduced net interest margins;
c. High wage inflation;
d. Increased competitiveness and contestability in key financial markets;
e. Higher forecast expenses associated with IT/cyber security risk factors; and
f. Higher forecast expenditures on the SFI’s restructuring and technology updates.

(viii) Where the local entity requires capital and the group is sound, the Central Bank expects, but does not require, a contractual commitment that the group will recapitalise its subsidiary. If the deficiency is small, and the SFI remains well above its regulatory capital requirement, then local actions such as reduction or suspension of dividends, or steps to improve profitability, may prove sufficient.

(ix) Where the group is weak but the local entity is sound, the Central Bank expects the local Board and management to ensure that the local entity's position is not weakened to support the group. Among other things, any form of capital reduction including through a return of capital or extraordinary dividend will require prior approval from the Central Bank.

(x) Where both the group and the local entity suffer from capital deficiencies, the local management and Board should also take care that the Bahamian entity does not subsidise the group in any capital support sense.

(xi) As with capital, SFIs will need a liquidity recovery plan for the scenarios of weak local entity and strong parent, weak parent and sound local entity, and both the local entity and the parent suffering liquidity challenges. There is an additional scenario in which global capital, funding, and derivatives markets become disordered.[5]

(xii) In each of these scenarios, the Central Bank expects that local management and Boards will ensure that the parent provides rapid and appropriate support, and that the local entity does not provide undue liquidity support to a troubled parent. As with capital, small liquidity deficiencies that remain above regulatory requirements may be addressed locally, but substantial deficiencies will require large and rapid parent support. Each SFI's liquidity recovery plan needs to include a contingency plan, possibly involving orderly wind-up and/or sale of the business, if parent support is not forthcoming.

(xiii) At minimum, trigger points for recovery planning should be:

a. Aligned with a SFI's existing capital or liquidity contingency plan triggers (but should not be limited to such triggers);
b. Incorporated into its overall risk management framework; and
c. Subject to review by the Board of Directors.

(xiv) The SFIs can also develop a selection of less severe early warning indicators to identify emerging signs of stress for each financial institution[6].

(i) Restoration Points

(i) A restoration point needs to be clearly defined in a SFI's recovery plan. SFIs should note that the successful restoration point is not simply meeting the minimum capital requirements but identifying what level of excess capital is needed based on risk preferences.

(ii) A SFI's recovery plan should define the restoration points being applied and the rationale for these restoration points. A SFI's recovery plan should define target restoration points for capital, liquidity, asset quality, profitability and credit rating. The restoration points should include restoration levels in relation to:

a. CET1 ratio;
b. Tier 1 capital ratio;

[5] Refer to Appendix below.

[6] Triggers should generally be aligned to the minimum tolerance levels set out in the SFI's Risk Appetite Statement, such that triggers for invoking recovery actions should apply before a SFI has breached regulatory minima.

c. Total capital ratio;
d. HQLA ratio;
e. LCR ratio;
f. Profitability, expressed both in ROA and ROE terms; and
g. Asset quality, expressed in terms of relevant indicators of impaired and restructured assets, as a percentage of total assets and total loans.

(iii) Other restoration points can also be applied, including ones relating to defined measures of market confidence in the SFI, depositor satisfaction, other stakeholder satisfaction, and resumption of business-as-usual operation of all critical functions and services.

(j) Recovery Options

(i) Recovery options are measures invoked in a stress situation to prevent a crisis and will be available to a SFI to restore its financial position before, during or following a crisis. Consideration of such options prior to a crisis is essential and increases the probability of a SFI's recovery.

(ii) The recovery plan should specify a range of recovery options that a SFI could activate to restore its financial position or confidence in its viability, following an adverse shock. The activation of these options should enable the SFI to survive a range of severely stressed scenarios. Recovery options should be sufficiently comprehensive to enable the SFI to respond effectively to a range of scenarios within the specified timeframe. Recovery options should not be limited to those that are easy to implement and should consider extreme options such as changing the SFI's structure and business model or the sale of strategic assets.

(iii) SFIs should identify the factors that could reduce the effectiveness of recovery options in restoring its financial position during or following a crisis, (e.g. prior experience in implementing a recovery option should be included where applicable, along with information on the circumstances which might render the recovery option unavailable). SFIs should also detail how these circumstances could be mitigated.

(iv) Specific recovery options should be in place to respond to each specific trigger point – although in some cases the same option may be used in response to more than one trigger.

(v) A SFI's recovery plan should contain recovery options in relation to:

a. Restoration of capital;
b. Restoration of liquidity;
c. Restoration of profitability; and
d. Asset quality.

a. Capital recovery options

A recovery plan should set out comprehensive and detailed recovery actions to restore capital to the target level. The recovery options need to be realistic, practicable, and credible. Priority should be given to recovery actions that have the greatest probability of successful implementation in the shortest period of time, and which make the greatest contribution to capital restoration. These recovery actions should generally be capable of completion within three months but not more than six months.

