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# SOLVENT WIND-DOWN OF TRADING BOOKS

Guidance for banks 2022

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## Acronyms

<b>AVA</b>	Additional valuation adjustment
<b>BRP</b>	Business reorganisation plan
<b>BRRD</b>	Bank Recovery and Resolution Directive
<b>BU</b>	Banking Union
<b>CBC</b>	Counterbalancing capacity
<b>CF</b>	Critical function
<b>CSA</b>	Credit support annex
<b>EfB</b>	SRB's 'Expectations for Banks'
<b>EU</b>	European Union
<b>FMI</b>	Financial market infrastructure
<b>FOLTF</b>	Failing-or-likely-to-fail
<b>FSB</b>	Financial Stability Board
<b>IRT</b>	Internal resolution team
<b>ISDA MA</b>	International swaps and derivatives association Master Agreement
<b>MIS</b>	Management information system
<b>NRA</b>	National resolution authority
<b>PRS</b>	Preferred resolution strategy
<b>SRB</b>	Single Resolution Board
<b>SRMR</b>	Single Resolution Mechanism Regulation
<b>SWD</b>	Solvent wind-down
<b>RWA</b>	Risk-weighted asset

# 1. Introduction

## 1.1. Purpose and Objectives

The SRB published the Expectations for Banks (EfB) document in April 2020 in order to assist banks under its remit to ensure an appropriate level of resolvability. The document sets out the necessary steps and initiatives for banks to take, structured along seven principles, in order to ensure they are resolvable and to demonstrate their preparedness for a potential resolution.

The current guidance<sup>1</sup> provides more details to banks<sup>2</sup> on how to demonstrate resolvability in relation to Principle 7.1 of the EfB (“Structure, complexity and interdependencies”), in particular with regard to the size and complexity of the trading books<sup>3</sup>. For certain banks, the size and complexity of their trading books could impede the credible and feasible implementation of their envisaged resolution strategies.

The solvent wind-down (SWD) of derivatives and trading books is an approach that can be used for exiting trading activities in an orderly manner and avoiding posing any risks to financial stability. The lack of a credible SWD plan may jeopardise the credibility and feasibility<sup>4</sup> of the resolution strategy of any institution with material trading books.

SWD of trading books is a tool also relevant for banks under business as usual, and as a recovery option, so it is expected that banks already have some capacity to wind down their trading activities in an orderly way if needed. For the purpose of this guidance, however, the focus is on the SWD as an element of resolution strategies, both in resolution planning and in post-resolution. For example, it could act as a reorganisation measure in the business reorganisation plan (“BRP”) (EfB Principle 7.3), and as a way to generate liquidity<sup>5</sup>, reduce RWA to facilitate the reorganisation and mitigate impact on the financial system by limiting stress and

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<sup>1</sup> This publication is not intended to create any legally binding effect and does not in any way substitute the legal requirements laid down in the relevant applicable European Union and national laws. It may not be relied upon for any legal purposes, does not establish any binding interpretation of EU or national laws and does not serve as, or substitute for, legal advice. This document may be subject to further revisions, including due to changes in the applicable EU legislation. The SRB reserves the right to amend this publication without notice whenever it deems appropriate, and it shall not be considered as predetermining the position that the SRB may take in specific cases, where the circumstances of each case will also be considered.

<sup>2</sup> For the purposes of this document the term “banks” refers to entities and groups that fall under the SRB’s remit.

<sup>3</sup> EfB 7.1 principle sets out that: “*Banks have identified, reduced and, where necessary, removed sources of undue complexity in their structure, which pose a risk to the implementation of the resolution strategy. Banks are expected, where necessary and proportionate in the specific cases, to: [...] reduce the complexity and size of the trading book if this is necessary to apply the resolution tools*”.

<sup>4</sup> As defined per SRMR Article 10(3).

<sup>5</sup> Not leading to any SWD specific liquidity expectation at this point, for details on applicable expectations for liquidity and funding in resolution, please refer to [relevant guidance](#).

contagion in the financial markets<sup>6</sup>. On account of the size and complexity of banks' trading books, SWD planning would further improve banks resolvability.

This document sets out the scope and minimum expectations for SWD planning and potential execution, with the main objectives to (i) adequately prepare, develop and maintain banks' capabilities (including, but not limited to funding needs in resolution and post resolution) for the planning of a SWD in resolution, and (ii) to ensure execution capabilities of the SWD plan in a reasonable timeframe.

The application of this operational guidance to each bank may be adapted to individual specificities, taking into account the proportionality principle, and based on a dialogue between each bank and its internal resolution team (IRT).

## 1.2. Background

The SRB SWD guidance for banks follows the work initiated by the Financial Stability Board (FSB)<sup>7</sup> on the "solvent wind-down of derivatives and trading portfolios" published in 2019. This guidance also reflects regular exchanges between the SRB and the supervisory and resolution authorities from jurisdictions outside the Banking Union where banks have large trading activities (e.g. the Prudential Regulation Authority and Federal Deposit Insurance Corporation). This guidance builds upon analysis conducted by the SRB as part of a pilot conducted with certain banks, surveys and two workshops with the industry (in October 2019 and April 2021).

This guidance aims at ensuring a level playing field among the banks concerned and seeks alignment with other jurisdictions where relevant.

## 1.3. Scope of application

This document provides additional operational guidance for banks under SRB's remit with material trading activities. All G-Sibs are expected to work on SWD planning as a RPC 2022 priority. Other banks will be identified and approached in the course of 2022 following a further assessment of the significance of their trading books, to work on SWD planning as a RPC 2023 priority.

In terms of activities in scope, all trading activities booked in trading books are included in the SWD exercise, while other assets such as loans in the banking book are not at this stage. Banks should provide their views on the importance of certain desks and market activities for the bank business model (for instance, desks directly supporting critical functions such as retail activities, or desks supporting core business lines as being among main contributors to profitability or liquidity), for key dependencies towards global and national market

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<sup>6</sup> BRRD Articles 31(1), 31(2)(b).

