

EBA/CP/2022/15

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14 December 2022

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# Consultation Paper

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Draft Guidelines on overall recovery capacity in recovery planning

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# 1. Responding to this consultation

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The EBA invites comments on all proposals put forward in this paper and in particular on the specific questions summarised in 5.2.

Comments are most helpful if they:

- respond to the question stated;
- indicate the specific point to which a comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed/ rationale proposed; and
- describe any alternative regulatory choices the EBA should consider.

## Submission of responses

To submit your comments, click on the 'send your comments' button on the consultation page by 14 March 2022. Please note that comments submitted after this deadline, or submitted via other means may not be processed.

## Publication of responses

Please clearly indicate in the consultation form if you wish your comments to be disclosed or to be treated as confidential. A confidential response may be requested from us in accordance with the EBA's rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

## Data protection

The protection of individuals with regard to the processing of personal data by the EBA is based on Regulation (EU) 1725/2018 of the European Parliament and of the Council of 23 October 2018. Further information on data protection can be found under the Legal notice section of the EBA website.

## 2. Executive Summary

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Directive 2014/59/EU<sup>1</sup> requires institutions to set up recovery plans to strengthen their ability to restore financial and economic viability when potentially facing situations of significant deterioration. Through recovery planning, institutions are preparing in advance to address a wide range of crises that could emerge.

In this context, section A of the Directive 2014/59/EU Annex specifically provides for institutions to include a summary of their overall recovery capacity (ORC) within their recovery plans, the ORC being the extent to which the recovery options allow that entity or those entities to recover in a range of scenarios of severe macroeconomic and financial stress<sup>2</sup>. The role of the ORC as summary measure within the recovery plan is further outlined by Article 4 of the Commission Delegated Regulation (EU) 2016/1075<sup>3</sup>. The Delegated Regulation, as set out in Article 16, also provides for competent authorities' assessment of the completeness of the recovery plan, including the ORC. Therefore, the existing legal framework requires on the one hand institutions to summarise their ORC and, on the other hand, competent authorities to assess it as part of the overall assessment of the institutions' recovery plan.

ORC is a key outcome of recovery planning providing an indication of the overall capability of the institution to restore its financial position following a significant deterioration of its financial situation. The determination of this component is relevant for institutions and competent authorities as well, enabling them to assess the extent to which institutions would be able to overcome a range of potential crisis situations through the implementation of suitable recovery options.

In order to ensure that ORC effectively fulfils its role as a summary of institutions' 'recoverability', it needs to be properly determined and consistently represented by institutions. In the absence of a specific framework and specific guidance on the relevant steps underlying the ORC determination, institutions have developed a wide range of different practices. This has also emerged from a recent survey carried out by the EBA among competent authorities on the current state of play of the ORC in terms of its consistent inclusion and homogeneous role within the recovery plan. Similarly, the ORC assessment by competent authorities turns out not to be fully aligned across jurisdictions both

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<sup>1</sup> Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014, establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (OJ L 173 12.6.2014, p. 190).

<sup>2</sup> Art. 12 (3) of the Commission Delegated Regulation (EU) 2016/1075.

<sup>3</sup> Commission Delegated Regulation (EU) 2016/1075 of 23 March 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges (OJ L 184 8.7.2016, p. 1).

in terms of nature and scope of the assessment performed mostly due to the divergence of practices in the ORC determination across institutions.

Against this background, the EBA has developed these own-initiative guidelines addressed to both institutions and competent authorities to achieve a harmonised approach to the determination and assessment of the ORC.

On this basis, these guidelines are composed of two parts:

- (i) The first is addressed to institutions, providing them guidance on setting the framework for the determination of the ORC;
- (ii) The second complements the framework by supporting competent authorities in their assessment of the institutions' ORC as part of the overall assessment of the recovery plans.

## Next steps

The draft guidelines are published for a three-month consultation period. Consultation responses can be provided by filling in the form on the EBA website.

## 3. Background and rationale

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### Setting the framework of ORC - Guidance to institutions

1. The ORC framework is based on two fundamental components:
  - (i) the list of credible and feasible recovery options and
  - (ii) the range of sufficiently severe scenarios.
2. ORC needs to be established on a sound basis in order to provide a proper indication of the institutions' 'recoverability'. This is the reason why the guidelines stress the importance of identifying recovery options that are credible and feasible under the scenario of reference. To guide institutions in an appropriate assessment of the credibility and feasibility of their recovery options - while taking into account that this will be dependent on the type of option, the specific business profile of the institution and the macro-economic environment of reference - the guidelines establish a non-exhaustive set of general qualitative requirements (i.e. past experience, level of preparedness, etc.) that institutions should take into account for their assessment of credibility and feasibility of the recovery options.
3. Among the qualitative elements to consider in the feasibility assessment, the institutions are expected to consider the different type of impediments which could negatively impact on the implementation of the option. In particular, the institutions should consider the following impediments:
  - (i) Operational. For example, in the case of a disposal recovery option, to assess the presence of operational links of the disposed entity with the rest of the group;
  - (ii) Reputational. For example, de-risking options could give negative signals to the market impacting, on its reputation;
  - (iii) Legal. For example, in the case of reduction of staff costs or dividend distribution, there are contractual clauses/terms in employees or other third-party contracts (i.e. governing pay terms, taxes, redundancies, bonuses, pensions) which could negatively affect the execution of the option;
  - (iv) Financial. For example, the reduction or elimination of business lines could impact on the business offer to customers impacting on its customer franchise and ultimately profitability;
  - (v) Business model and profitability. For example, the disposal of an asset management subsidiary to raise liquidity could alter the business model of an institution as well as its long-run profitability;



- (vi) Market situation. The implementation of options is not fully within the institution's control but relies on action by third parties for example in the case of disposals or raising liquidity.
4. Moreover, for the ORC to provide a proper indication of the ability of the institution to recover, it is essential that the scenarios under which it is determined are sufficiently severe. Only an appropriate level of severity would in fact ensure the implementation of the full set of available recovery options allowing the institution to truly demonstrate its full capacity to restore its business and financial viability. To this purpose, in accordance with the existing EBA guidelines on scenarios<sup>4</sup>, scenarios are considered severe enough if - within a reasonable timeframe - they would lead institutions to the 'near-default' point in case no recovery options are implemented. In particular, in order to ensure appropriate determination of the ORC, the guidelines specify that scenarios should at least lead to the breach of the relevant capital or leverage or liquidity regulatory requirements<sup>5</sup>. In order to design such scenarios, in line with the EBA/GL/2014/06, 'reverse-stress testing' could be used as a tool for identifying scenarios that would threaten to cause the non-viability of the business model unless recovery actions were successfully implemented.
  5. While institutions are expected to design scenarios that breach the afore-mentioned regulatory requirements, the guidelines recognise that, in limited exceptional cases, institutions could provide a detailed explanation to the competent authorities on why in their case, scenarios that do not breach the capital or leverage regulatory requirements should be still considered severe enough. This flexibility is left to the very few cases of institutions, for instance with extremely strong capital/leverage position, which can reasonably demonstrate that they cannot draw up a plausible scenario breaching capital or leverage regulatory requirements and that the designed scenario would anyway threaten their failure. No residual flexibility is provided instead for liquidity regulatory requirements as they could always be theoretically subject to extremely fast and unexpected acute depletion.
  6. In defining the methodology for the determination of ORC, the guidelines specify the steps that an institution should follow:
    - 1) Selection of recovery options – the institution should identify the recovery options that could be credibly and feasibly used under each specific recovery plan scenario;
    - 2) Adjustment of recovery options – the institution should further refine the choice of options by considering several constraining factors related to the simultaneous or sequential implementation of the combination of options. Among those factors, the institution should consider important aspects such as mutual exclusivity (for example, a portfolio which would be sold cannot be securitized – again – at a later stage),

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<sup>4</sup> EBA/GL/2014/06 on the range of scenarios to be used in recovery plans.

<sup>5</sup> The scenarios should lead to the breach of Total SREP Capital requirement (TSCR) or Total SREP Leverage ratio requirement (TSLRR) as defined in the EBA SREP Guidelines (EBA/GL/2022/03 or any other version updating them, if any) or liquidity regulatory requirements as defined according to the outcome of the SREP assessment (i.e. LCR and/or NSFR 100% threshold including any relevant addition as a result of the SREP), including the cases where multiple breaches of these requirements occur.



interdependencies (for example, limiting dividends or distributions on AT1 instruments may affect subsequent CET1 or AT1 issuances), operational capability to implement a multitude of recovery options simultaneously (for example, depending on the size and experience of the bank, preparing the securitization of several asset portfolios in parallel might run up against operational constraints, as there may only be a limited number of staff with the required expertise);

- 3) Calculation of 'scenario-specific recovery capacity' – the institution should add-up the quantitative impacts of the selected options under the specific scenario showing how the recovery capacity accumulates over a timeline of 12 months for the impact on the capital position (including leverage) and 6 months for the impact on the liquidity position and using, as starting point for the calculation, the breach of the recovery plan indicators resulting in the implementation of the relevant recovery options (for instance including those related to capital or liquidity). The outcome of this calculation is the recovery capacity for the specific scenario, which is quantified in terms of the relevant recovery plan indicators in Annex II ("Minimum list of recovery plan indicators") of EBA Guidelines on recovery plan indicators under Article 9 Directive 2014/59/EU<sup>6</sup> referring to CET1 Ratio, Total Capital Ratio, Leverage Ratio, NSFR and LCR ('relevant RP indicators');
- 4) Determination of the ORC range – once the institution has calculated its 'scenario-specific recovery capacity' under each relevant scenario, it will define its ORC as a range of these capacities. More specifically, the capital ORC will be the range formed by the highest and lowest recovery capacity under the scenarios whose impact is mostly on capital (including leverage) and/or under scenarios with significant impact on both dimensions (capital, including leverage, and liquidity). The same will apply for the building of the liquidity ORC range.

