

**GUIDELINES ON RECOVERY PLAN OF
A DOMESTIC SYSTEMICALLY IMPORTANT BANK (DSIB)
(Appendix to Sec. 126 on DSIBs)**

1. Introduction

- 1.1 Given the severity of the impact of a DSIB's distress or disorderly failure on the domestic financial system and economy, the supervisory policies and process for DSIBs seek to reduce the probability of a DSIB's failure, not only to minimize the impact thereof.
- 1.2 Among the supervisory measures aiming to reduce the probability of a DSIB's failure is the requirement for a DSIB to come up with a concrete and reasonable recovery plan that sets out the actions that it will take to restore its viability in cases of significant deterioration of its financial condition in different scenarios.
- 1.3 This document sets out the guidelines that DSIBs should follow in drawing up and maintaining a recovery plan that prepares them for future destabilizing events and/or crises.
- 1.4 The recovery plan shall be applied on a group-wide basis¹, covering all institutions in the banking group, as well as affiliates assessed by the DSIB as essential to restore, or will have an impact on, the banking group's viability and financial position. If covered institutions have their respective recovery plan, the DSIB shall ensure that each of the covered institutions' recovery plans is consistent with the group recovery plan.

2. Definition of Terms

For the purposes of these guidelines, the following definitions shall apply:

- 2.1 *Institutions in the banking group* means the DSIB and the entities that directly or indirectly control or are directly or indirectly controlled by such DSIB.
- 2.2 *Control* of an enterprise exists when there is:
- a. Power over more than one-half of the voting rights by virtue of an agreement with other stockholders; or
 - b. Power to govern the financial and operating policies of the enterprise under a statute or an agreement; or
 - c. Power to appoint or remove the majority of the members of the board of directors or equivalent governing body; or

- d. Power to cast the majority votes at meetings of the board of directors or equivalent governing body; or
- e. Any other arrangement similar to any of the above.

Control is presumed to exist if there is ownership or holding, whether direct or indirect, of twenty percent (20%) or more of a class of voting shares of a company. The DSIB, for itself or on behalf of any entity within the banking group, may disclaim or rebut the presumption of control by providing sufficient information or documents to show that:

- a. The shares are owned or held exclusively for investment purposes;
- b. It will not serve on the board of directors and will not nominate any candidate to serve on the board or otherwise seek board representation;
- c. It will have only limited contacts with the entity's management that are customary for interested shareholders; and
- d. It will engage only in normal and customary transactions with the entity.

2.3 *Point of non-viability* is as defined under Item "3, Annex F" of Appendix 59 and other relevant regulations.

2.4 *Financial market infrastructure* is a multilateral system among participating financial institutions, including the operator of the system, used for the purposes of recording, clearing, or settling payments, securities, derivatives, or other financial transactions. It includes payment systems, central securities depositories, securities settlement systems and central counterparties.

3. Guiding Principles

3.1 The recovery plan shall serve as a guide to the recovery of a DSIB in distress. It should be capable of being carried out during the recovery stage when the DSIB has not yet reached the point of non-viability and the prospect of recovery is reasonable if appropriate recovery measures are taken.

3.2 The recovery plan shall, at the latest, be activated when the DSIB breaches the total required CET1¹ capital and/or the minimum liquidity ratios as may be prescribed by the Bangko Sentral . To ensure timely implementation of appropriate recovery measures and continuous operation of essential and systemically important functions and services, the recovery plan should utilize early warning indicators with specific levels (i.e., quantitative indicators which may be supplemented with qualitative indicators) that will trigger activation of the recovery plan even before the above-said breaches happen. Breach of an internally-set trigger level need not automatically initiate a particular recovery action. Instead, it shall prompt senior management

to evaluate the situation and decide whether to take action under the recovery plan or refrain from taking such action. This preparatory mechanism, including the operational procedures, monitoring, escalation and approval process, should be clearly defined in the recovery plan.