<sup>7</sup> See 2019 discussion paper, <https://www.fsb.org/wp-content/uploads/P030619-1.pdf>.

activities (e.g. hedging desk, funding desk, etc.), and towards external counterparties (as a provider of market making or clearing activities). The objective is to understand the challenges and potential impediments of winding down the underlying books or desks in order to determine the appropriate sequencing of a potential wind-down and any desks and books to be ultimately kept in the resolved entity, if any. The bank should reflect in its analysis past, current and foreseen wind-down experience of trading books.

## 1.4. Expectations

Institutions with material trading books are expected to develop a granular plan (an SWD plan) and *ex-ante* capabilities to wind down their trading books. Where winding down of trading books is involved, this will require careful planning and analytical capabilities including:

- A plan outlining the different segments and the associated exit strategies for its trading activities and the potential financial implications;
- Information provision on SWD planning such as capacity to update the plan in a timely manner, using business as usual (BAU) tools, systems and infrastructures as much as possible;
- The capabilities to execute the wind-down, included in a SWD playbook that would focus on governance, HR and communication defined in line with the FSB discussion paper<sup>8</sup>.

## 1.5. Timeline of application

G-Sibs are expected to prepare to plan and ensure that capabilities are ready to deliver “Day-1” expectations in 2022, while other banks approached in 2022 are expected to deliver on these in 2023. Banks should take all the necessary steps to ensure that all “Day-1” SWD-related expectations are implemented on time. Banks are then expected to further demonstrate their capabilities to operationalise and test the SWD plan through annual exercises, to enhance and maintain the SWD playbook and to build upon the lessons learnt in an iterative approach, until reaching a satisfactory level of compliance with expectations. It means being able to fully deliver the expectations set in the SWD guidance and adapt the plan to evolving market situation, in coordination with the respective IRT, with the objective of achieving horizontal consistency and a level playing field.

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<sup>8</sup> FSB includes the following regarding “playbooks”: “[...] some firms have adopted playbooks to help provide clarity on the necessary steps and actions of the solvent wind-down strategy, both in recovery and in resolution, including, for example, identification of key sign-off and escalation points, parties involved in the decision-making in a solvent wind-down, their responsibilities in the execution of a solvent wind-down and communication with relevant stakeholders.”

Table 1. Overview of Day-one and steady-state expectations

Deliverables	Day-one expectations	Timing	Steady-state expectations	Timing
SWD Playbook	<ul style="list-style-type: none"> <li>Description of governance structures and organisation for the purpose of SWD (approximate steps/timelines, HR needs and special arrangements, communication)</li> </ul>	End of 2022 (G-Sibs) End of 2023 (others)	<ul style="list-style-type: none"> <li>Comprehensive and detailed playbook with upgrade from Day-1 playbook (clear procedures/escalation protocols and decision-making process, systems and infrastructures)</li> </ul>	End of 2023 (G-Sibs) End of 2024 (others)
SWD plan – designing strategies	<ul style="list-style-type: none"> <li>Trading book segmentation and identification of exit strategies by segment with narrative and sequencing</li> <li>Core analysis with supporting metrics: incorporate latest market development within three months</li> <li>Latest impacts on balance sheet within four weeks</li> <li>Initial identification of interdependencies and residual positions</li> </ul>	Mid-2022 (G-Sibs) Mid-2023 (others)	<ul style="list-style-type: none"> <li>Comprehensive upgrade from Day-one requirements</li> <li>Core analysis with supporting metrics: incorporate latest market development within one month</li> <li>Latest impacts on balance sheet within five working days</li> <li>Refined identification of interdependencies and residual positions</li> </ul>	End of 2023 (G-Sibs) End of 2024 (others)
SWD plan – Exit costs	<ul style="list-style-type: none"> <li>Assessment of capabilities in BAU</li> <li>Identification and reasoning of estimation/modelling methodologies for direct and indirect exit costs</li> </ul>	Mid-2022 (G-Sibs) Mid-2023 (others)	<ul style="list-style-type: none"> <li>Comprehensive upgrade from Day-one requirements</li> <li>Additional value adjustments (AVA) calculations and reporting per each segment (incl. the calculations and reporting of each individual AVA component<sup>9</sup>)</li> <li>Full periodic reporting capacity for planning and execution purposes</li> <li>Full internal computation of in-house metrics (if applicable)</li> <li>Capacity to implement full exit costs updates with fresh data on periodic basis (minimum quarterly)</li> </ul>	End of 2023 (G-Sibs) End of 2024 (others)
SWD plan – Operational costs	<ul style="list-style-type: none"> <li>Comprehensive identification, description and breakdown of all operational costs</li> <li>Initial costs estimation (one-off and BAU costs at segment level)</li> </ul>	Mid-2022 (G-Sibs) Mid-2023 (others)	<ul style="list-style-type: none"> <li>Comprehensive upgrade from Day-one requirements</li> <li>Exhaustive and accurate operational costs estimations for SWD (during 24 months)</li> <li>Reflection of different assumptions and scenarios in operational costs estimations</li> <li>Full reporting and data update capacity</li> </ul>	End of 2023 (G-Sibs) End of 2024 (others)
SWD – Risk-based costs	<ul style="list-style-type: none"> <li>Initial assessment at (most appropriate) segment level with initial sets of risk indicators</li> </ul>	Mid-2022 (G-Sibs) Mid-2023 (others)	<ul style="list-style-type: none"> <li>Comprehensive upgrade from Day-one requirements</li> <li>Full capacity for identifying risks and impacts on potential losses (by risk categories)</li> <li>Comprehensive risk reduction strategy executable in a timely manner</li> </ul>	End of 2023 (G-Sibs) End of 2024 (others)

<sup>9</sup> Based on the core approach of the Commission Delegated Regulation (EU) 2016/101 of 26 October 2015 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for prudent valuation under Article 105(14)