An explanatory box on the relevant steps for the ORC determination is provided at the end of the 'Background and rationale' section of this consultation paper.

## Competent authorities' assessment of ORC

7. The other relevant component that complements the ORC framework is the assessment by the competent authorities. This step, as part of the overall assessment of the recovery plan in accordance with Articles 6 and 8 of Directive 2014/59/EU and the Commission Delegated Regulation (EU) 2016/1075, is relevant to inform the supervisory view on the capacity of the institutions to restore their viability and financial position when subject to a range of severe stress.
8. Firstly, when assessing the set of the recovery options provided by the institutions, competent authorities should review all the relevant aspects underlying their implementation. These aspects range from the credibility and feasibility assessment to the anticipated timeline for their execution, their likely impact on the institutions' 'relevant RP indicators' as well as any

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<sup>6</sup> EBA/GL/2021/11.





constraining factors related to their simultaneous or sequential implementation. Peer group analysis could support this assessment through the comparison of the relevant qualitative and quantitative assessment performed by peer group institutions.

9. In the assessment of the severity of the scenarios, competent authorities should verify that, in line with the objective of the recovery plan to identify measures that restore the viability and financial position of an institution in severe stressed conditions, the 'near-default' point would be reached by the institution in case no recovery options are implemented. In case this level of severity is not met by the institution, competent authorities may request to the institution to perform appropriate adjustments including the resubmission of the recovery plan as a result of a material deficiency assessment in accordance with Article 6 of Directive 2014/59/EU. The rationale is that if an institution does not envisage scenarios that are severe enough to threaten their failure, the assumption underlying the recovery plan would not be fulfilled and thereby the plan would not play its role of providing a complete picture of the institution's 'recoverability'. Competent authorities could however accept a scenario that has not breached the capital or leverage regulatory requirements described in paragraph 21 of the guidelines only in those specific and extraordinary cases where they are satisfied with the explanation provided by the institution with regard to the attained level of severity taking into account, among others, the institution's overall risk profile.
10. The result of the ORC assessment by the competent authorities is the so-called 'adjusted ORC'. It is obtained by analysing, as thoroughly as possible given the data obtained from the institutions' recovery plans, the relevant assumptions and steps performed by the institutions to determine their ORC as the range of the 'scenario-specific recovery capacities' and it aims to reflect the competent authorities' overall assessment of the institutions' ORC. The 'adjusted ORC' is quantified both in terms of capital and liquidity ORC, in line with the outcome of the institutions' ORC. The 'adjusted ORC' by the competent authorities is expected to result either in a lower or in an equal level compared to the ORC calculated by the institutions having considered all the available information.
11. Competent authorities would assign an indicative summary ORC score with three potentially different outcomes (i.e. 'Satisfactory', 'Adequate with potential room for improvement' or 'Weak') based on the level reached by the 'adjusted ORC' compared respectively to the institutions' 'relevant RP indicators' thresholds and regulatory requirements (in accordance with paragraph 21 of the guidelines) adding the relevant regulatory buffer requirements.
12. To complement their ORC assessment, it is explicitly provided for competent authorities to consider qualitative elements, not already reflected in the 'adjusted ORC', of the ORC framework. This may result in the adjustment - either upward or downward - of the previously assigned summary ORC score in case this latter, as an outcome of the competent authorities' assessment of the additional qualitative elements, does not fully represent the supervisory view on the ORC of the institution. The final ORC score will therefore appropriately reflect both the quantitative and qualitative overall assessment of the competent authorities.



13. Where the final ORC score is 'Weak' or 'Adequate with potential room for improvement', competent authorities could identify a material deficiency in the recovery plan ('Weak' level) in accordance with Article 6 of Directive 2014/59/EU or a specific area of improvement related to the ORC ('Weak' or 'Adequate with potential room for improvement' levels). When considering the subsistence of a material deficiency or an area of improvement, the guidelines foresee that competent authorities take into account, inter alia, some additional elements, such as the current condition of the institution (e.g. whether a capital conservation plan is in place), the progress that the institution has made to improve the ORC compared to the previous recovery plans as well as the existence of sound capital (including leverage) and/or liquidity headroom.
14. The objective of the assignment of an ORC score is to enable competent authorities to take into account the evolution of the institutions' ORC over time, fostering consistency and a harmonised supervisory approach. The score could as well serve as a component of the assessment of the recovery plan information in the context of the overall assessment of the institutions' risk profile within the annual Supervisory Review and Evaluation Process (SREP).
15. Applying the proportionality principle already reflected in Article 4 of Directive 2014/59/EU with regard to the simplified obligations regime, these guidelines specify that competent authorities may apply all or part of these guidelines to institutions subject to simplified obligations. For that determination by competent authorities, proportionality will also be relevant taking into account that application of the ORC framework depends on i) the number and/or complexity of available recovery options and ii) the number and design of scenarios included in the recovery plan and, therefore, the simplified scope of the plan may reduce or even not require the application of the ORC framework as part of the institution's recovery plan.
16. These guidelines take into account the principle of proportionality when determining the scope of their application to investment firms. In this context, while the guidelines should apply in principle to all institutions as defined in Directive 2014/59/EU, competent authorities should be able to waive specific parts of the guidelines to investment firms, where their application would not be appropriate for the recovery planning of the investment firm or the investment firm group having regard to its business model as well as its legal structure, risk profile, size and complexity.

### Explanatory box on the ORC determination

This explanatory box provides an illustrative example of how the different steps for the ORC determination detailed in these guidelines could be practically implemented by institutions. Its objective is to increase clarity for institutions showing how the steps for the ORC determination may work in a simplified practical case.

It is relevant to highlight that the example presented, including its assumptions, figures, tables and graphical representations of the information, is purely fictional and it is meant for illustrative purposes only. Therefore, this box does not intend to provide any prescriptive criteria to be followed by the institutions when carrying out the relevant assessments and providing the related representation in their recovery plans, which should always be performed by the institutions according to their relevant specificities and internal practices in line with their risk management framework.

#### Background

Let's assume the case of Institution XYZ, a medium sized (no Global Systemically Important Banks – G-SIB, no Other Systematically Important Institutions – O-SII) banking institution based in the EU subject to the Directive 2014/59/EU requirements under Article 5 of drawing up and maintaining a full recovery plan.

In its recovery plan, Institution XYZ has identified a menu of credible and feasible recovery options that it could implement to restore its financial position following a significant deterioration. The recovery options identified are the following:

- A. Capital raising - issue of ordinary shares;
- B. Entity disposals - disposal of the subsidiary I in country Z;
- C. Risk reduction - reduction of existing loans and new business origination;
- D. Asset sales - disposal of credit portfolios and equity stakes;
- E. Cost savings - skip of bonuses;
- F. Earnings retention - dividend cancellation;
- G. Liability management - liability management transactions addressed to institutional investors;
- H. Access to standard central bank facilities - use of facilities/discounts at central bank by pledging eligible assets.

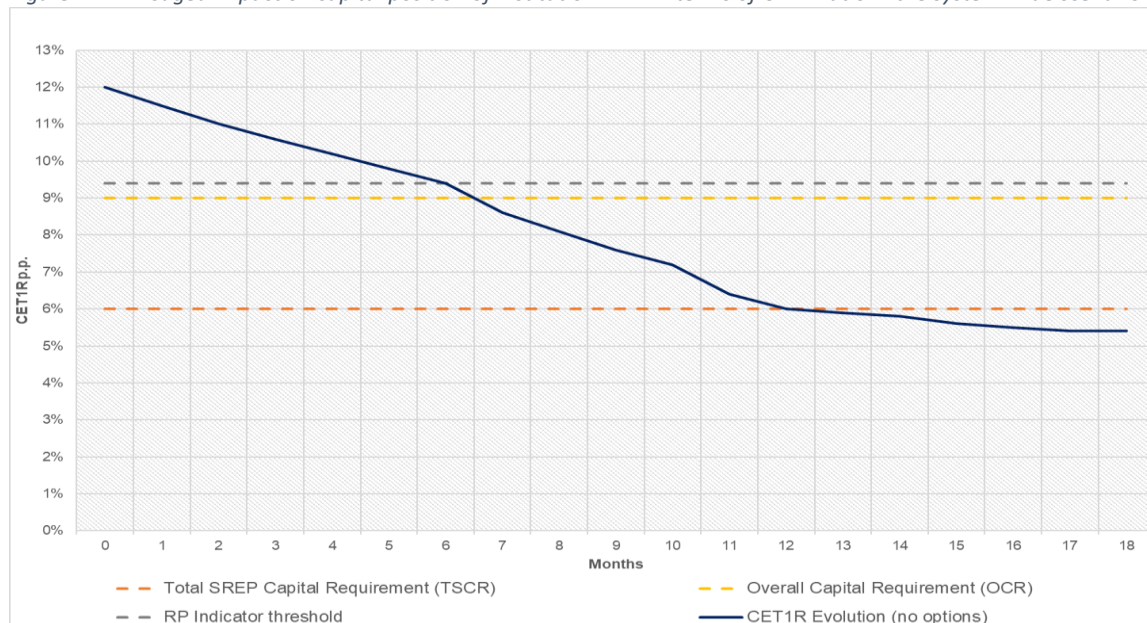
In accordance with the recovery plan requirements, Institution XYZ has developed the following three scenarios of severe financial and macroeconomic stress in order to test its recovery options. The type of scenarios considered, in line with the EBA/GL/2014/06, are the following:

- **Scenario 1** (*system-wide with slow-moving events*) - the effect of this scenario is mainly a significant negative impact on institution's capital profile;
- **Scenario 2** (*idiosyncratic with fast-moving events*) - the effect of this scenario is mainly a significant negative impact on institution's liquidity profile;

- **Scenario 3** (combination of system-wide and idiosyncratic events) - the effect of this scenario is a significant negative impact both on the institution’s capital and liquidity profiles.