Recovery actions should be classified into specific categories, including initiatives to:

a. Raise equity from existing shareholders via a rights issue or through private placement of equity to existing controlling shareholders, consistent with what is permitted under the SFI's constitution;
b. Raise equity from new investors, such as the issuance of shares to selected potential shareholders;
c. Convert debt into equity where the SFI has a tranche of debt with contractual provisions to enable it to be converted into equity upon specified triggers being met;
d. Write down debt where the SFI has a tranche of debt with contractual provisions to enable the debt to be written down upon specified triggers being met;
e. Suspension of distributions (including dividends) to shareholders;
f. Reduction or suspension in new lending, so as to reduce the amount of additional capital required;
g. Initiatives to reduce operational expenses, so as to reduce the amount of additional capital required;
h. Sale of assets or change in the mix of assets so as to reduce the amount of additional capital required and to increase the risk-weighted capital ratio by reducing the amount of risk-weighted credit exposures;
i. Sale of subsidiaries; and
j. Issuance of new debt that meets the eligibility criteria for inclusion.

Each recovery action should specify the amount estimated to be raised or capital savings induced by the recovery action and the timeframe for completion. In the case of issuing new capital instruments or raising capital from existing shareholders, the recovery plan should include as attachments the draft capital issuance documentation and underwriting documentation, or at least detailed terms sheets for the documentation.

b. Liquidity recovery options

Recovery actions for liquidity, like all recovery actions, should be specific, realistic, practicable and credible. The recovery actions should be set out in order of priority, based on the probability of successful implementation and contribution to the estimated need for additional liquidity. Speed of implementation is critical for any liquidity actions, where success and credibility of recovery actions are measured in hours and days, rather than weeks or months.

Recovery actions should be set out under specific categories, such as initiatives to:

a. Sell marketable securities;
b. Obtain liquid assets from controlling shareholders where feasible;
c. Raise liquidity via borrowing from other SFIs under committed standby facilities;
d. Borrow from the central bank under business-as-usual liquidity facilities provided routinely to SFIs by the central bank;
e. Sell illiquid assets in exchange for liquid assets, including via sale and repurchase agreements or securitisation;
f. Lengthen the maturity profile of liabilities;
g. Shorten the maturity profile of assets (where feasible);
h. Reduce the need for liquidity by reducing new lending and reducing operating expenses, where feasible; and
i. Renegotiating the terms of scheduled debt repayments and debt servicing where this is considered feasible and prudent.

Any documentation needed for liquidity actions should be set out in draft form attached to the recovery plan or at least detailed terms sheets for documentation provided as part of the recovery plan. Recovery options should be quantified in terms of the estimated impact on liquidity. The implementation steps and timeframe for implementation should be set out in relation to each recovery action.

c. Profitability recovery options

All recovery actions should meet the standard test of being realistic, practicable and credible, and capable of delivering the intended outcomes in a realistic timeframe. Restoration of profitability is likely to be less urgent and critical to a SFI's survival in the short term, and it is likely to take longer to achieve than capital and liquidity recovery actions, the recovery plan could be expected to attach lower priority to profitability restoration initiatives in the short-term. However, restoration of profitability will be critical for the longer term survival of the SFI, both in terms of capital maintenance and market confidence.

Recovery options should be set out comprehensively with detailed implementation steps. The following categories of recovery options are likely to be helpful:

a. Initiatives to reduce operating expenses, consistent with maintaining acceptable risk management practices and critical functions and services;
b. Initiatives to increase revenue from under-performing business lines where feasible and where this is consistent with the SFI's risk appetite and risk management frameworks;
c. Initiatives to reduce or eliminate business activities that do not meet defined ROA and ROE hurdles, and
d. Initiatives to reduce average funding costs where feasible, consistent with the bank's risk appetite and risk management frameworks.

d. Recovery options for asset quality

Asset quality concerning recovery actions need to meet the standard tests of being realistic, practicable and credible. These recovery actions should be achievable within timeframes that are likely to be seen as credible and realistic by financial markets, rating agencies, depositors and other stakeholders as they need to assist in restoring market confidence in the SFI.

Recovery actions should be classified into categories, such as initiatives relating to:

a. The restructuring of loans to enhance recoverability – e.g. by elongating the term of the loan, suspending interest payments, etc.;
b. Transferring impaired loans into an asset management company owned by the SFI;
c. Selling impaired loans to other parties;
d. Write-off loans considered to be irrecoverable; and
e. Strengthening the quality of lending policies and procedures, and associated credit risk management arrangements, in order to enhance asset quality for new loans.