SWD – RWA, capital and liquidity impacts	<ul style="list-style-type: none"> <li>• Market risk reduction estimate</li> <li>• Initial estimation of counterparty credit risk and operational risk reduction</li> <li>• Initial capital impacts</li> <li>• Short-term and long-term impact of SWD plan on liquidity</li> </ul>	Mid-2022 (G-Sibs) Mid-2023 (others)	<ul style="list-style-type: none"> <li>• Comprehensive upgrade from Day-1 requirements</li> <li>• Full estimates of market, credit and operational risks reduction and capital</li> <li>• Capacity to provide market, counterparty credit and operational RWA for remaining positions</li> <li>• Capacity to monitor liquidity during SWD execution</li> <li>• Full identification of factors impacting liquidity for SWD purposes</li> </ul>	End of 2023 (G-Sibs) End of 2024 (others)
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## 2. Deliverables and technical aspects

### 2.1. Data and granularity

SWD planning requires a variety of **qualitative and quantitative information**. This section provides detail and expectations on the data that banks will use to produce their SWD plans and analysis.

First, banks should use trading data, information and metrics using current '**business-as-usual**' systems to fit the set of dimensions relevant for SWD planning, with the objective of improving the quality of future information submissions to the SRB if this is not feasible from day one. Relying on business as usual systems should ensure the operational capacity to execute such plan in case of resolution.

The guidance also refers in many instances to the most '**relevant segment**'. Banks are encouraged to provide information on a granular level in light of the information available. In principle, information in the SWD plan should aim for the **desk level**<sup>10</sup>, but banks are encouraged to use a more appropriate segment if more relevant, such as a business unit if they have their own internal segmentation of activities. For example, in some specific cases, such as providing Credit Valuation Adjustment (CVA), such a level of granularity might not be achievable and banks can provide data using a different segment, for example counterparty level in this instance.

Once the most appropriate segmentation of the activities has been determined, ideally at desk level, banks are expected to provide a short desk 'identity card', where banks report the desk name, location, legal entity (including outside the Banking Union), asset class and trade types (e.g. Fixed income flow, FX options, equity derivatives...).

**The SWD plan needs to include information on the initial snapshot as well as on the target snapshot:**

- The initial snapshot should provide a description of the trades and desk at the starting point of the wind-down period, including both positions subject to SWD strategy, as well as positions targeted for the 'rum' portfolio (i.e. remaining positions in the trading books, not subject to the SWD);
- While the target snapshot would provide only a description of the trades and desks that the bank is expected to still own after the wind-down period.

**An impact assessment over time is equally important.** Given the expected length of the SWD exercise, the reporting should also be more dynamic than just having the starting and the ending positions. Banks are expected to forecast and document the impacts on capital and liquidity and the need for financial resources at intermediary, regular terms, with a quarterly minimum frequency to reflect the expected evolution and pace of

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<sup>10</sup> Similar to the split proposed by the Fundamental Review of Trading Books (Basel Committee on Banking Supervision, 2019)

executing the unwind strategy. These milestones might not be as granular as the initial and final snapshots, but could include, at entity level, the evolution of risk and costs.

**Banks should consider their trading book positions as either cancellable<sup>11</sup>, transferable or saleable positions and further split into categories based on product types and business lines as well as by exit strategies (see subsequent section “Exit strategy taxonomy”).** Banks are expected to have performed a granular segmentation of their books based on the key characteristics that will affect the exit strategy. This may include (i) product type; (ii) counterparty type; (iii) underlying-type; (iv) master agreements’ (MA) credit support annexes (e.g., CSA<sup>12</sup> for ISDA MA) and long form confirmations; (v) currency, (vi) maturity and (vii) first order sensitivity to the main underlying (delta, PV01... depending on which is the most relevant for the product type). For all trading book positions in scope for SWD, banks are expected to also assign an exit strategy to each segment, including timing and cost of exit. In addition, where the strategy would be novation<sup>13</sup> or sale, the institution is expected to have identified potential acquirers (by name or type) of the portfolio when feasible.

**The target portfolio can be seen as a forecast of the rump portfolio.** The rump portfolio represents the residual portfolio, which is expected to remain on the financial institution’s trading book after the application of the SWD plan. The target portfolio represents all ‘sticky’ trades that the bank will not be able to dispose of, because of their complexity, illiquidity, lack of attractiveness, trade-off between maintenance and sell-off costs, or the existence of any dependencies blocking the possibility for winding down. In resolution, banks should also estimate the value of the rump portfolio, as it is particularly relevant for these most illiquid, less marketable assets and thus representing the highest potential losses.

**The rump portfolio should be further divided into non-discretionary rump and discretionary rump.** The non-discretionary rump includes positions that the bank believes it would be unable to liquidate at reasonable cost, despite all reasonable efforts, as well as positions which the bank holds to support such positions (but which it would be able to exit otherwise). The discretionary rump, on the contrary, includes positions which the bank believes can be liquidated, but where the cost would be greater than the full cost of maintaining such positions to maturity or to some future point<sup>14</sup>.

**Several metrics of interest have been identified with respect to initial and target portfolios.** In particular, the size, complexity and associated risks are the most important; in addition, potential haircuts and related

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<sup>11</sup> For callable trades and/ or trades for which the term sheet allows for early termination.

<sup>12</sup> Document that defines the terms for the provision of collateral by the parties in derivatives transactions. It is one of four parts of a standard contract or master agreement developed by the International Swaps and Derivatives Association (ISDA)

<sup>13</sup> Novation entails the termination of a given contract and its replacement with a new economically equivalent contract, but with a different counterparty.

<sup>14</sup> In line with the FSB discussion paper on SWD of derivatives and trading portfolios

costs should be taken into account. Banks are expected to include current capital requirements for the non-discretionary and discretionary rump portfolio.

**To better capture the size of the portfolio, banks are expected to report on the book value of positions held by the desk.** The SRB would recommend the use of the fair value – most likely available from Risk Management areas, or at least the market value used as the regular business valuation if the former is not available. These metrics should leverage on front office valuation from the business as usual system, and will, especially for less liquid trades, provide a more realistic view of the real value of the portfolio.