As far as the severity of the scenario is concerned, Figure 1 illustratively represents the impact of the system-wide scenario on Institution XYZ capital requirements, in terms of CET1 Ratio, in case no recovery options were implemented (i.e. the ‘unmanaged case’). In line with the proposed guidance in paragraph 21 of these guidelines, Institution XYZ has developed this scenario so that it would lead to the breach of its Total SREP Capital Requirement (TSCR) for CET1 Ratio<sup>7</sup> in the ‘unmanaged case’ (within 12 months).

Figure 1 – Envisaged impact on capital position of Institution XYZ<sup>8</sup> in terms of CET1 Ratio in the system-wide scenario



### Determining the ORC

#### Step 1 – Selection of recovery options

Based on the nature of the macroeconomic and financial stress, Institution XYZ will choose credible and feasible options which, in terms of their effects on the ‘relevant RP indicators’ would be the most effective in the respective scenarios.

#### Step 2 – Adjustment of recovery options: additional constraining factors

In selecting recovery options, Institution XYZ takes into account at least the relevant constraining factors related to the simultaneous and sequential implementation of recovery options in accordance with paragraph 30 of these guidelines.

In particular, in each scenario Institution XYZ analyses possible interactions between the selected recovery options and explains why the selected recovery options do not conflict with each other and to what extent interdependencies between the recovery options exist. For example,

<sup>7</sup> Where TSCR = P1 + P2R, in this example TSCR = 4.5% + 1.5% = 6%.

<sup>8</sup> Only binding regulatory requirements have been included in the ‘capital requirements stack’, therefore P2G has not been represented in this illustrative example.

Institution XYZ explains why the recovery option ‘Risk reduction - reduction of existing loans and new business origination’ does not affect the feasibility and effectiveness of the recovery option ‘Liability management - liability management transactions addressed to institutional investors’. When interdependencies have been detected, this analysis could either result into the exclusion of one of the mutually exclusive options or into the adjustment of their expected impact when they are combined.

Additionally, the analysis performed by Institution XYZ shows at what stage each recovery option is taken. The quantitative impact of the recovery options on the ‘relevant RP indicators’ over time is also shown. Let’s assume the outcome of step 1 & 2, for the sake of simplicity, may be summarized as follows.

Figure 2 – Selection of Recovery Options (ROs) and adjustment for the additional constraining factors



**Step 3 – Calculation of ‘scenario-specific recovery capacity’**

Once the recovery options have been identified and selected according to the previous steps, Institution XYZ expresses the ‘scenario-specific recovery capacity’ as the sum of their impacts over time according to paragraph 25 of these guidelines, representing it in terms of the ‘relevant RP indicators’ provided in paragraph 27.

**Scenario 1 - System-wide with slow-moving events whose impact is mainly on the capital side**

Figure 3 – ‘Scenario-specific recovery capacity’ for Scenario 1 for CET1 Ratio & Total Capital Ratio (TCR)

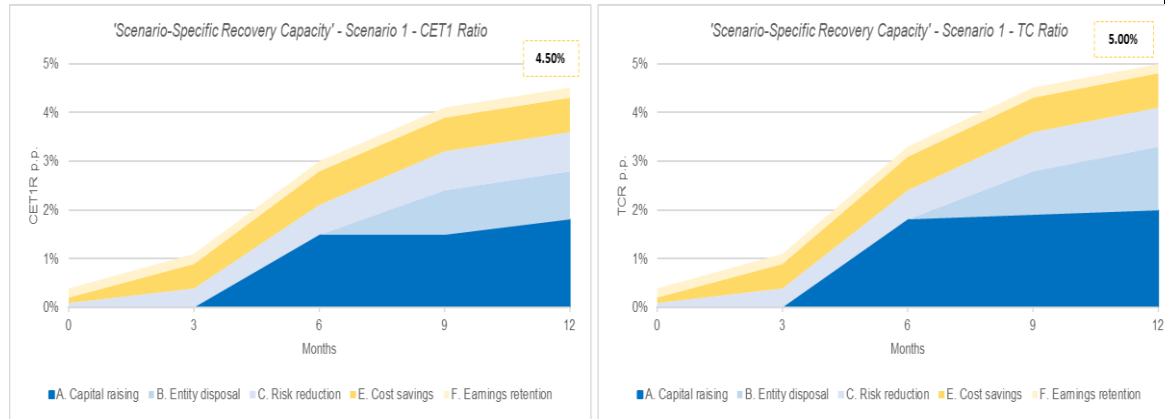
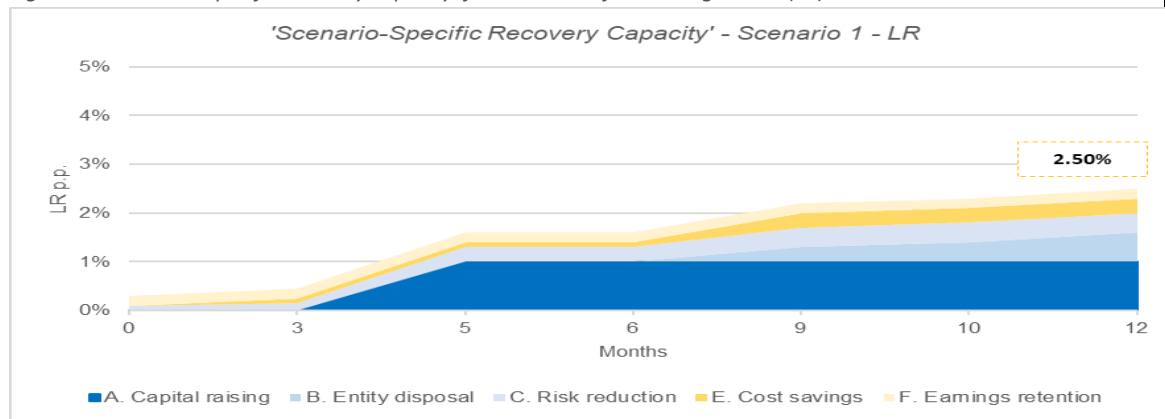
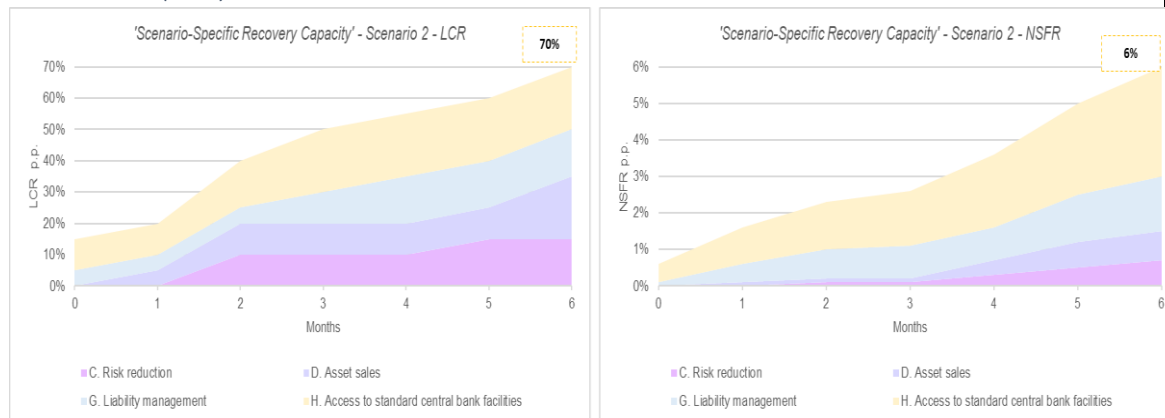


Figure 4 – ‘Scenario-specific recovery capacity’ for Scenario 1 for Leverage Ratio (LR)



**Scenario 2 - Idiosyncratic with fast-moving events whose impact is mainly on the liquidity side**

Figure 5 – ‘Scenario-specific recovery capacity’ for Scenario 2 for Liquidity Coverage Ratio (LCR) & Net Stable Funding Ratio (NSFR)



**Scenario 3 - Combination of system-wide and idiosyncratic events whose impact is both on capital and liquidity side**

Figure 6 – ‘Scenario-specific recovery capacity’ for Scenario 3 for CET1 Ratio & Total Capital Ratio (TCR)