However, launch of the recovery plan earlier than planned may be required by the Banko Sentral when warranted, as approved by the Deputy Governor of the Supervision and Examination Sector, depending on the circumstances at the time.

3.3 *Governance and Oversight of the Recovery Plan.* The Board of Directors shall put in place a robust governance structure and sufficient resources to support the recovery planning process, which include the following:

- a. Clearly defining the responsibilities, both in normal times and during a crisis, of the business units, the senior management and the Board of Directors, as well as identifying a senior level executive primarily responsible for ensuring continuous compliance with the Banko Sentral guidelines and internal policies on recovery plan.
- b. Integrating the recovery planning process into the DSIB's business-as-usual risk management framework to ensure that the recovery plan shall:
 - Be designed as an extension of existing capital, liquidity and contingency funding plans, but shall have an end view of DSIB recovering from more severe stress situations; and
 - Cover the contingency arrangements² established to allow the DSIB to continue to operate and maintain essential and systemically important functions and services as it implements the recovery measures; and
- c. Maintaining adequate Management Information Systems (MIS) which can generate necessary information on a timely basis to enable the Board of Directors and the senior management to effectively discharge their respective responsibilities.

3.4 The recovery plan is a detailed list of options or courses of action that will be taken by the DSIB to address a range of severe stress scenarios to restore its financial strength and viability. It shall reflect the DSIB's nature, size, interconnectedness, level of substitutability, and complexity. It shall have the following components to ensure effective and rapid execution:

- a. *Strategic analysis.* In devising the recovery plan, the DSIB is expected to conduct and document strategic analysis, which identifies the DSIB's essential and systemically important functions and services (i.e., mapped to the companies/legal entities that perform such

functions or provide such services) and sets out the actions necessary to operate and maintain them in a recovery scenario. The strategic analysis shall also include the following:

- information on linkages³ between and/or among the parent bank and covered institutions, and operational data such as the extent of asset encumbrance, amount of liquid assets, off-balance sheet activities, etc.;
- underlying assumptions (exogenous and DSIB-specific) for each recovery option, stress scenario, and other aspect of the recovery plan;
- assessment of the viability of any business lines and covered institutions, which may be subject to separation in a recovery scenario, as well as the impact of such separation on the remaining group structure and its viability;
- processes for determining the value and marketability of the material business lines, operations, and assets; and
- any additional requirements that the DSIB may potentially be subjected to during crisis situations in order to maintain its membership in financial market infrastructures, for example, as regards pre-funding or collateralizing of positions, and identify options for addressing the additional requirements.

b. *Stress scenarios.* The DSIB is required to identify scenarios that are severe enough to activate the recovery plan. It could make use of its existing stress testing program as foundation for building scenarios.

The recovery plan shall include DSIB-specific (idiosyncratic), market-wide, and combined (both DSIB-specific and market-wide) stress scenarios. Each stress scenario shall be comprehensively described and assessed as to its impact on capital and/or liquidity.

c. *Recovery options.* Along with more evident and straightforward recovery options that reduce the risk profile, raise or conserve capital and address liquidity pressures, the DSIB is expected to seriously consider including specific drastic measures that could modify its structure and/or business model. Range of possible recovery measures may include the following:

- recapitalizations, capital conservation measures such as suspension of dividends and discretionary payments of remunerations;
- sale of subsidiaries and spin-off of business units;
- voluntary restructuring of liabilities through debt-to-equity conversion; and

- measures to secure adequate funding while ensuring sufficient diversification of funding sources and adequate availability of collateral.