**Trade complexity is one of the determining factors affecting the SWD strategy.** More complex positions can be assumed to be less liquid, to hold a bigger risk of being inadequately priced, and/or to require more time to wind down, making them particularly important to flag at planning phase for the SWD exercise. To better assess the complexity of the trades held by a given desk, banks are expected to also report the fair value amount of the positions falling under the **level 3 of the IFRS13 accounting standards**, as well as the first order sensitivity to the main underlying/ risk factor (delta, PV01... depending on which is the most relevant for the product type).

## 2.2. Interdependencies

**Banks should consider external and internal interdependencies.** In particular, they should not elaborate SWD plans for each desk or business line independently without considering a general strategy or sequencing. More generally, **the SWD strategy needs to highlight all existing interdependencies**, especially with regard to critical functions and critical services, and on core business lines and essential services, building on work already performed on the institution's service delivery model and its mappings<sup>15</sup>, already expected as part of the Identification of Operational Interdependencies and operational continuity guidance<sup>16</sup>, in line with Efb dimension 4 "Operational continuity in resolution and access to FMI services". The impact of SWD on the rest of the group could be evaluated in terms of the operational and financial interdependencies including FMI access, shared services, IT infrastructure, cost allocation, liquidity, business model and revenues. This is especially pertinent in the case of universal banks or when parts of banks' trading activities need to be maintained for the rest of the group, such as the funding desk or basic FX activities.

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<sup>15</sup> These cover the mappings of relevant services, staff and operational assets to critical functions and core business lines needed for the effective implementation of the resolution strategy and any consequent restructuring.

<sup>16</sup> <https://www.srb.europa.eu/system/files/media/document/20211025%20SRB%20Operational%20guidance%20for%20banks%20on%20separability%20for%20transfer%20tools%20FINAL.pdf>

Furthermore, as part of the SWD strategy, banks need to consider the sequence of the actions, to highlight any interplay between desks or potential clashes of exiting different markets at the same time.

## 2.3. Exit strategy taxonomy

A solvent wind-down of derivatives and trading books could be achieved through several exit strategies that may be used singularly or in combination<sup>17</sup>:

- **Close-out or termination of position prior to maturity**
  - Negotiate Closeout (individual trades or by counterparty);
  - Bilateral Tear Up;
  - Cash Security Sale or Buyback.
- **Contractual run-off** (allowing contracts to run to maturity – within the wind-down period – without being replaced or renewed.)
  - Contractually Matures (3rd Party);
  - Contractually Matures (Intra-Group).
- **Auction/ Transfer/ Novation of positions** (Termination of a contract or its partial replacement with a new contract.)
  - Package & Sell;
  - Return of Collateral;
  - Securitisation.
- **Compression or Consensual tear-up** (Replacing a portfolio of derivative contracts with an economically equivalent portfolio with a lower exposure expressed in terms such as gross notional outstanding.)
- **Rump**<sup>18</sup> (Remaining/residual portfolio after performing wind-down exercise)
  - Discretionary rump (i.e. positions the firm believes can be liquidated but where the cost to do would be greater than the full costs of maintaining positions to maturity or to some future date where liquidation would be optional);
  - Structural rump (positions that the firm believes it would be unable to liquidate under certain scenarios despite all reasonable efforts).

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<sup>17</sup> The proposed taxonomy is inspired by the FSB discussion paper on SWD of derivatives and trading portfolios.

<sup>18</sup> While this does not qualify as an exit strategy by definition, this is part of the taxonomy banks should use to classify portfolios.

## 2.4. Detailed expectations for SWD plan

### SWD plans are made of two components:

- Solvent exit strategies per segment with a narrative explaining the foreseen reorganisation, sequencing, etc. This part is expected to be rather stable over time, and should be seen as the backbone of the plan;
- The underlying SWD analysis with corresponding supporting metrics such as FTEs needed, timing, exit and operational costs etc. This part is expected to be more volatile depending on underlying input data and latest state of the portfolio (considering remaining time to maturity, new, amended and cancelled trades etc.).

As part of their SWD planning, banks are expected to develop the capabilities to perform a full refresh (hence both components described above) of the plan taking into consideration the latest market conditions, including the selection of exit strategies amidst changing market conditions, on a timely basis.

For the first year of introduction of the new policy, banks are expected to submit their first SWD plan within a **maximum of five months** following the request date, to be considered as the time of reception of this operational guidance and before **30 June 2022, whichever comes first**. The development of the SWD strategy is a multi-year project and SWD plans are expected to be progressively updated and finalised.

**Steady-state expectations** for such re-submissions are for them to be delivered on a more timely basis, **within two months** of the announcement of a material restructuring of the trading activities of the bank.

Banks are expected to also develop the capacity for a **'quick refresh'** to update the second component described above. **Day-one expectations** are for banks to be able to conduct such a quick refresh within **four weeks**. **In the steady state**, banks are expected to have the capacity to refresh the plan in a maximum of **five working days**.

## 2.5. Detailed expectations for the SWD Playbook

The SWD playbook is defined, in line with the FSB discussion paper, as a handbook developed by a bank, which aims to help provide clarity internally on the necessary steps and actions of the solvent wind-down strategy. This includes, but is not limited to, the identification of key sign-off and escalation points, parties involved in the decision-making in a solvent wind-down, their responsibilities in the execution of a solvent wind-down and communication with relevant stakeholders. While the SWD plan is meant to outline the different trading segments and the associated exit strategies for their trading activities and the potential financial implications, the SWD playbook is meant to be a more static document covering governance, HR and communication. The structure of the SWD playbook should be consistent with banks' other recovery and resolution playbooks and include references to these and other operational and strategic documents as necessary. In particular, banks are invited to:

- (a) Keep strategic and operational documents up-to-date on regular basis. The documents should contain clear and effective description of the procedures, system and infrastructure, while senior management/committees are expected to be fully involved for the benefit of the decision-making process and related delivery of tasks;
- (b) Keep the communication plan (for business continuity or resolution purposes) aligned with the steps described in the solvent wind-down plan (where applicable);
- (c) Investigate synergies with other playbooks.