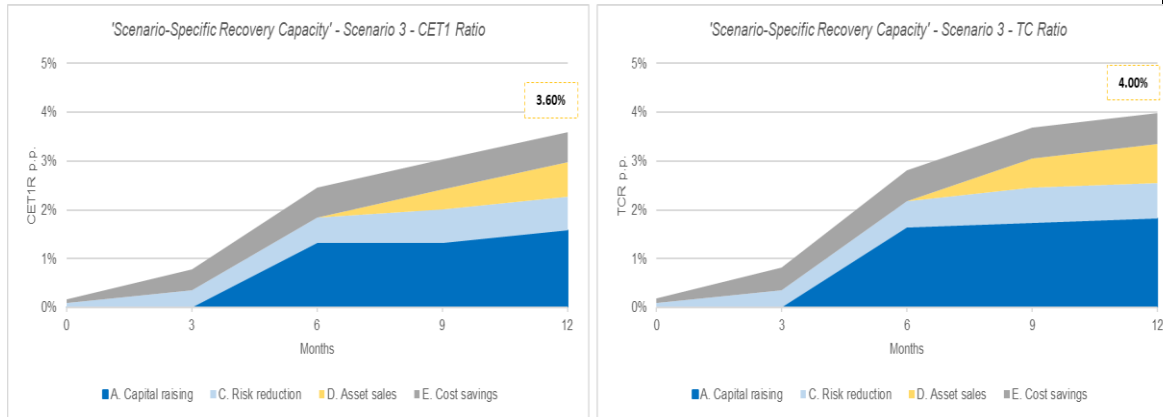
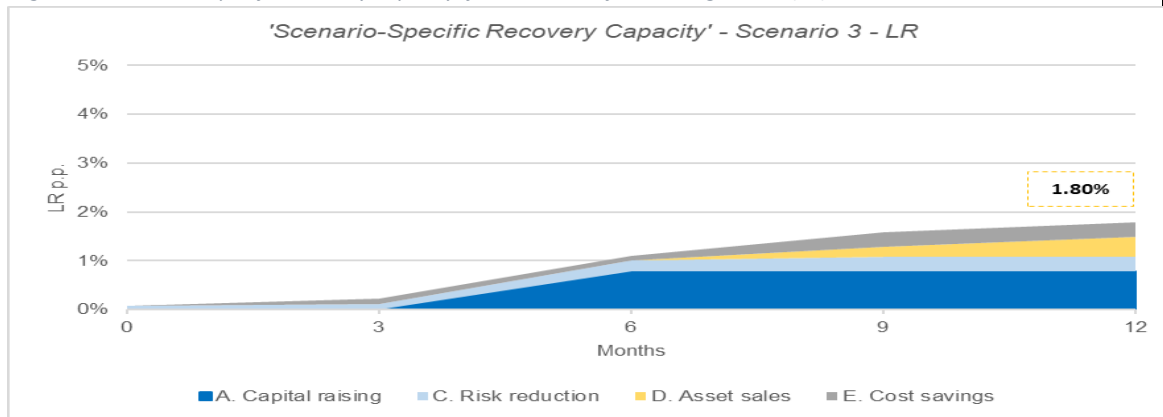
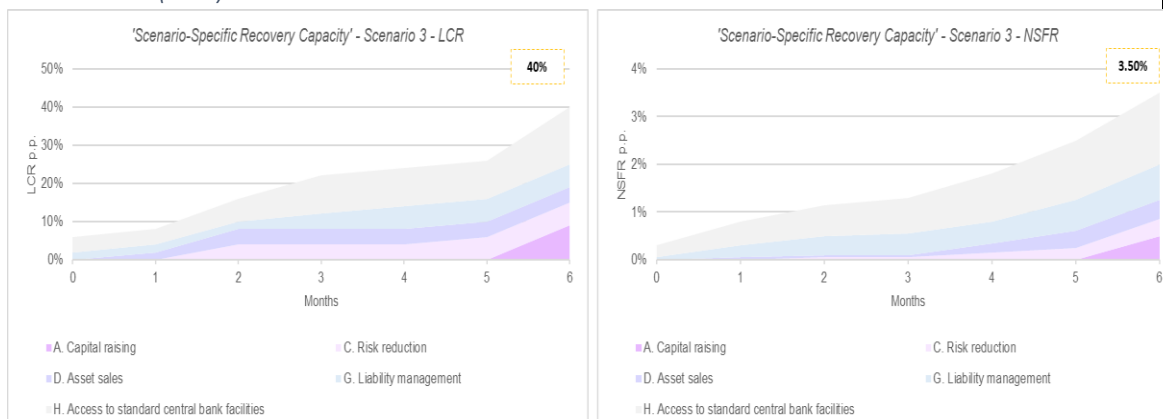


Figure 7 – ‘Scenario-specific recovery capacity’ for Scenario 3 for Leverage Ratio (LR)



\*Options G & H are assumed to have an immaterial impact on capital and leverage and therefore they are not reported in these figures

Figure 8 – ‘Scenario-specific recovery capacity’ for Scenario 3 for Liquidity Coverage Ratio (LCR) & Net Stable Funding Ratio (NSFR)

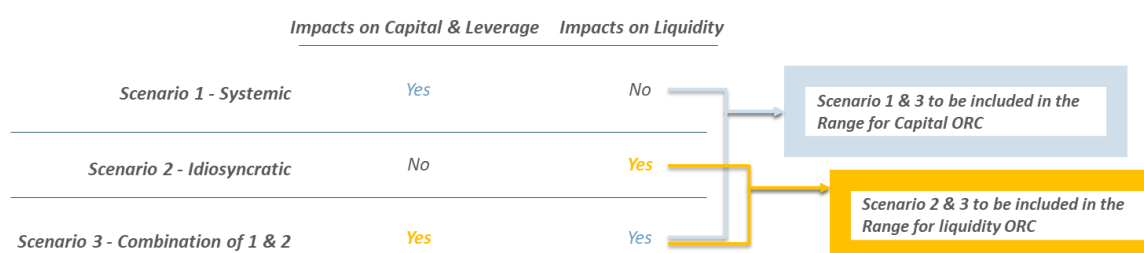


\*Option E is assumed to have an immaterial impact on liquidity and therefore it is not reported in these figures

### Step 4 – Determination of the ORC<sup>9</sup> range

Institution XYZ is finally determining the ORC as the range of the ‘scenario-specific recovery capacity’, in line with the criteria defined in paragraph 32 of these guidelines. Given the nature and the impact of the three considered scenarios, for the determination of the ORC range in terms of capital including leverage (capital ORC) and liquidity (liquidity ORC) only relevant scenarios are considered - namely scenarios where a depletion of the financial position in terms of capital including leverage and/or liquidity has been observed.

Figure 9 – Relevant scenarios for the determination of the ORC



Considering the same illustrative figures used for the calculation of the ‘scenario-specific recovery capacities’ in step 3, Institution XYZ will finally determine the ORC range as follows.

Table 1 – Capital ORC determination

Relevant scenario	CET 1 Ratio	TC Ratio	LR
Scenario 1 – Systemic	+4.50% (450 bps)	+5.00% (500 bps)	+2.50% (250 bps)
Scenario 3 – Combined	+3.60% (360 bps)	+4.00% (400 bps)	+1.80% (180 bps)
<b>Capital ORC</b>	<b>360 – 450 bps</b>	<b>400 – 500 bps</b>	<b>180 – 250 bps</b>

Table 2 – Liquidity ORC determination

Relevant scenario	LCR	NSFR
Scenario 2 – Idiosyncratic	+70%	+6.00%
Scenario 3 – Combined	+40%	+3.50%
<b>Liquidity ORC</b>	<b>40%-70%</b>	<b>3.50%-6.00%</b>

Institution XYZ finally provides a graphical representation of its capital and liquidity ORC range as follows.

<sup>9</sup> To support the determination of the ORC, institutions could use as a reference value their recovery capacity under the application of no scenario (Business as Usual-Recovery Capacity - ‘BAU-RC’): i.e., the sum of the impacts of the list of credible and feasible recovery options under no scenario while also adjusted for mutual exclusivity between certain options and any other constraining factors that would restrict the institutions’ ability to successfully implement and/or generate the full impact from the recovery options. The ‘BAU-RC’ represents a useful comparative reference value which institutions can use for the determination of the ORC when considering appropriate haircuts to the impacts of their recovery options under scenario-specific conditions. The steps for the calculation of the ‘BAU-RC’ should therefore follow those of the ‘scenario-specific recovery capacity’ provided that no scenario-specific assumptions should be applied in this case.



Figure 10 – Minimum and maximum Capital ORC representation

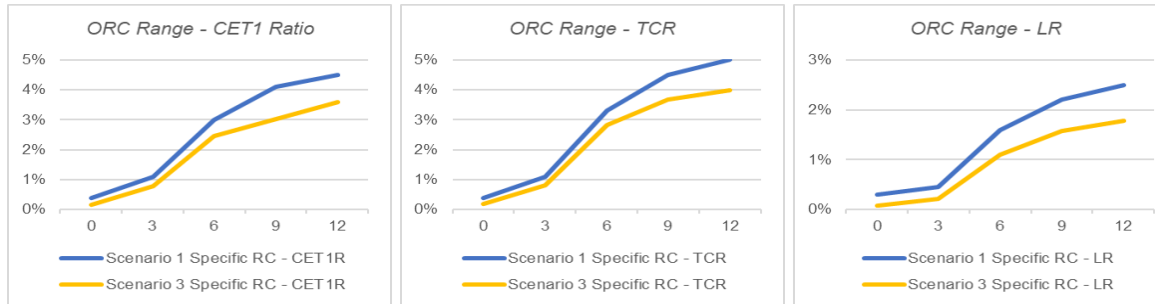
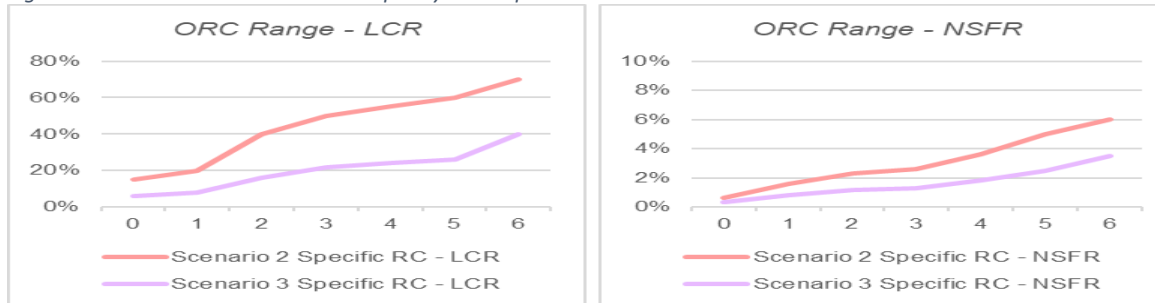


