South African Reserve Bank

From the Office of
the Registrar of Banks

Ref: 15/8/3

D1/2015

2015-02-04

To: All banks, branches of foreign institutions, controlling companies, eligible institutions and auditors of banks or controlling companies

Directive issued in terms of section 6(6) of the Banks Act, No. 94 of 1990

Minimum requirements for the recovery plans of banks, controlling companies and branches of foreign institutions

Executive summary

This Office had previously issued Guidance Notes 4 of 2012 to provide high-level guidance to banks, controlling companies and branches of foreign institutions (hereinafter referred to collectively as 'banks') on the key elements of a recovery plan.

The purpose of this directive is to specify the minimum requirements relating to the recovery plans of banks.

1. Introduction

1.1 In response to the global financial crisis, the Financial Stability Board (FSB) released its *Key attributes of effective resolution regimes for financial institutions (Key attributes)* on 4 November 2011. The *Key attributes* constitute the international standard for resolution planning with which South Africa, as a member of both the FSB and the Group of Twenty Finance Ministers and Central Bank Governors (G-20), has to comply.

1.2 One of the main objectives of an effective resolution regime is to minimise the cost of crisis resolution to the taxpayer, reduce moral hazard in the financial system, and protect financial stability. In support of these objectives, the necessary processes and arrangements have to be in place to allow for the effective recovery of financial institutions, where possible without intervention, financial support or guarantees from the central bank or government.

1.3 An important tool in this regard is the requirement for financial institutions to have recovery plans in place in order to improve the financial institution's ability to recover through its own actions from severe stress, whether idiosyncratic or systemic.

1.4 The purpose of a resolution plan is to prepare and consider actions for the resolution of the financial institution without a systemic disruption or cost to taxpayers. Banks are responsible for the development of their own recovery plans, and supervisory authorities are responsible for the development of resolution plans.

1.5 Previously, this Office had issued Guidance Notes 3 of 2012, 4 of 2012 and 10 of 2012 to provide high-level guidance to banks on the key elements of a recovery plan.

1.6 The purpose of this directive is to specify the minimum requirements in respect of banks' recovery plans. This directive replaces Guidance Notes 3 of 2012, 4 of 2012 and 10 of 2012.

1.7 Based on the aforesaid information, and in terms of the provisions of section 6(6) of the Banks Act, No. 94 of 1990 (the Banks Act), banks are hereby directed to ensure that their recovery plans include and cover the requirements specified in paragraphs 2 to 9 below.

2. Definitions

2.1 'Core business lines' are the business lines that a bank would seek to protect through the implementation of its recovery options in order to ensure the sustainability of the bank after the implementation of one or more recovery options.

2.2 'Core shared services' are activities performed by a bank or outsourced to a third party where failure would impair the bank's ability to continue its core business lines.

2.3 'Critical functions' are performed by a bank for third parties where failure would lead to a disruption of the services that are vital for the sustained functioning of the real economy and for the financial stability in the country where the bank is present. These functions could include deposits and withdrawals, payments, clearing and the settlement of transactions.

2.4 'Critical shared services' are activities performed by a bank or outsourced to a third party where failure would lead to the inability to perform critical functions.

2.5 For the purposes of this directive, the 'point of failure' is defined as the point where the execution of recovery options was unsuccessful or is likely to be unsuccessful, and where the resolution actions by the supervisory or resolution authority should be undertaken to recover or resolve the bank.

3. Scope of application

3.1 The requirements set out in this directive shall apply to all registered banks and locally registered branches of foreign institutions. The level of detail and the range of recovery options in the recovery plan should be commensurate with the risk profile of the relevant bank or institution.

3.2 Those banking groups that have been classified as systemically important within the South African banking sector, and have been informed of this in writing by the Bank Supervision Department, are required to have group-wide recovery plans in place. This Office may, at its discretion, also require non-systemically important banks to develop group-wide recovery plans. Such banks will be informed of this requirement. In such cases, where a requirement refers to a bank, the requirement for a recovery plan as well as the principles set out in this directive shall also apply to the banking group.

4. Be practical and specific

4.1 A bank's recovery plan should be detailed enough to be practical and needs to be specific to the business of the bank[1].

5. Governance requirements

5.1 The development, maintenance, approval and annual review of the recovery plan should be subject to an appropriate governance process with clearly assigned roles and responsibilities for operational staff, senior management and the board of directors (or committee of similar standing in the case of a locally registered branch of a foreign bank).

5.2 The board of directors should express its view on the recoverability of the bank from severe financial stress based on the recovery options identified in the recovery plan.

5.3 An overview of any material changes and/or updates made since the previous version of the bank's recovery plan needs to be included in the recovery plan.

6. Group structure and key information on legal entities

6.1 In instances where a bank is required to develop a group-wide recovery plan, the recovery plan should cover the entire banking group, including banks, foreign branches and subsidiaries.

6.2 Details on the bank's strategy, business model, core business lines (as defined in paragraph 2.1) and main activities should be provided.

6.3 Mapping of the bank's legal and operational structures, together with relevant information about its organisational structure, business units and activities, should be provided.

---

[1] Also locally registered branches of foreign banks and banking groups (in the cases specified in paragraph 3.2)

6.4 In the context of a banking group, the recovery plan should include an identification of interdependencies among group entities, including material intra-group exposures and funding relationships, shared services, capital mobility within the group as well as intra-group guarantees that would apply in both business-as-usual and crisis times. The purpose of this is to identify economic, systemic and legal interlinkages that may be barriers to recoverability.

6.5 Banking groups should identify significant legal entities within the group and provide details on the criteria used in this regard. These criteria should be based on an assessment of the legal entity's possible impact on the overall banking group as measured by criteria such as (but not limited to) size, profitability, strategic importance, systems and any other interdependencies. Recovery options should be developed for these significant legal entities to determine the extent of the banking group's commitments to the recovery of these entities.