**Day-one expectations:** banks shall work on a first draft of the SWD playbook(s), where the following elements are described and detailed:

- i. Existing governance structures and organisation for the purpose of a SWD implementation and communication:
  - a. Flowchart on key roles involved in the decision making of a SWD, and their responsibilities;
  - b. Flowchart on governance from decision, to execution, to communication with key sign off and escalation points.

Reference to existing operational and strategic documents is accepted, as long as it is relevant in the context of SWD of trading books:

- ii. When using existing operational and strategic documents, banks update the content and assess if additional material and information are necessary and applicable for SWD in resolution. Banks are expected to demonstrate that such assessment has been completed;
- iii. Evaluate HR needs and any special arrangements such as retention policy:
  - a. Key FTEs to be retained during the SWD implementation;
  - b. Analysis of special arrangements on the retention policy (including costs).
- iv. Draft a specific communication plan:
  - a. Communication to clients;
  - b. Communication to FMIs;
  - c. Internal communication;
  - d. Communication to authorities.
- v. Identify the various steps and estimate their approximate timelines for execution.

**Steady State expectations:** banks are expected to have finalised a comprehensive SWD playbook covering:

- i. An upgrade of the day-one milestone: a description and analysis on governance, HR and communication. These strategic and operational documents should be updated on a regular basis and contain clear and effective description of the procedures, system and infrastructure, whilst senior

management/Committees are expected to be fully involved for the benefit of the decision-making process and related delivery of tasks;

- ii. A description of divisional or business area segments, depending on the bank's business model and organisation, consistent with banks' other recovery and resolution playbooks and including references to these and other operational and strategic documents as necessary.

## 2.6. Underlying assumptions on idiosyncrasy and market conditions

The SRB recognises that the circumstances in which SWD can occur are hard to forecast and can be volatile. Banks should assume in their plans that the bank's failure and related SWD execution takes place under an idiosyncratic scenario, where only the bank in resolution is ailing<sup>19</sup>, and in normal market conditions (a stressed environment might be considered in subsequent submission if relevant, but is not considered at the moment). Banks should also assume that the SWD of trading books post resolution would happen **under the circumstances of the preferred resolution strategy (PRS)**, if the bank estimates the PRS would have an impact on the execution of the strategy. Banks are also expected to be able to refresh their analysis and perform sensitivity analysis to account for changing market conditions in real-life circumstances. Banks should model the following limitations and adverse reactions of counterparties to the SWD execution in the resolution context:

- **The bank has to assume a passive wind-down during the first three to six months following the cut-off date<sup>20</sup>.** The bank cannot assume that it can terminate a trade, unless the termination is to facilitate the close-out of a client-initiated termination. Furthermore, it cannot assume any application of SWD strategies and the wind-down of the financial institution's positions only result from contractual maturities and client initiated terminations. It is suggested to **use six months** for this initial period but banks can use a shorter or longer period if properly justified, but **not less than three months**.
- **The bank has failed to maintain, establish or re-establish market confidence, and as a result, it cannot continue using the bilateral OTC markets.** Imposing a restriction on OTC markets access provides a signal to the market that the bank is on its way out from complex trading activities and encourages the use of listed products for hedging from day one of the SWD strategy implementation. Once the passive wind-down period (three to six months) is over, bilateral OTC markets can be accessed, but only if justified for active wind-down purposes.
- **The bank can assume an active wind-down during the remainder of the wind-down period.** Between the fourth and seventh (depending on the passive period chosen as explained above) and 24th month following the cut-off date, the bank can initiate the termination of a trade, in case it has the

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<sup>19</sup> This scenario does not impact other counterparty banks.

<sup>20</sup> The date chosen as the reference date for the underlying data, and assumed to be the date of resolution for the exercise.

contractual rights to do so (e.g. cancellable swaps). Furthermore, the bank could apply SWD techniques.

- **The bank cannot assume any transfer of the whole portfolio during the whole wind-down period of 24 months.**<sup>21</sup>
- **The bank could assume continuation of an existing direct and indirect FMI access, which was present prior to resolution.** Resolution, as a sole ground, cannot be considered as one of the termination triggers of FMIs and this assumption is extended to any existing indirect accesses to CCPs via clearing members.
- **The bank should assume higher margin requirements from existing direct and indirect FMI accesses.** Under a resolution SWD exercise, higher margin requirements would be imposed on the banks by the FMIs. As long as the bank meets the (increased) liquidity (margin/collateral) requirements of the FMI, the access should be maintained.
- **The bank is expected to actively pursue cost reduction from direct and indirect FMI accesses.** The bank should not use the intention to maintain indirect clearing clients as a rationale to maintain CCP membership after the SWD period, as this function should be assumed to be substitutable and this transition should be one of the objectives of the SWD period.

## 2.7. Cost taxonomy

Wind-down costs can be broken down into the following categories:

- **Exit costs:** excess costs over accounting fair value from exiting portfolios through a SWD plan. They can be seen as the combination of quantitative estimates of expected haircuts (e.g. close-out costs additional valuation adjustment (AVA), investing and funding costs AVA), as well as qualitative/expert judgements given e.g. concentrated positions, early termination, operational risk, unearned credit spread, and so on.
- **Operational costs:** direct and indirect costs of running the business through the wind-down. They comprise e.g. staff costs (including severance packages), IT costs, costs for facilities and occupancies, costs from professional services, for infrastructure or legal services. They should reflect the different operating models and intragroup dependencies.
- **Risk-based costs:** hedging costs and potential losses/additional costs arising from market price movements that cannot be hedged, counterparty defaulting, etc. Compared to the two previous categories, this one is more complex to estimate and more subjective. From the AVA perspective, this corresponds to dimensions such as model risk AVA, market price uncertainty AVA, etc.