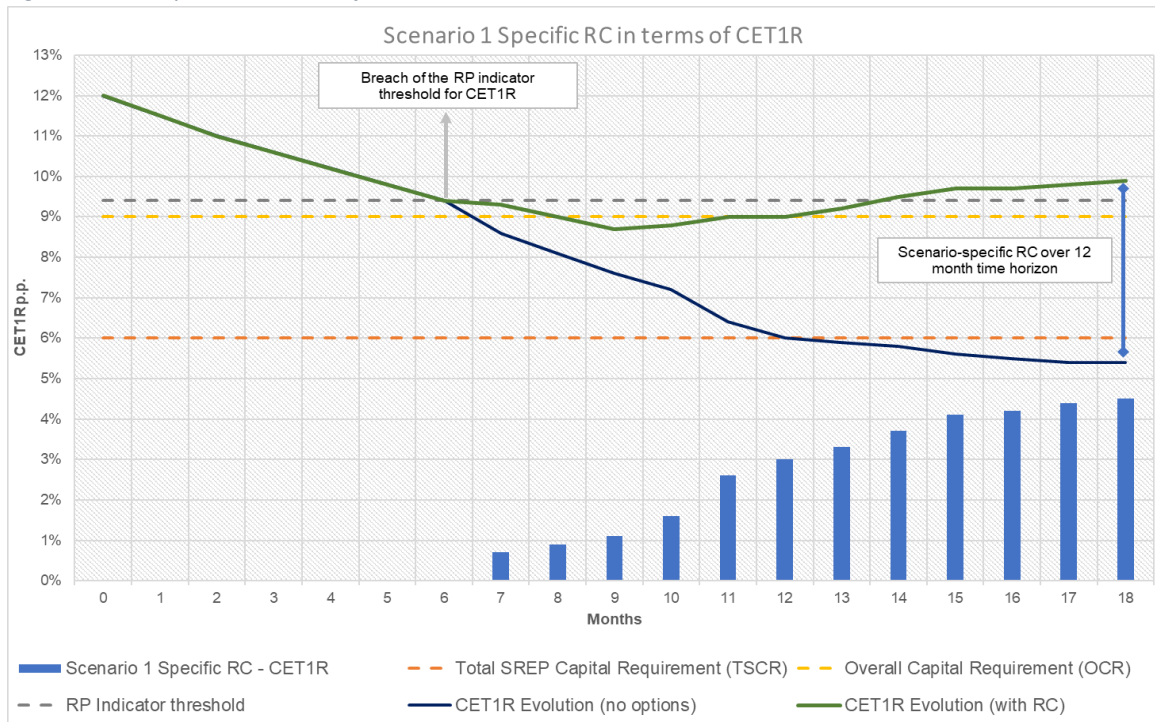
Figure 11 – Minimum and maximum liquidity ORC representation

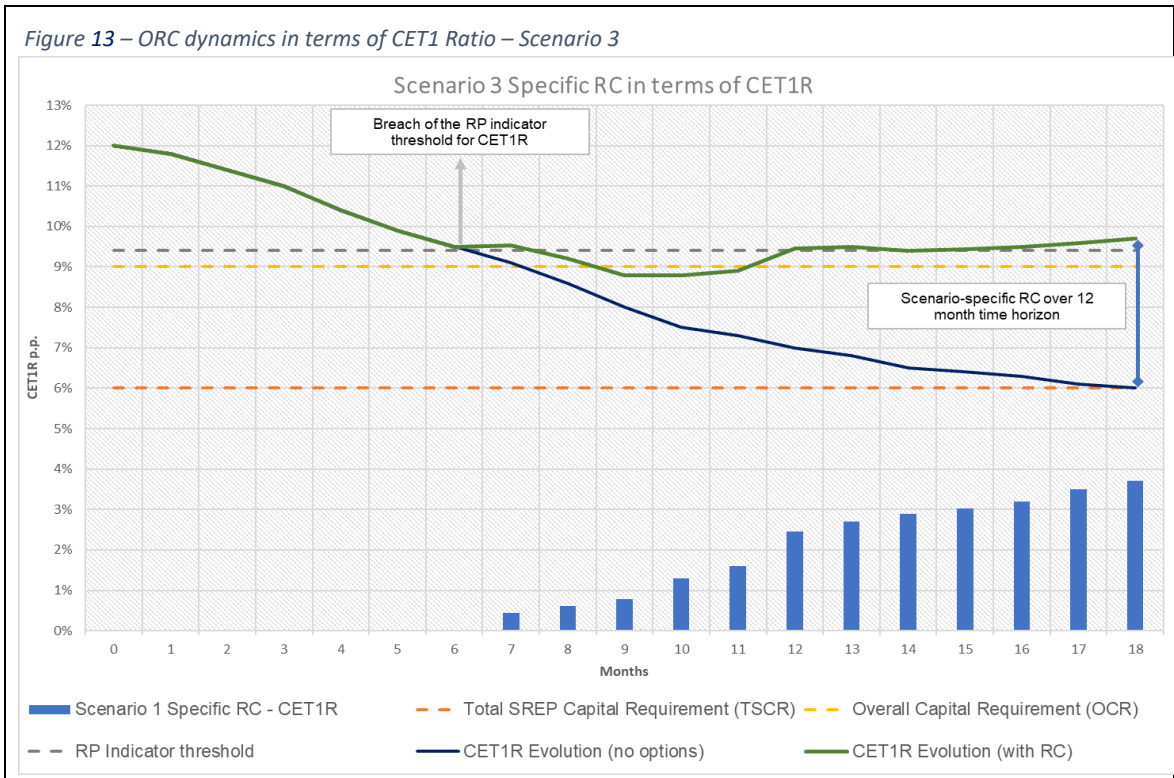


ORC dynamics over time

With regard to the specific dynamics of the ORC over time, let’s consider for illustrative purposes the Capital ORC by Institution XYZ in terms of CET1 Ratio. In particular, given the initial setting of Institution XYZ depicted in Figure 1, the institution is able to attain a level of the CET1 Ratio above the recovery plan indicator threshold in each scenario within the expected timeframe (i.e. 12-month for capital).

Figure 12 –ORC dynamics in terms of CET1 Ratio – Scenario 1





## 4. Draft Guidelines

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In between the text of the draft Guidelines that follows, further explanations on specific aspects of the proposed text are occasionally provided, which either offer examples or provide the rationale behind a provision, or set out specific questions for the consultation process. Where this is the case, this explanatory text appears in a framed text box.

EBA/GL/20XX/XX

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DD Month YYYY

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## Draft Guidelines

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# on overall recovery capacity in recovery planning

# 1. Compliance and reporting obligations

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## Status of these guidelines

1. This document contains guidelines issued pursuant to Article 16 of Regulation (EU) No 1093/2010<sup>10</sup>. In accordance with Article 16(3) of Regulation (EU) No 1093/2010, competent authorities and financial institutions must make every effort to comply with the guidelines.
2. Guidelines set the EBA view of appropriate supervisory practices within the European System of Financial Supervision or of how Union law should be applied in a particular area. Competent authorities as defined in Article 4(2) of Regulation (EU) No 1093/2010 to whom guidelines apply should comply by incorporating them into their practices as appropriate (e.g. by amending their legal framework or their supervisory processes), including where guidelines are directed primarily at institutions.

## Reporting requirements

3. According to Article 16(3) of Regulation (EU) No 1093/2010, competent authorities must notify the EBA as to whether they comply or intend to comply with these guidelines, or otherwise with reasons for non-compliance, by [dd.mm.yyyy]. In the absence of any notification by this deadline, competent authorities will be considered by the EBA to be non-compliant. Notifications should be sent by submitting the form available on the EBA website with the reference 'EBA/GL/202x/xx'. Notifications should be submitted by persons with appropriate authority to report compliance on behalf of their competent authorities. Any change in the status of compliance must also be reported to EBA.
4. Notifications will be published on the EBA website, in line with Article 16(3).

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<sup>10</sup> Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC, (OJ L 331, 15.12.2010, p.12).

## 2. Subject matter, scope and definitions

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### Subject matter

5. These guidelines specify how institutions should include in the recovery and group recovery plans a summary of their overall recovery capacity in accordance with Articles 5 and 7 and Annex, Section A, point (1) of Directive 2014/59/EU<sup>11</sup> and with Chapter 1, Section II of Commission Delegated Regulation (EU) 2016/1075<sup>12</sup> and how competent authorities should assess the overall recovery capacity of institutions within the context of the assessment of the recovery and group recovery plans in accordance with Articles 6 and 8 of that Directive and with Chapter 1, Section III of that Commission Delegated Regulation.

### Scope of application

6. These guidelines apply to institutions as defined in point 23 of Article 2(1) of Directive 2014/59/EU subject to the obligations set out in Articles 5 to 9 of that Directive as further specified in Articles 3 to 21 of Commission Delegated Regulation (EU) 2016/1075.
7. For institutions that are not part of a group subject to consolidated supervision pursuant to Articles 111 and 112 of Directive 2013/36/EU, these guidelines apply at the individual level.
8. For institutions that are part of a group subject to consolidated supervision pursuant to Articles 111 and 112 of Directive 2013/36/EU<sup>13</sup>, these guidelines apply at the level of the Union parent undertaking and at the level its subsidiaries.
9. Competent authorities may specify how to apply all or part of these guidelines to institutions which are subject to simplified obligations with regard to their recovery plans as set out in Article 4 of Directive 2014/59/EU.
10. Competent authorities may waive part of paragraphs 27, and from 42 to 48 to institutions that are investment firms, where their application would not be appropriate for the recovery

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<sup>11</sup> Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (OJ L 173, 12.6.2014, p. 190).

<sup>12</sup> Commission Delegated Regulation (EU) 2016/1075 of 23 March 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges, (OJ L 184 8.7.2016, p. 1).

<sup>13</sup> Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176 27.6.2013, p. 338).



planning of the investment firm or the investment firm group having regard to its business model as well as its legal structure, risk profile, size or complexity.

## Addressees

11. These guidelines are addressed to competent authorities as defined in points (2)(i) and (2)(viii) of Article 4 of Regulation (EU) No 1093/2010 and to financial institutions as defined in point (1) of Article 4 of Regulation (EU) No 1093/2010 where these financial institutions fall within the scope of these guidelines.