In this case, the plan should identify expected impacts on asset quality and the timeframe required to achieve the desired outcomes. Implementation steps should be specified in detail.

(vi) Other types of recovery options may include:

i. Injecting additional capital;
ii. Reducing or suspending dividends;
iii. Selling investments, subsidiaries, assets, or business lines;
iv. Accessing additional funding or using liquid assets to generate cash;
v. Cost reductions from suspending variable remuneration, and major projects and expenditures. Available options to address liquidity shortfall may also include drawdown on liquidity facilities, parent-based liquidity support, initiatives to lengthen the maturity profile of funding, slowing lending, cutting non-essential expenditures, and securitisation (if feasible);
vi. Changes to the business model to de-risk the business; and
vii. Restructuring.

(vii) Recovery options should not assume that government support would be available, or that a regulator would provide liquidity beyond pre-announced arrangements (including acceptable collateral).

(viii) Activating specific recovery options should not be automatic. Instead, the recovery plan should identify one or more recovery options that could be activated in response to the breach of a trigger. The choice of whether to activate a recovery option, or of which option to activate, will depend on the circumstances and should be discussed as part of the SFI's escalation processes for decision-making. The recovery plan should identify:

i. Who has the authority to approve each recovery option;
ii. The prioritisation/sequencing of recovery actions, differentiating between idiosyncratic and system-wide scenarios;
iii. The timeframe for recovery options to be completed and the implementation steps needed; and
iv. An estimate of the likely maximum amount that the recovery option could contribute to capital/liquidity restoration.

(ix) A SFI's recovery plan should outline the steps it will take when remedying the causes of the breach of capital, liquidity, profitability, asset quality, etc. The SFI's recovery strategy should include initiatives to correct the deficiencies in its risk management systems and controls which caused the SFI to experience such difficulty.

Special note: Domestic Systemically Important Banks ("DSIBs")
It is open to most SFIs to include large balance sheet and risk reductions in their recovery plans. If DSIBs collectively or individually seek to rapidly reduce their portfolios, they <u>must</u> first engage in discussions with the Central Bank. The Central Bank expects that DSIB's recovery plans will allow for DSIBs to support their borrowers, including providing additional funding for qualified borrowers.

(k) Feasibility, Timing, Impact and Objective

Each recovery option should take the following key elements into consideration:

1. Feasibility
Some recovery options may not be available or may be less effective in certain circumstances (e.g. when there are market-wide stresses). It may also not be feasible to undertake multiple recovery options at the same time.

2. Timing
SFIs should include the expected impact and timeframe over which each recovery option could be implemented. Some recovery options may require a long time to implement or for the benefits of the option to materialise. It is therefore important that recovery options correspond with the timeframe to restore financial health or market confidence under each stress scenario.

3. Impact
SFIs should assess in advance the likely impact of each recovery option, not only on its immediate need for additional capital, funding, etc., but also on potential side effects such as the impact on critical functions and critical services, on the rest of the financial group (where applicable), and on the longer term viability of the institution.

4. Objective
SFIs should identify what a successful restoration point for capital, funding, market confidence, etc., and whether the successful activation of one or more recovery options would deliver a successful outcome. In general, the restoration points for capital and liquidity should be set at levels that would enable a SFI to re-establish market confidence in the SFI and would generally be aligned to the target operating range for capital and liquidity in the SFI's Risk Appetite Statement.

(l) Communications

(i) In the event of the activation of a recovery plan, there should be clearly defined protocols for when and/or how communication with internal and external stakeholders, the Central Bank, and in some cases, the local media will occur to ensure that the communication is of one accord.

(ii) SFI's should note the importance of their recovery plan to contain guidance on who the key stakeholders are, what information they would reasonably expect to receive during the recovery process, the communication channels for dissemination of information, and those responsible for ensuring that this all happens in both a timely and effective manner.

(iii) The recovery plan should list who will be responsible for approving communications, which should be a central source to avoid sending mixed messages to internal and external stakeholders and the media.

(iv) The recovery plan should include contact lists of those who will need to be informed, a protocol for what information can be communicated and how it should be conveyed.

(m) Implementation of Framework

(i) A SFI should assess whether it is able to leverage other plans and processes to enhance the recovery plan.

(ii) SFIs will identify any preparatory measures related to the credibility and effectiveness of individual recovery options and detail a plan to conduct these.

(iii) SFIs should outline the preparatory measures that would enable them to increase the scope and feasibility of recovery options, as well as the credibility/effectiveness of the recovery plan overall. Preparatory measures may include:

a. Measures necessary to overcome legal impediments to the transfer of own funds/repayment of assets or liabilities within the group;
b. Measures necessary to increase the sale of any capital issuance, including indicative documentation for share issuance and underwriting agreements;
c. Measures necessary to facilitate the sale of assets or business lines; and
d. Structural changes to the group necessary to increase the credibility and effectiveness of the recovery plan; and
e. Indicative documentation and legal and operational pre-positioning needed for implementing liquidity support arrangements, such as standby facilities and sale and repurchase agreements, including collateral requirements.