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<sup>21</sup> This is to be seen as a constraint of the exercise, not as the indication that such arrangement would not be foreseen in an actual asset separation deal, or that such transfer would not be considered for the rump after the SWD period.



- **Link between costs and liquidity needs:** These costs and liquidity needs have to be split across time buckets and then compared with expected revenues and liquidity gains from sales to identify expected costs/gains maturity mismatches, in line with EfB Principle 3.1 and 3.3. In no way is the bank required to submit a fully self-funded plan with no liquidity gaps, but it should be explicit and transparent about potential shortfalls.

### 2.7.1. EXIT COSTS

Exit costs are the excess costs over accounting fair value from exiting portfolios through a SWD plan. They can be seen as the combination of quantitative estimates (e.g. close-out costs AVA, investing and funding costs AVA), as well as qualitative/expert judgements estimates of expected haircut (e.g. concentrated positions AVA, unearned credit spreads AVA, operational AVA, early termination AVA, and so on). Those AVAs are needed to obtain a prudent valuation of fair valued positions<sup>22</sup>, taking into account the dynamic nature of trading book positions.

These costs are, by design, not unique but relative to market conditions, assumptions on counterpart behaviours, trade-off between the cost of holding the trade and selling it at any price, or financial stability aspects of fire sale. **For these reasons, banks should explicitly describe their methodology and state their assumptions.**

**Day-one expectations:** banks define internal methodologies for the estimation/modelling of exit costs related to SWD planning and provide an explanation on how the analysis was performed and the choice of models. These methodologies enable banks to identify and estimate direct and indirect costs, as well as key drivers of cost estimates. The Commission Delegated Regulation (EU) 2016/101 of 26 October 2015 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for prudent valuation under Article 105(14) provides a detailed, mandatory framework already in place that covers these dimensions (close-out costs AVA, investing and funding costs AVA etc.) – **banks are advised to rely on this, and complement with any other metric/input not covered by AVA they deem relevant.**

1. Banks analyse their capacities in business as usual and evaluate whether the business as usual systems and practices can be adapted for the purpose of the resolution planning capabilities for the SWD preparation.
2. The requirements on estimating exit costs should be **appropriate** and **proportionate**.
3. Banks can propose their own metrics (not using the prudential additional value adjustments (AVAs) as estimates of exit costs or on top of AVAs) as long as they can prove that these are fit for purpose.

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<sup>22</sup> Cfr Commission Delegated Regulation (EU) 2016/101 of 26 October 2015 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for prudent valuation under Article 105(14)

Banks should also explain their reasoning for making those specific valuation adjustments appropriate for the context of SWD exit costs in resolution.

**Steady state:** banks are capable of calculating AVAs following the core approach and are able to calculate each component of the prudential AVAs (e.g. AVAs for model risk, price uncertainty, close-out costs, unearned credit spread, funding cost, early termination, concentrated position, and so on) feeding SWD exit costs for each appropriate segment (depending on the metric, by trade, portfolio, desk, business unit or by counterparty).

1. Banks are able to update the SWD strategy on a regular basis with refreshed data, based upon the AVA variables here above in a period of four weeks.
2. During resolution planning, AVAs are reported on a quarterly basis (milestones), while banks should, in a real resolution case, be able to provide numbers to the SRB updated at minimum on a weekly basis.
3. Depending on the size and complexity of the trading activity, banks should be able to compute with their own metrics on a daily basis.

### 2.7.2. OPERATIONAL COSTS

Banks are expected to identify all costs of running the business through the wind-down. They might comprise staff costs (including severance and retention packages), for infrastructure (such as IT costs, facilities and occupancies), costs from professional services or third parties services (such as legal services, audit and accounting, FMI access, intercompany payments for shared services, etc.). They are expected to reflect the different operating models and intragroup dependencies.

#### **Day-one expectations:**

1. Banks are expected to provide a comprehensive description of all operational costs (including interdependencies and shared services) and break them into direct and indirect costs, for each relevant segment of activity. If another scope is used (desk, business lines), banks are expected to substantiate their choice and the relevance for the assessment of operational costs.
2. Banks are expected to include an estimation of one-off costs, such as consultancies, redundancy packages etc.
3. Banks are expected to have the capacity to estimate costs in business as usual at the most appropriate segment level
4. Estimation of costs may be simple, by using a rule of three. The estimation is broken down by segment (or other relevant chosen scope) and proportionally to the wind-down pace.

**Steady state:** banks are expected to be able to report an accurate and comprehensive estimation of operational costs based on a diverse set of assumptions and scenarios throughout time (during the 24 months

of SWD, including the management of the residual positions). Banks are able to report those estimates of operational costs within a reasonable timeframe (one week) and refresh estimates in a timely manner.

### 2.7.3. RISK-BASED COSTS

Risk-based costs refer to potential losses and additional costs arising from market price movements that cannot be hedged, counterparty defaulting, etc. Compared to the two previous categories, this one is more complex to estimate and more subjective.

**Day-one expectations:** banks are expected to include an estimation of risk-based costs using the bid/ask spreads and the difference between Marked to Market (MtMkt) vs Marked to Model (MtModel) pricing and sensitivities, calculated at the level of the most appropriate segment. From the AVA perspective, this corresponds to dimensions such as ‘model risk AVA’, ‘market price uncertainty AVA’.

**Steady state:** banks are expected to have full capability in identifying risk indicators and events leading to higher risks and potential losses. Structured documentation explains their judgement and methodology in the quantification of such material risks, covering market risks, credit risks and operational risks. Banks have also consistently developed a comprehensive risk reduction strategy to be executed in a timely manner for the planning of SWD. During the execution of SWD, such indicators and events might take into account specific market conditions.

### 2.7.4. LIQUIDITY IMPACT

**Day-one expectations:** The expected range of liquidity impact of the SWD exercise should be estimated for a two-year horizon and provided for the bank and the SRB to identify how much liquidity SWD can generate in the long run, and to identify potential liquidity gaps in the earlier days of the execution of the wind-down strategy.