Each recovery option should be comprehensively described, including the time needed to implement such option, and assessed as to probability of success or effectiveness to address the stress scenario. For each recovery option, the following should be laid down and discussed:

- estimated benefits⁴ or outcome that would be derived from the recovery option, any assumptions made to quantify the benefits, and the time frame within which the benefits would be achieved;
- negative effect, if any, on the financial condition, franchise, credit ratings, as well as relevant stakeholders;
- preparatory actions to ensure that recovery option shall be effectively and timely implemented;
- process to implement or carry out the recovery option, including the escalation and decision-making process, indicating the owner/s of the process to instill responsibility and establish accountability, which is crucial in times of stress; and
- circumstances or factors that could render the recovery option unavailable/ infeasible or could hinder the effectiveness of the recovery option, as well the remedial measures to be undertaken to overcome these impediments including the time frame to accomplish the remedial measures. These remedial measures when timely and effectively implemented improve the credibility and the probability of success of the recovery option.

Considering that several key steps may be involved to execute a recovery option and a combination of a number of recovery options may be required to address a stress scenario, the recovery plan should include estimates of the sequencing of actions and time needed to implement each.

- d. *Communication strategy.* The recovery plan shall contain communication strategy with supervisory authorities / regulators, public, financial markets, employees and other stakeholders.

3.5 The recovery plan shall not include assumption for any access to or receipt of government/public financial support/aid provided by the Philippine National Government and its

offices, agencies and instrumentalities to preserve or restore viability, solvency or liquidity of banks (or any of the covered financial institutions), which may include, among others, financial assistance in the form of loans and advances extended by the Bangko Sentral, pursuant to Sections 83 and 84 of Republic Act No. 7653 (The New Central Bank Act).

3.6 The recovery plan and updates thereon shall be approved by the Board of Directors, and in the case of branches of foreign banks, it shall be approved by the Head office or the designated Regional office. On the other hand, the senior management shall be responsible for developing, maintaining and updating, and where necessary, executing the recovery plan.

The recovery plan shall be updated at least annually, and upon occurrence of events that materially alter the DSIB's structure, business model or operations, strategy or risk exposure. Updating of the recovery plan shall involve:

- review of the exogenous and DSIB-specific assumptions the recovery plan is based upon; and
- assessment of the relevance and applicability of the recovery plan.

4. Reporting Requirement and Review by the Bangko Sentral

4.1 The recovery plan shall form an integral part of the Internal Capital Adequacy Assessment Process (ICAAP) document to be submitted every 31 March of each year. Thus, the ICAAP document shall also contain discussions on the governance and oversight of the recovery plan as discussed in paragraph 3.3, as well as a summary of any material changes on the recovery plan as provided for under paragraph 3.6, including the reason/s therefor. The first recovery plan shall be submitted on 30 June 2016 as supplement to the 2016 ICAAP document, which is required to be submitted on or before 31 March 2016.

The Bangko Sentral shall review the recovery plan as part of the overall supervisory process for DSIB, focusing on assessing the recovery plan's robustness, credibility and ability to be effectively implemented.

4.2 Relative to paragraph 3.2 on breach of an internally-set trigger level, the senior management shall submit, within three (3) banking days, to the appropriate supervising department of the Bangko Sentral sufficient information about the DSIB's decision whether or not to implement recovery measures under its recovery plan. The three (3) banking days shall be reckoned from the date of decision by the designated authority, as defined in the recovery plan.

(Circular No. 1024 dated 06 December 2018)

Footnotes

1. 6 percent CET1 Capital + 2.5 percent Capital Conservation Buffer + Countercyclical Capital Buffer at the rate determined by the Monetary board (0 to 2.5 percent)+1.5 or 2.5 percent Higher Loss Absorbency Requirement.
2. For continuous functioning of internal processes, IT systems, clearing and settlement facilities, supplier and employee contracts, etc.
3. Core business operations and interconnectedness by reference to business lines, legal entities and jurisdictions, intra-group exposures through intra-group guarantees and loans, and trades booked on a back-to-back basis; dependencies for liquidity, capital or operational support, etc.
4. Impact or effect on DSIB's financial condition if the recovery option becomes successful, which may be on capital, risk-weighted assets/risk profile, liquidity, leverage and other measures of financial strength, as well as impact on customers, counterparties and market confidence.