## Definitions

12. Unless otherwise specified, terms used and defined in Directive 2014/59/EU, Directive 2013/36/EU and Directive (EU) 2019/2034<sup>14</sup> have the same meaning in the guidelines.

# 3. Implementation

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## Date of application

13. These guidelines apply from **dd.mm.yyyy**

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<sup>14</sup> Directive (EU) 2019/2034 of the European Parliament and of the Council of 27 November 2019 on the prudential supervision of investment firms and amending Directives 2002/87/EC, 2009/65/EC, 2011/61/EU, 2013/36/EU, 2014/59/EU and 2014/65/EU (OJ L 314 5.12.2019, p. 64).

## 4. Setting the framework of overall recovery capacity (ORC) for institutions

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15. Institutions, for determining the overall recovery capacity (ORC), should define the following components in accordance with Section I of these guidelines:
  - a. A List of credible and feasible recovery options;
  - b. A range of scenarios of severe macroeconomic and financial stress.
16. Following the definition of the previous components, institutions should determine the ORC as a range of the 'scenario-specific recovery capacities' for all the relevant scenarios of severe macroeconomic and financial stress considered in the recovery plan, where the 'scenario-specific recovery capacity' is defined as the sum of the quantitative impacts of each recovery option that would be available and appropriate under each specific scenario, quantified in terms of institutions' relevant recovery plan indicators referring to capital (including leverage) and liquidity listed in paragraph 27 ('relevant RP indicators').

### Section I. ORC basic components

#### List of credible and feasible recovery options

17. The starting point for the determination of the ORC should be a comprehensive full list of credible and feasible recovery options, each one of them considered independently from the others and without any reference to the recovery plan's specific scenarios. From this list, institutions should select all the recovery options that could be used under each specific scenario showing their 'scenario-specific recovery capacity'.
18. To ensure that the ORC effectively represents the ability of the institutions to restore their financial position following a significant deterioration, only recovery options that are deemed to be credible and feasible by the institutions in accordance with Title II, Chapter I, Sections II and III of Directive 2014/59/EU and in line with the general factors set out in paragraph 19 should be considered when determining the ORC.
19. The general factors for the credibility and feasibility assessment of the recovery options to be considered by the institutions when determining the ORC should take into account the type of option, the specific business profile of the institutions and the ongoing macroeconomic environment in which they operate and should include in particular the following elements:
  - a. The expected external impact on the key stakeholders as well as any anticipated impact of the execution of the recovery option on the financial system;
  - b. Past experience from the implementation of the recovery option by the institution or its peers provided there is available information;





- c. Level of preparedness for implementing the recovery option;
- d. Assessment of the continuity of operations following the implementation of the recovery option, including all the arrangements to maintain access to financial markets and the functioning of the internal processes;
- e. The expected financial impact on the institution's relevant capital, liquidity, profitability and risk profiles on the basis of clear and transparent key assumptions ensuring the credibility of the estimation;
- f. The anticipated timeline for the implementation of the recovery option;
- g. Presence of any operational, legal, reputational and financial impediments as well as any other impediments to the implementation of the recovery option.

## Range of scenarios of severe macroeconomic and financial stress

20. The other component of the ORC is the 'range of scenarios of severe macroeconomic and financial stress'. In order to determine the ORC, institutions should calculate their recovery capacity specific for the relevant scenarios envisaged in the recovery plan (i.e. the so-called 'scenario-specific recovery capacity').
21. To calculate the 'scenario-specific recovery capacity', institutions should assume that the scenario results in them breaching their Total SREP Capital or Leverage ratio requirement (TSCR and TSLRR) as defined in the EBA Guidelines on common procedures and methodologies for the supervisory review and evaluation process ("SREP Guidelines")<sup>15</sup> or their minimum regulatory liquidity requirements as determined by the most recent SREP assessment.
22. In the exceptional circumstances where an institution argues that it is not able to draw up a plausible severe scenario that would lead to a breach of the capital or leverage requirements as specified in paragraph 21, the institution should provide a detailed explanation to the competent authorities on why that specific scenario should be still considered severe enough to threaten its failure unless recovery measures were implemented in a timely manner.

### ORC basic components

#### **Questions for Public Consultation**

**Question 1:** do you have any comments on the general factors to be considered when assessing credibility and feasibility of the recovery options?

**Question 2:** do you have any comments on the specification of the scenario severity for the purpose of calculating the 'scenario-specific recovery capacity'?

<sup>15</sup> EBA/GL/2022/03.

## Section II. Calculating ‘scenario-specific recovery capacity’

### Starting point

23. Institutions should consider as starting point for the calculation of the ‘scenario-specific recovery capacity’ the breach of any recovery plan indicator that, according to the recovery plan, would result in a decision by the institution to implement one or more recovery options.

### Timeframe

24. When assessing the expected timeframe for the recovery option as referred to in Article 12(2)(c) of Commission Delegated Regulation (EU) 2016/1075, for the purposes of calculating the ‘scenario-specific recovery capacity’ institutions should have regard to the specific features of the recovery options and the type of events included in the scenario (e.g. system-wide, idiosyncratic, combined).
25. Institutions should calculate the effects of the implementation of their recovery options, for an impact on their capital (including leverage) position over a 12-month time horizon and for an impact on the liquidity position over a 6-month time horizon, from the starting point determined in accordance with paragraph 23.
26. For recovery options with a longer timeframe than the ones set out in the paragraph 25, only the impact observed within the identified timeframes set out in that paragraph should be included in the calculation of the ‘scenario-specific recovery capacity’.

### Representation

27. Institutions should express their ‘scenario-specific recovery capacity’ at least for the following ‘relevant RP indicators’<sup>16</sup>:
- a. Common Equity Tier 1 (CET1) Ratio;
  - b. Total Capital Ratio;
  - c. Leverage Ratio;
  - d. Liquidity Coverage Ratio (LCR);
  - e. Net Stable Funding Ratio (NSFR).

In case where the listed indicators were not included by the institutions in their recovery plan indicators framework based on the rebuttable presumption provided by the “EBA Guidelines

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<sup>16</sup> Included in Annex II (‘Minimum list of recovery plan indicators’) in the EBA Guidelines on recovery plan indicators under Article 9 of Directive 2014/59/EU (EBA/GL/2021/11).



on Recovery Indicators”<sup>17</sup>, the ‘scenario-specific recovery capacity’ should be expressed in terms of the respective substitute indicators. Institutions should include in their recovery plans the nominal amounts underlying the computation of the relevant indicators (numerator and denominator) to allow competent authorities to properly assess and challenge the reported figures.

28. Institutions should express their ‘scenario-specific recovery capacity’ by reporting the sum of the impacts of the recovery options as defined in paragraph 16 to determine the extent to which they would be able to recover in that scenario. The impacts should be represented in terms of the ‘relevant RP indicators’ over time, including the relevant time buckets, in line with the timeframe determined in accordance with paragraph 25.

### Calculating the ‘scenario-specific recovery capacity’

#### **Question for Public Consultation**

**Question 3:** do you agree with the proposed criteria for the relevant starting point, timeframe (in particular with regard to the 6-month period for the LCR and NSFR) and representative indicators (in particular with regard to the explicit consideration of potential other/substitute indicators – e.g. MREL) for the calculation of the ‘scenario-specific recovery capacity’?

## Section III. Determining the ORC

### Step 1 – Selection of recovery options

29. To calculate the ‘scenario-specific recovery capacity’, institutions should select - from the list of the recovery options which are credible and feasible in accordance with paragraphs from 17 to 19 all the options that would be available and appropriate under that specific scenario. Recovery options with low/limited probability of successful implementation should not be included by institutions when calculating their ‘scenario-specific recovery capacities’.

### Step 2 – Adjustment of recovery options: additional constraining factors

30. When selecting recovery options appropriate to a specific scenario, institutions should take into account in particular the following additional constraining factors related to the simultaneous or sequential implementation of recovery options:
- a. Mutual exclusivity – whether some recovery options are mutually exclusive;

<sup>17</sup> See Annex II – Minimum list of recovery plan indicators in the EBA Guidelines on recovery plan indicators under Article 9 of Directive 2014/59/EU (EBA/GL/2021/11).



- b. Interdependencies – whether activating one recovery option could affect the subsequent or simultaneous implementation of another option;
- c. Operational capability to implement a multitude of recovery options simultaneously;
- d. Increased reputational effects – whether implementing several recovery options in combination could reduce their impact and lead to impediments or relevant reputational effects;
- e. Consequences to their business model or profitability when more than one recovery option that alone does not have a significant impact is applied together or sequentially with others (combined consequences).

### Step 3 – Calculation of ‘scenario-specific recovery capacity’

31. When calculating the ‘scenario-specific recovery capacity’, institutions should employ a dynamic balance sheet approach and, therefore, the impacts stemming from recovery options under a specific scenario should consider the effects of the recovery options used previously, if any, under the same scenario. In particular, the effect of a capital issuance should consider the total risk exposure amount (TREA) base at the moment of its implementation under the stress scenario. If recovery options such as risk reduction had been carried out previously under the same scenario, then the TREA base would be more favorable.

### Step 4 – Determination of the ORC range

32. To determine the ORC range, institutions should consider the highest and lowest ‘scenario-specific recovery capacity’ respectively in terms of capital including leverage (capital ORC) and liquidity (liquidity ORC) ‘relevant RP indicators’ using the relevant scenarios for each of these dimensions. In this context, institutions should consider as relevant those scenarios where a depletion in terms of capital including leverage (for capital ORC) and/or liquidity (for liquidity ORC) ‘relevant RP indicators’ has occurred.

#### Determining the ORC

##### **Questions for Public Consultation**

**Question 4:** do you have any comments on the general steps to be followed for the determination of the ORC?

**Question 5:** do you have any comments on the definition of the ORC as a range between the lowest and the highest ‘scenario-specific recovery capacity’ both in terms of capital and liquidity?