**Steady state:** When it comes to liquidity expectations related to SWD, the existing liquidity in resolution policy and guidance<sup>23</sup> prevail. In particular, when considering key liquidity drivers, scenarios, simulations (including the maturity ladder tables to present the results) and the evolution of peak intraday liquidity needs, banks should consider and include, as part of the compliance with the EfB principle 3.1 – “Estimation of liquidity and funding needs in resolution”, the impact of the execution of the SWD plan. This analysis should also be included in the SWD plan.

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<sup>23</sup> <https://www.srb.europa.eu/en/content/guidance-liquidity-and-funding-resolution>

## 2.8. Further definitions

- **Cut-off date:** In the context of this guidance, the cut-off date is the date chosen as the reference date for the underlying data, and assumed to be the date of resolution for the planning exercise. It is not recommended to use a year-end cut-off date.
- **Wind-down period:** A period starting on the cut-off date and lasting for up to 24 months. A bank could choose a shorter period and therefore should provide justification for that choice.
- **Remaining/residual trading position:** An overview of the rump at the end of the wind-down period. All trades and desks that the bank would still own after the wind-down period (after 24 months or less).
- **Initial trading position:** An overview at the cut-off date, consisting of the list of the trading desks, grouped by activity, business line, and entity. To each desk should correspond one of several SWD strategies, depending on the trade type or complexity, their expected market appeal, the need to restructure the portfolio beforehand, the function fulfilled by the desk for global market activities or for the rest of the group etc. It should include both desks subject to winding down strategies, and targeted for the rump portfolio.
- **Passive wind-down:** This represents a total run-off scenario. It should not include any assumptions about the transfer of portfolio or an application of SWD techniques (such as compression, novation, risk neutral transfer of portfolios), and the wind-down of the financial institution's positions only result from contractual maturities and client initiated terminations. Moreover, the bank cannot assume that it can terminate a trade, unless the termination is to facilitate the close-out of a client-initiated termination.
- **Active wind-down:** Contrary to the passive wind-down, an active role of the bank is assumed. The bank could apply SWD strategies as described above (such as compression, novation ...). Moreover, the bank can initiate the termination of trade, in case it has the contractual rights to do so (e.g. cancellable swaps).

## 3. Expectations – Solvent wind-down of the trading books

Institutions with material trading books are expected to develop a granular plan and *ex-ante* capabilities to wind down their trading books. Where winding down of trading books is involved, this will require careful planning and analytical capabilities including:

- A plan outlining the different segments and the associated exit strategies for its trading activities and the potential financial implications;
- Information provision on the Solvent wind-down (SWD) planning such as capacity to update the plan in a timely manner, using business as usual tools, systems and infrastructures as much as possible;

- The capabilities to execute the wind-down, including a SWD playbook focused on governance, HR and communication.

The main objectives are to (i) adequately prepare, develop and maintain banks capabilities for the planning of a SWD in resolution, whether as part of the resolution strategy, or as actions implemented in the post resolution phase and (ii) execute the SWD plan in a reasonable timeframe.

### 3.1. Solvent wind-down plan and supporting analyses

#### *Objectives:*

- To outline different segments of the bank's trading books and the associated exit strategies that could be implemented in resolution and as part of the business reorganisation;
- To understand and anticipate potential financial implications such as capital and liquidity gaps and gains linked with trading activities.

#### *Expectations:*

Banks with material trading books are expected to:

- Perform a granular segmentation of their trading books based on the key characteristics which will impact the exit strategy, such as product type, counterparty type, underlying asset type, master agreements' (MA) credit support annexes (e.g., CSA for ISDA MA) and long form confirmation, currency and maturity, first order sensitivity to the main underlying (delta, PV01... depending on which is the most relevant for the product type), complexity (for instance amount of the positions falling under the level 3 of the IFRS13 accounting standards) etc.;
- Analyse and document the main interdependencies and risks of winding down their trading books, then assess how they would influence the sequences of the wind-down. For example, banks should identify which desks may remain until the end of the wind-down process:
  - Analyse their booking model practices to identify when they are different across businesses lines or entities and how to mitigate potential booking/transferring issues;
  - Analyse the market risk and CCR exposures against substantial counterparties and between their different legal entities to identify key interdependencies.
- Assign and substantiate an exit strategy to each segment including timing of exit, where exit strategies could be used singularly or in combination and may include, among others, close out, contractual run-off, auction or transfer to third parties, novation, compression or consensual tear-up.
  - Assess the potential stress impact the SWD might generate on market liquidity.

- Calculate the potential exit costs/expected haircuts for each segment considering the accounting fair value of each segment. Such estimates can be supported by different valuation adjustments (AVAs<sup>24</sup>) reflecting the prudential adjustment as appropriate (e.g. model risk AVA, market price uncertainty AVA, close-out costs AVA, concentrated position AVA, and so on) or any internal method/metrics as long as proper justification that they are fit-for-purpose is provided. This can also be supported by lessons from past wind-down exercises, in particular when it comes to counterparty behaviour.
- Articulate a hedging strategy and estimation of risk-based costs as a range by taking into account any reduced market access (e.g. basis risk if firms are only able to hedge using certain products) or effects resulting from any systemic stress on the wider market (such as market capacity), and the timing of any such reduced market access or wider effects. This should include changes in acceptable collateral and associated haircuts.
- Consider potential losses due to risks the bank would be unable to hedge up to and during the resolution period, i.e. risk-based costs.
- Identify and explain elements of its portfolio which it would not be able to wind down ('rump' or 'residual positions'); identify any hedges or funding positions that would be required to support holding the position until it matures, or a purchaser is found.
- Analyse and document the financial and operational dependencies of winding down its trading books:
  - Internal, such as the dependencies in relation to shared services, IT infrastructure, staff/human resources, interdependencies, impact on critical functions and critical services, on core business lines and essential services.
  - External, such as market access requirements.
  - Provide a comprehensive description of all operational costs (including interdependencies and shared services) and break them into direct and indirect costs, analyse and estimate these operational costs of winding down their derivatives and trading business, at the most appropriate segment (covering cost such as compensation, severance, IT, trading, real estate, shared services, third-party agreements, legal services). Banks are also expected to consider and estimate one-off costs.
- Assess and estimate the capital and liquidity impacts of winding down their trading business:
  - Include the potential liquidity impact of winding down their trading books in the estimation of liquidity in resolution; forecast the liquidity sources and uses for at least the material period of the wind-down.
  - Perform the assessment at the most appropriate segment for several maturity buckets, and take into account potential liquidity maturity mismatches.