(n) Updating

(i) Recovery plans should be reviewed on an annual basis and regularly updated to reflect any change to a SFI's business activities, its financial situation, its legal or organisational structure, or any other matter, which could have a material effect on or necessitate a change to the recovery plan. The recovery plan should be subject to approval by the SFI's Board of Directors. SFIs must notify the Central Bank within *one month* of making any material changes to a recovery plan.

(o) Integration with the Risk Management Framework

(i) The recovery plan is intended to be used in relatively severe situations of capital and liquidity stress, on the presumption that milder stress situations are covered in other plans. The recovery plan should be integrated into the SFI's wider Risk Management Framework, focusing in particular on the Internal Capital Adequacy Assessment Process (ICAAP), Contingency Funding Plans (CFP) for capital and liquidity, as well as the Business Continuity Plan (BCP).

(ii) SFIs should ensure that there is a coherent process for being alerted to and addressing a liquidity stress.

(iii) The Central Bank expects that a SFI's ICAAP, CFP, BCP, recovery plan, and (where relevant) concurrent stress test documents will be consistent with each other. For example, similar scenarios in two documents should have broadly similar impacts (there may be exceptions) and the recovery plan should include all management actions proposed in other documents, either by cross-reference to those documents or replicated in the recovery plan. Where the documents are produced by different people in the organisation, the Central Bank expects them to effectively co-ordinate to consider related documents together.

CENTRAL BANK'S SUPERVISORY REVIEW AND EVALUATION PROCESS

17. SFIs should monitor their full set of recovery indicators, increasing frequency as a SFI becomes more troubled. SFIs must report on a timely basis to the Central Bank any breach of indicator thresholds, even if it does not result in the implementation of a recovery action. SFIs should regularly review and update their list of credible and feasible recovery options and any preliminary measures that are necessary to quickly implement the recovery options that should be taken.

18. As a part of the assessment of a SFI's recovery plan, the Central Bank will use the SFI's analysis of its recovery options, along with the Central Bank's own assessment to estimate the SFI's current recovery capacity in various scenarios.

19. If a recovery plan is unable to restore the financial and operational health of a SFI, then the institution may no longer be viable or may have no reasonable prospect of becoming viable, and in such circumstances the criteria for placing the SFI into resolution may be satisfied.

20. The Central Bank will assess the appropriateness and adequacy of a SFI's recovery planning process and the integration of that process in its risk governance framework, taking into account the systemic importance, size, and complexity of the SFI. The quality and reasonableness of the recovery plan will also be assessed. In some respects, this will be similar to the supervisory review and evaluation of the SFI's ICAAP with the quality of the recovery plan providing information about a SFI's risk management capabilities and providing information that can be fed into the supervisory risk assessment of the SFI.

21. Where the Central Bank is of the view that a recovery plan submitted by a SFI is deficient, the SFI will be notified and required to resubmit the recovery plan within a specified timeframe with such revisions as may be reasonably required to address the deficiencies in the plan.

22. Each SFI will be required to submit its recovery plan periodically to the Central Bank and the cycle for submission will be tailored to each SFI.

APPENDIX

1. The following, which is required from all Host-Supervised (foreign-owned) banks, including bank and trust companies, should be contained in the recovery plan.

2. A scenario on capital, covering three scenarios:

    a. The local subsidiary requires capital, and the group is sound;

    b. The group or parent is weak, but the local subsidiary is sound; and

    c. Both the local subsidiary and the group require capital.

3. A scenario on liquidity, also covering three scenarios:

    a. The local subsidiary/branch requires liquidity, and the group is liquid;

    b. The local subsidiary/branch is liquid, but the group requires liquidity;

    c. Both the local subsidiary/branch and the group require liquidity; and

    d. International funding and capital markets have become disordered, along the lines of the late 2008 North Atlantic financial crisis.

4. The Central Bank does not require or expect that the recovery plan for Host-supervised institutions will become particularly long or complex. We note that the Central Bank's Basel III capital framework already includes substantially super-equivalent and more flexible capital buffers than the Basel Committee rules text, and to some extent, this super-equivalence allows a simpler approach to recovery planning.

Home-Supervised Domestic Banks

5. Home-supervised domestic banks must complete the recovery plan outlined in this Annex, and must complete the more extensive requirements associated with home-supervised domestic banks. In this case, the recovery plan referenced here should focus narrowly on aspects of support or non-support from the parent bank or group, with local recovery strategies outlined in the recovery planning for domestic banks.