## 5. Competent authorities' assessment of ORC

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33. When assessing recovery plans, competent authorities should ensure, in a manner laid down in the following paragraphs, that, in determining their overall recovery capacity, institutions comply with Title 4 of these guidelines<sup>18</sup>.

### Section I. Assessment of the 'scenario-specific recovery capacity'

34. To assess the 'scenario-specific recovery capacity' provided by the institutions under each severe macroeconomic and financial stress, competent authorities should review the overall adequacy of the scenarios put forward by the institutions in accordance with Article 5 (6) and Article 7 (6) of Directive 2014/59 as specified in EBA Guidelines on the range of scenarios to be used in recovery plans (Guidelines on the range of recovery plan scenarios)<sup>19</sup> and in line with Title 4 of these guidelines.

35. In particular, competent authorities should assess whether scenarios are severe enough with respect to the criteria defined in paragraph 21. In the exceptional case under paragraph 22, competent authorities should assess the detailed explanation provided by the institutions (to still consider such scenario severe enough) and decide whether the severity of the scenario is sufficient considering, inter alia, the overall risk profile of the institutions. In cases where competent authorities consider that the scenario envisaged by the institutions is not severe enough, they could require institutions, where appropriate, to make adjustments, including the resubmission of the recovery plan as a result of the material deficiency assessment in accordance with Article 6 of Directive 2014/59/EU. Competent authorities should not take into account the institutions' 'scenario-specific recovery capacity' based on such a scenario when assessing the ORC.

36. Competent authorities should assess the credibility and feasibility, including the timeframe, the impacts and any constraining factors of the recovery options selected by the institutions and should challenge, in the context of the severe macroeconomic and financial stress, the extent to which institutions would be able to restore their viability and financial position.

37. Competent authorities should review, where appropriate and feasible, the assessment and calculation performed by the institutions covering in particular the following areas:

- a. Feasibility/Probability that a recovery option would be successfully implemented, including by reviewing the feasibility of the recovery options where this is assumed to be unrealistic or not driven by a proper assessment in line with paragraphs from 17 to 19;

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<sup>18</sup> Title '4. Setting the framework of overall recovery capacity (ORC) for institutions'.

<sup>19</sup> EBA GL 2014/06 of 18 July 2014



- b. Timeframe for the implementation of the recovery options, including by lengthening the expected timeframe for their implementation if the institution's assessment is considered unrealistic. In cases where the recovery options' timeframe would exceed the timeframe as defined in paragraph 25, only the effects observed within the relevant timeframes should be considered for the ORC assessment by the competent authority;
  - c. Assessment of the quantitative impact of the recovery options, including by adjusting downwards the impact or by applying haircuts to the quantification provided by institutions where the likely impact of the recovery options is not based on realistic and plausible assumptions and quantifications;
  - d. Additional constraining factors related to the simultaneous or sequential implementation of recovery options, as specified in paragraph 30, including by removing or adjusting downward the impact of specific options where interconnection between some of them is detected, giving priority, inter alia, to options with the highest feasibility level and/or with the most material impact in the given implementation period.
38. Competent authorities should take into consideration, where appropriate and available, peer group analysis in order to facilitate amongst others:
- a. Cross-institutional comparison of the type of recovery options to be implemented under the different scenarios, thereby identifying whether some specific types of options have been missed by an institution;
  - b. Peer group comparison of the expected financial impact from each type of recovery option under different stressed scenarios;
  - c. Cross-institutional comparison of the expected time required to implement a recovery option and to realise its benefits;
  - d. Cross-institution comparison of the expected impediments and preparatory measures for each type of recovery option.

#### Assessment of the 'scenario-specific recovery capacity'

##### **Question for Public Consultation**

**Question 6:** do you have any comments on the scope of the assessment of the 'scenario-specific recovery capacity' by the competent authorities?

## Section II. Assessment of ORC – 'Adjusted ORC'

39. Competent authorities should ensure that the ORC is calculated by the institutions as the range between the lowest and the highest 'scenario-specific recovery capacity' both in terms of capital (including leverage) and liquidity 'relevant RP indicators' in line with the criteria set out in paragraph 32.



40. Based on the assessment of the institutions' 'scenario-specific recovery capacity', competent authorities should determine the 'adjusted ORC' of the institutions as a range both in terms of capital 'adjusted ORC' and liquidity 'adjusted ORC' and perform an overall quantitative and qualitative assessment of the ORC.
41. The 'adjusted ORC' should reflect the competent authorities' assessment of the institutions' ORC having considered and reviewed the relevant elements underlying its determination. Based on the outcome of this assessment, competent authorities' 'adjusted ORC' should be either lower or equal to the ORC determined by institutions.

### ORC score

42. Competent authorities should assess the 'adjusted ORC' specified in accordance with the paragraphs 40 and 41 assigning the following levels considering the 'relevant RP indicators' thresholds and the related regulatory requirements:
  - a. 'Satisfactory' – in cases where the 'relevant RP indicators' of the institutions after the inclusion of the 'adjusted ORC' are above their thresholds defined in line with the "Guidelines on Recovery Indicators";
  - b. 'Adequate with potential room for improvement' – in cases where the 'relevant RP indicators' of the institutions after the inclusion of the 'adjusted ORC' would fail to be above the thresholds defined in line with the "Guidelines on Recovery Indicators", but they would still be equal to or higher than institutions' capital including leverage and liquidity regulatory requirements referred to in paragraph 21 adding all applicable regulatory buffers;
  - c. 'Weak' – in cases where the 'relevant RP indicators' of the institutions after the inclusion of the 'adjusted ORC' would fail to meet the institutions' capital (including leverage) and liquidity regulatory requirements referred to in paragraph 21 adding all applicable regulatory buffers.
43. In cases where the 'adjusted ORC' would result between different levels under paragraph 42, competent authorities should select the most appropriate classification taking into consideration, in particular, the severity of the scenarios and the number of 'relevant RP indicators' positioned at the different levels.
44. To complement their ORC assessment, competent authorities should take into account general qualitative considerations, not already reflected in the 'adjusted ORC', on the ORC framework. This may result in an upward or downward adjustment of the indicative scoring under paragraph 42 by the competent authorities when they consider it does not fully represent the ORC position of the institutions, taking into account, in particular, the following elements:
  - a. The difference between institutions' ORC determination and the competent authorities 'adjusted ORC';
  - b. Overall evidence or lack of past implementation experience;



- c. The presence or absence of any preparatory measure ahead of options' implementation;
  - d. Additional information related to the level of concentration, the timeframe for implementation, the feasibility and credibility of the recovery options as well as the level of stress applied by the institutions;
  - e. Institutions' ability with regard to data availability, quality and aggregation as well as institutions' governance in terms of crisis management preparedness.
45. 'Weak' ORC should lead either to the assessment of a material deficiency in the recovery plan in accordance with Article 6 of Directive 2014/59/EU or to the identification of a specific area of improvement related to the ORC in the competent authorities' assessment of the institutions' recovery plan.
46. 'Adequate with potential room for improvement' ORC may lead to the identification of a specific area of improvement related to the ORC in the competent authorities' assessment of the institutions' recovery plan.
47. When carrying out the assessment of the identification of a material deficiency or a specific area of improvement in the recovery plan related to the ORC according to the paragraphs 45 and 46, competent authorities should take into account the following non-exhaustive situations:
- a. Whether the institution already operates in severe stressed conditions, including where a capital conservation plan in accordance with Article 142 of Directive 2013/36/EU has been requested;
  - b. Whether the institution has already improved the ORC compared to previous recovery plans and there is no longer room for ORC potential improvement given the size, business model and risk profile of the institutions;
  - c. Whether the institution's capital, leverage and/or liquidity position displays sound headroom with respect to the regulatory requirements and therefore the scenarios employed by the institution are extremely severe and thus too penalising with respect to the peers.
48. The classification referred to in paragraphs from 42 to 44 should support the assessment of the ORC by competent authorities as a relevant component of their overall recovery plan assessment.

#### Assessment of ORC – 'Adjusted ORC'

##### **Questions for Public Consultation**

**Question 7:** do you have any comments on the proposed ORC score?





**Question 8:** do you have any comments on the possibility to identify areas of improvement or material deficiencies related to the competent authorities' assessment of the ORC?

## 5. Accompanying documents

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### 5.1 Draft cost-benefit analysis / impact assessment

As per Article 16(2) of Regulation (EU) No 1093/2010 (EBA Regulation), any guidelines and recommendations developed by the EBA shall be accompanied by an Impact Assessment (IA), which analyses ‘the potential related costs and benefits’.

This analysis presents the IA of the main policy options included in this Consultation Paper on the draft Guidelines on overall recovery capacity (ORC) in recovery planning. The analysis provides an overview of the identified problem, the proposed options to address this problem as well as the potential impact of these options. The IA is high level and qualitative in nature.

#### A. Problem identification and background

In accordance with section A of the Directive 2014/59/EU Annex, institutions are expected to include a summary of their ORC within their recovery plans. The role of the ORC as a summary measure within recovery plans is also bolstered by Article 12 of the Commission Delegated Regulation (EU) 2016/1075. The same Commission Delegated Regulation, in accordance with Article 4, also provides competent authorities with the task of assessing the information contained in the recovery plan submitted by the institutions, thereby including the ORC.

The concept of the ORC is described in high-level terms in Article 12 of the Commission Delegated Regulation (EU) 2016/1075 as ‘*the extent to which the recovery options allow that entity or those entities to recover in a range of scenarios of severe macroeconomic and financial stress*’ and with no detailed guidance on the relevant steps underlying its determination. The lack of more practical guidelines has led to several different practices across institutions, arriving in some cases to the non-representation of this measure despite the afore mentioned regulatory requirements. This situation has been outlined by an EBA survey conducted among competent authorities on the current state of play of the ORC within the recovery plan of the institutions. This survey also highlighted that, in light of the divergent practices among institutions, the ORC assessment by competent authorities is carried out in a not fully consistent manner both in terms of nature of the review (e.g. whether the assessment is coupled with a proper challenge of the institutions’ ORC) and scope (e.g. including the selection criteria for the recovery options by the institutions or the relevant time horizon for the ORC determination).