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<sup>24</sup> Cfr Final draft RTS on prudent valuation (EBA/RTS/2014/06/rev1)

- Demonstrate that any assumptions relating to the speed at which they are able to perform liquidity transformations are based on realistic market conditions and past experiences.
- During execution, monitor regularly the liquidity impact of the SWD plan using a range of internal metrics (internal stress tests, gapping methodology etc.) and regulatory metrics (LCR, NSFR).
- Include the potential impact of winding down their trading books in the modelling of capital adequacy; forecast the capital adequacy for at least the material period of the wind-down. Capital analysis is expected to be supported by qualitative descriptions explaining RWA moves over time (with quarterly minimum frequency). In particular, this will focus on changes in market risk, CVA, and CCR capital requirements.
- Perform a robust assessment to identify the key risks and sensitivities of the plan, and potential mitigating factors.

## 3.2. Information provision

### *Objectives:*

- To streamline the drafting of SWD plans and their timely update;
- To ensure the SWD planning process is integrated in and relies on internal, business as usual tools, systems and infrastructures.

### *Expectations:*

For the information provision of SWD planning, banks with material trading books are expected to:

- Establish appropriate management information system<sup>25</sup> (MIS) capabilities that can support at a minimum:
  - The accurate, comprehensive and timely (within a matter of days) provision of the necessary information and data (at a sufficient level of granularity and segmentation) to support the firm's assessment and implementation of solvent wind-down exit strategies to ensure that any timelines set by the SRB are complied with;
  - The accurate, comprehensive and timely provision of trading book data at a sufficient level of granularity and to enable valuations to be performed within a suitable timeframe so that any timelines set by the SRB are complied with;

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<sup>25</sup> Please refer to the Efb, in particular Principle 5.1 MIS capabilities to provide information necessary for the preparation and update of resolution plans.

- The ability to perform sensitivity analysis, with the flexibility in its infrastructure to perform ad-hoc sensitivity analysis under any given set of circumstances in a robust and timely manner;
- The ability to monitor and report not only on franchise or business-line basis but also on legal entity basis, also for entities that are outside of EU jurisdictions.
- Institutions are expected to be able to demonstrate that related Service Level Agreements (SLAs) are in place and can be maintained during resolution.
- Establish appropriate management and expert resources and capabilities (in business as usual and evaluate whether the business as usual systems and practices can be adapted for the purpose of the resolution planning capabilities for the SWD preparation). Those capabilities should enable, at group level, the ability to:
  - Develop methodologies to assess and model exit, operational and risk-based costs, as well as capital and liquidity impacts;
  - Consider the residual portfolio of derivative or trading book positions remaining (i.e. the rump) after a solvent wind-down;
  - Refresh its analysis on the potential costs of holding and maintaining the positions to maturity;
  - Include the dimension of the impact of interdependencies and between legal entities;
  - Provide a qualitative and quantitative overview on the liquidity impact on the SWD plan execution in a timely way, in line with the existing liquidity policy<sup>26</sup>;
  - Estimate the gross (outflows and inflows) and net (liquidity position) impact at different level of granularity (e.g. up to desk level);
  - Identify the quantum and location of unencumbered collateral, while mobilisation of unencumbered collateral is necessary to support the availability of liquidity (in line with the EfB document)
  - Put in place procedures to test their plans and the capacity to refresh them in a timely manner. In particular, banks should be able to refresh the data, estimates and numbers provided in their SWD plan given new market conditions (including stress situations) and up to date balance sheet and portfolio risk;
  - Document the lessons learnt from past and current wind-down experiences and take steps to address identified issues or mitigate risks.

Such capabilities could also be demonstrated via the organisation of fire-drill exercises on specific segments during the resolution-planning phase.

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<sup>26</sup> [SRB operational guidance for liquidity and funding in resolution](#)



### 3.3. Solvent wind-down plan execution

#### *Objectives:*

- To ensure operational readiness to execute the SWD plan in the event of resolution, also in terms of governance and communication;
- To execute the solvent wind-down strategy within a reasonable timeframe (i.e. two years);
- To manage risk both prior and after resolution, and minimise market disruption and risks to financial stability arising from trading activities and derivatives;
- To enable flexibility and adaptability to whichever market condition banks might witness at the time of resolution.

#### *Expectations:*

Banks are expected to include in the SWD plan, a **SWD playbook** covering governance, HR and communication in line with the FSB definition.

In particular, as regards to the bank capabilities to execute the solvent wind-down strategy, banks are expected to:

- Perform periodic reviews of the plan. The senior management (i.e. at least CFO, CRO, and, when necessary, CEO) is expected to understand the key concepts underlying the plan and the main implications on profitability, solvency and liquidity perspective. Business line heads must actively participate in the approval of the plans of respective areas.
- Demonstrate the firm's capability to effectively manage risk and market impacts while executing the wind-down in a constraint timeframe, especially in market situations where access to certain hedging instruments is not easily available or the hedge is temporarily illiquid.
- Monitor residual positions during resolution, including the estimation of the costs of maintaining held-to-maturity instruments (initially kept in the trading books for some reason) in the core SWD analysis.
- Provide clarity on the necessary internal steps and actions of the solvent wind-down strategy, associated with expected timelines, such as the identification of key sign-off and escalation points, parties involved in the decision-making in a solvent wind-down, their responsibilities in the execution of a solvent wind-down and communication with relevant stakeholders. Lessons from previous wind-down of core and non-core activities related to governance can also support.