6.6 Any branches that are considered systemically significant in the country of operation should also be included in the banking group's recovery plan.

7. Triggers

7.1 Each bank should develop triggers that would activate the recovery plan for capital, liquidity and operational purposes. Operational triggers need to reflect the financial impact of an operational disruption for an extended time period.

7.2 These triggers should be an extension of the banking group's existing risk appetite and risk management framework for capital, liquidity and operations. A clear distinction should exist between early warning indicators for these risk areas and the triggers for the activation of the recovery plan.

7.3 Triggers should be subject to the risk governance process, and should be reviewed and approved by senior management and/or the board of directors.

7.4 The number of triggers should be consistent with the bank's risk profile and activities. Triggers should be quantitative, qualitative or both. An adequate number of triggers should be identified to ensure early detection and prompt corrective action in various types of stress scenarios.

7.5 Triggers need to be practical and specific. They should be defined in terms of their duration, impact, value and/or some other measure, and may differ for different types of stress scenarios. Triggers should be conservative enough to allow for a proactive and effective recovery when breached.

7.6 Clear escalation procedures should exist for when triggers are breached. A breach should not be automatically linked to specific management actions, but a review by senior management and/or the board of directors should decide on the appropriate action to take based on prevailing circumstances.

8. Stress scenarios

8.1 This Office recognises that stress scenarios may not be able to predict all causes of severe financial stress for a bank, but is of the opinion that the identification of possible stress scenarios assist in the development and calibration of triggers as well as recovery options in severely strained conditions.

8.2 Reverse stress testing should be used as a starting point for the development of stress scenarios that are severe enough to bring the bank to failure if no corrective actions are taken, thus necessitating the implementation of the recovery plan. The identification of the circumstances under which this would occur should facilitate the development of the stress scenarios and recovery options that take into account strained operating conditions. Typically, such scenarios would entail a combination of a number of stress events.

8.3 The bank needs to identify and then provide a quantitative and qualitative description of the point of failure through the use of reverse stress testing. This point of failure would be the point where the bank's recovery options' cumulative capital and/or liquidity benefit would not be able to meet the capital/liquidity required for the bank's operations to remain sustainable.

8.4 The recovery plan's stress scenarios should be linked to the existing stress testing framework of the bank, and should be used in the calibration of the triggers that would result in the activation of the recovery plan.

8.5 The number of stress scenarios should be commensurate with the risk profile and activities of the bank. The stress scenarios should cover at least one systemic stress scenario and at least one idiosyncratic stress scenario resulting in a liquidity, capital and an operational disruption of such a severe nature that it could lead to the bank's failure. Scenarios should describe both slow- and fast-moving crises, and could be combined with macroeconomic stress scenarios and/or indicators.

9. Recovery options

9.1 The bank has to identify appropriate recovery options for capital, liquidity and operational disruptions, bearing in mind the impact of the chosen stress scenarios and any possible constraints in South African market conditions on the various recovery options.

9.2 The recovery options should be an extension of the bank's capital, liquidity and contingency funding and of the business continuity and disaster recovery plans, but should enable the bank to recover from a more severe financial stress scenario. Banks may have to consider recovery options that would not normally be considered, for example the sale of specific portfolios and/or units, and/or structural changes, to facilitate the recovery of the bank. The recovery options identified should only include actions over which the bank has discretion.

9.3 Each recovery option needs to be evaluated in a consistent manner that includes details of the expected quantum of the benefit it could provide during a stressed period, the impact on capital and/or liquidity as a result of the implementation, the time frame for execution and/or implementation during stressed periods, and other factors that could impact the effectiveness thereof. Other factors could include the process to be followed, the approvals required, the identification of potential buyers, valuations, separability assessments, costs, human resources, management information, possible spin-offs, and legal and structural considerations. The key executives and/or managers and/or members of the bank that would be involved in the implementation of each recovery option should be identified. Possible barriers to implementation should be identified, and actions to overcome these should be initiated.

9.4 The cumulative impact of the recovery options should be considered since the execution of one recovery option could potentially reduce the plausibility and/or effectiveness of the remaining recovery options.

9.5 The ultimate aim of the recovery actions chosen for implementation should not only be to mitigate the impact of the identified stress, but also to identify, address and recover from the cause of the stress where the stress was caused by a deficiency in the risk management or control processes of the bank.

9.6 Where appropriate, the bank should initiate steps to prepare for the timely execution of the identified recovery options through the drafting of pro-forma applications and separability plans.

9.7 The bank should identify its critical functions, critical shared services, core functions and core shared services as defined in paragraph 2 above.

9.8 Details regarding any outsourcing or shared services agreements in the bank that could affect any of the recovery options should be provided.

9.9 The bank should link its recovery options to the identified stress scenarios to determine the effectiveness of its recovery plan. The cumulative impact of the recovery options should be considered on the remainder of the recovery options and ultimately on the long-term viability of the bank.

9.10 The recovery plan should contain details of the governance process to be followed in the implementation of the recovery options in a crisis situation. These should cover the internal and external stakeholder communication teams and processes, the escalation process, the decision-making process as well as the process to be followed once the recovery plan has been activated and the criteria to be used to determine which recovery option should be implemented.

10. Effective date

10.1 This directive becomes effective on date of issue.

11. Acknowledgement of receipt

Two additional copies of this directive are enclosed for the use of your institution's independent auditors. The attached acknowledgement of receipt, duly completed and signed by both the chief executive officer of the institution and the said auditors, should be returned to this Office at the earliest convenience of the aforementioned signatories.

René van Wyk
Registrar of Banks

The previous directive issued was Directive 11/2014 dated 12 December 2014.