These practices, both at the level of institutions and competent authorities, jeopardize the ORC for being a meaningful summary indicator of ‘recoverability’.



## B. Policy objectives

The draft Guidelines' aim is to enhance the quality and the harmonisation of the ORC for being a meaningful summary indicator of 'recoverability'. For this, as said above, it needs to be determined and consistently summarised by institutions, as well as soundly assessed by competent authorities.

Therefore, this EBA-own initiative Guidelines, addressed to both institutions and competent authorities, aim to provide:

- 1) A sound framework for institutions by outlining the relevant steps they are expected to perform to come up with a sound determination of their ORC in a range of severe stresses;
- 2) A consistent supervisory competent authorities' assessment of the institutions' ORC as part of the overall supervisory assessment of the recovery plan.

## C. Options considered, assessment of the options and preferred options

Section C. presents the main policy options discussed and the decisions made by the EBA during the development of the Draft Guidelines. Advantages and disadvantages, as well as potential costs and benefits from the qualitative perspective of the policy options and the preferred options resulting from this analysis, are provided.

### Range of scenarios of severe macroeconomic and financial stress

The EBA considered 3 policy options when assessing the level of severity to be attained by the stressed scenarios to be relevant for the ORC quantification.

**Option 1a: do not provide any additional guidance regarding the severity of the relevant scenarios for the ORC quantification.**

**Option 1b: specify that relevant scenarios for the ORC determination should lead to the breach of the relevant capital or leverage or liquidity regulatory requirements<sup>20</sup> if recovery options were not implemented ('unmanaged case').**

**Option 1c: specify that relevant scenarios for the ORC quantification should lead either to:**

- a) the breach of the relevant capital or leverage or liquidity regulatory requirements (option 1b), or
- b) the breach of the relevant recovery plan indicators referring to capital (including leverage) and liquidity ('relevant RP indicators') threshold  
based on the baseline level (i.e. starting point before the stressed scenario) of the relevant RP indicators of the institution.

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<sup>20</sup> Respectively Total SREP Capital requirement (TSCR) or Total SREP Leverage ratio requirement (TSLRR) as defined in the EBA SREP Guidelines (EBA/GL/2022/03 or any other version updating them, if any) or liquidity regulatory requirements as defined according to the outcome of the SREP assessment (i.e. LCR and/or NSFR 100% threshold including any relevant addition as a result of the SREP), including the cases where multiple breaches of these requirements occur.



In accordance with the Commission Delegated Regulation (EU) 2016/1075, the recovery options need to be quantified in different severe stressed conditions that should lead the institutions to the 'near-default' point, which is not further detailed in the current regulation. According to the internal survey conducted by the EBA, different interpretations by institutions are currently observed and this is an element leading to divergent practices in the ORC determination. Providing a guidance in this respect is thus necessary and that is why Option 1a was not chosen and discussions were then held on options 1b and 1c which both set severity thresholds that should be generally met.

Option 1b specifies that severe scenarios for the ORC quantification should be scenarios that lead to the breach of the relevant requirements of the institution in the 'unmanaged case'. The underlying rationale under Option 1b is that most severe scenarios would allow to assess the proper use and impact of the entire set of institutions' credible and feasible recovery options, therefore representing the most effective way of testing these options and the 'recoverability' built upon them. It is recognised that for certain type of institutions it may be extremely difficult to design such scenario while preserving a fully plausible setting and without adopting extremely very far-reaching assumptions. Therefore, this option embeds a conditional residual flexibility for capital and leverage requirements. This flexibility implies the possibility to design a scenario which does not breach the aforementioned regulatory minima, provided that a satisfactory and detailed explanation on why the envisaged scenario should be considered severe enough is provided to the competent authorities. In such cases, it is anyway expected that the scenario should lead to the 'near-default' point and therefore be severe enough to allow the appropriate testing of the recovery plan assumptions.

According to Option 1c, the level of severity attained by the ORC scenarios should be differentiated based on the baseline level of the institutions' 'relevant RP indicators'. On the one hand, it is acknowledged that this approach would have led to a more tailor-made specification of scenario severity. On the other hand, the recovery options will be stressed under less severe conditions than in Option 1b and the breach of one or more recovery plan indicators thresholds would not automatically trigger the implementation of any recovery options which therefore institutions may even decide not to apply in that specific scenario. In addition, even though the simple setting of severity threshold as foreseen in both options 1b and 1c would harmonize the ORC quantification amongst institutions, the choice of the regulatory threshold as disclosed in Option 1b will increase this harmonization and allow better consistency between institutions. Since one of the main purposes of the recovery plan is to assess the institutions 'recoverability' in terms of its capacity to restore its business and financial viability in extremely severe conditions, Option 1b is the preferred option compared to Option 1c.

Based on the above considerations, the Option 1b has been chosen as the preferred option.

## Timeframe

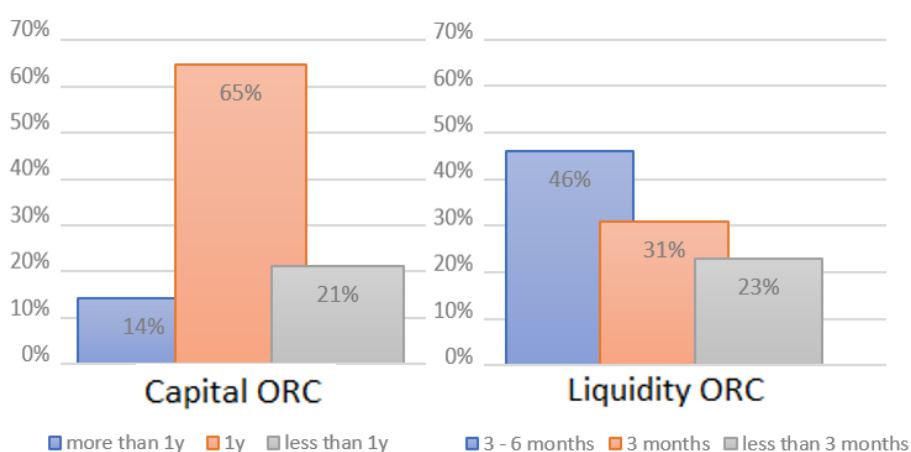
When calculating the ‘scenario-specific recovery capacity’, institutions should consider the timeframe associated to the impact of the recovery options. The EBA considered 2 policy options regarding the relevant timeframe for the ORC quantification.

**Option 2a: not to provide any relevant timeframe to take into account for the impact of the implementation of the recovery options over time.**

**Option 2b: to provide a maximum timeframe to take into account for the impact of the implementation of the recovery options over time.**

The survey conducted by the EBA allowed to verify that for capital generation the considered time horizon is equal to one year for most institutions; the time decreases to 3-6 months for liquidity.

Figure 1: Time horizon for ORC assessment



Source: EBA survey

**The Option 2b was considered the preferred one** as it should lead to greater harmonization without causing a significant increase in costs. In fact, the GLs indicate one year and six months for the time horizon to be considered for an impact on capital/leverage position and on liquidity position respectively and this is in line with the practices already adopted by most of the institutions.

## Competent authorities' assessment

According to the survey conducted by the EBA, most of the competent authorities review the institutions' ORC, however the approaches adopted in conducting their assessments differ under some aspects. The EBA considered 2 policy options.

**Option 3a: to not provide any guidelines for the competent authorities.**

**Option 3b: to provide a set of general principles aimed at increasing the harmonisation of the assessments.**



The Option 3b could lead to additional costs as it implies an increase in analysis activities for the competent authorities. However, a harmonisation of the assessment conducted by the competent authorities was considered a key aspect for ensuring the credibility and increasing the usability of the ORC.

#### D. Conclusion

The technical specifications provided by the GLs increase the harmonisation across institutions for the purpose of determining the ORC, fostering consistency and a harmonised supervisory approach benefiting both institutions and competent authorities. The respective gains of efficiency from better consistency across institutions practices will benefit the quality of the assessments on a permanent basis. For the institutions, these specifications are expected to trigger costs but not of material impacts as they enhance an already established process without creating a new one. The vast majority of competent authorities are already reviewing and challenging institutions' ORC determination, notably by requiring adjustments, therefore the impact of the GLs on the calculation process is not expected to be significant, except for those competent authorities that focus exclusively on the recovery options impacts, i.e. not challenging the whole ORC but some of its components, in which the impact of the GLs on the calculation process could be moderate. Overall, the impact assessment on the guidelines suggests that the expected benefits of the draft Guidelines are higher than the incurred expected costs.

## 5.2 Overview of questions for consultation

**Question 1:** do you have any comments on the general factors to be considered when assessing credibility and feasibility of the recovery options?

**Question 2:** do you have any comments on the specification of the scenario severity for the purpose of calculating the 'scenario-specific recovery capacity'?

**Question 3:** do you agree with the proposed criteria for the relevant starting point, timeframe (in particular with regard to the 6-month period for the LCR and NSFR) and representative indicators (in particular with regard to the explicit consideration of potential other/substitute indicators – e.g. MREL) for the 'scenario-specific recovery capacity'?

**Question 4:** do you have any comments on the general steps to be followed for the determination of the ORC?

**Question 5:** do you have any comments on the definition of the ORC as a range between the lowest and the highest 'scenario-specific recovery capacity' both in terms of capital and liquidity?

**Question 6:** do you have any comments on the scope of the assessment of the 'scenario-specific recovery capacity' by the competent authorities?

**Question 7:** do you have any comments on the proposed ORC score?

**Question 8:** do you have any comments on the possibility to identify areas of improvement or material deficiencies related to the competent authorities' assessment of the ORC?