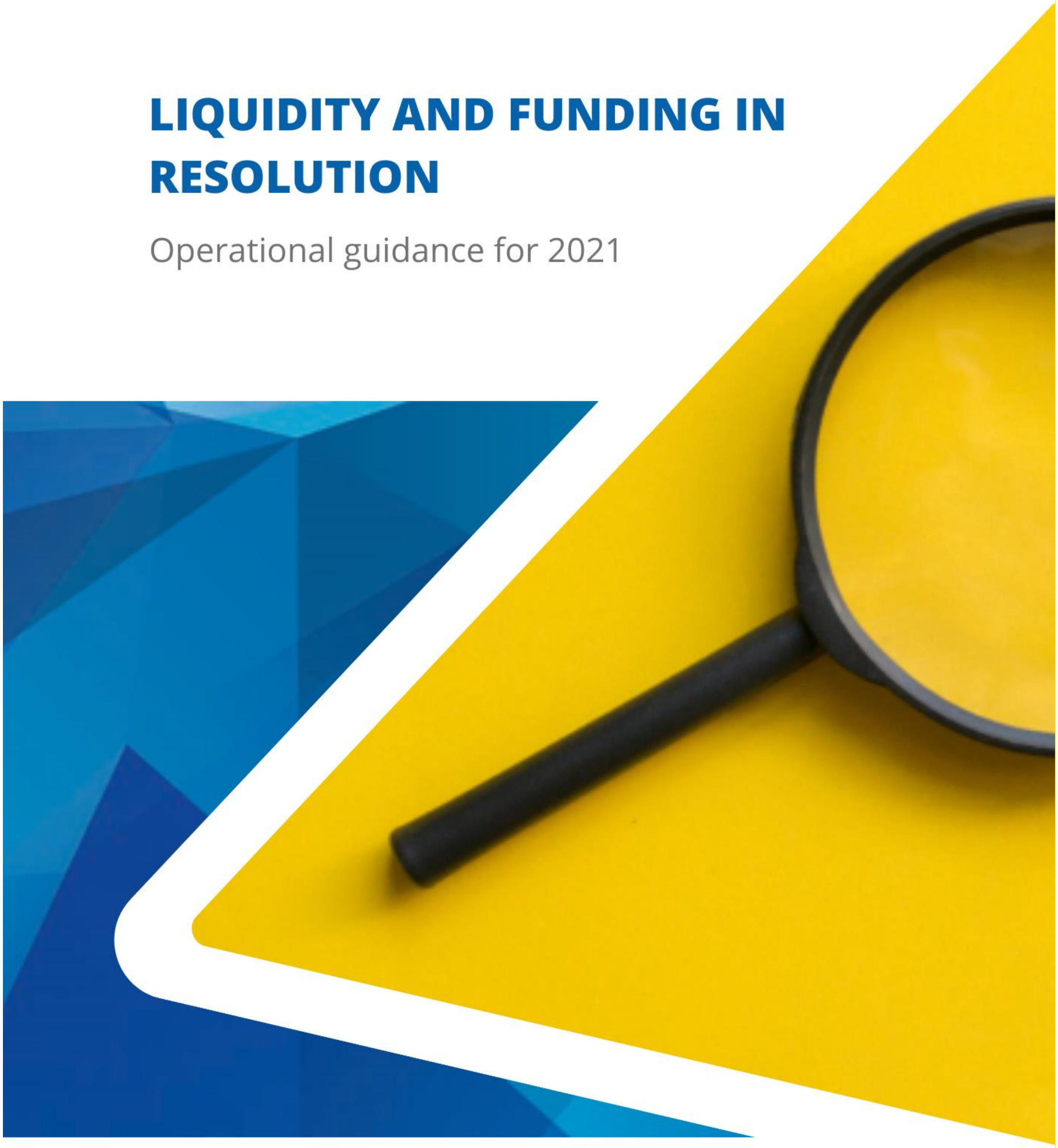
LIQUIDITY AND FUNDING IN RESOLUTION

Operational guidance for 2021



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Abbreviations

BRRD	Bank Recovery and Resolution Directive
BU	Banking Union
CBC	Conterbalancing capacity
CF	Critical function
ECAI	External Credit Assessment Institution
EfB	SRB's 'Expectations for Banks'
EU	European Union
FMI	Financial market infrastructure
FOLTF	Failing-or-likely-to-fail
FSB	Financial Stability Board
IRT	Internal resolution team
KLE	Key liquidity entity
LDR	Liability data report
MIS	Management information system
MPE	Multiple point of entry
NRA	National resolution authority
PRS	Preferred resolution strategy
SPE	Single point of entry
SPV	Special purpose vehicle
SRB	Single Resolution Board
SRMR	Single Resolution Mechanism Regulation
TREA	Total risk exposure amount

1. PURPOSE AND OBJECTIVES

Banks are likely to face liquidity stress in resolution because of the reluctance of market participants, both wholesale and retail, to roll-over or provide funding to a bank in crisis. Even after a successful execution of the resolution strategy, liquidity stress may persist for some time due to the asymmetry of information regarding the viability of the resolved bank's business model. Despite that, banks need to ensure that they continue to meet their obligations as they fall due during the different resolution phases.[1]

As outlined in the Expectations for Banks (EfB), banks are expected (i) to develop methodologies to estimate ex-ante the liquidity needs for the implementation of the resolution strategy; (ii) to be able to measure, report and forecast their liquidity position and relevant liquidity metrics during the resolution process; (iii) and to be able to identify and mobilise assets (especially of lower quality and less liquid) that could be used as collateral to obtain liquidity in resolution anticipating any legal, regulatory and operational obstacles to their mobilisation under stressed conditions.

This guidance focuses on the first dimension (i.e. the estimation of liquidity needs) aiming at enhancing banks' resolvability and preparedness for a potential resolution[2].

In meeting these expectations, banks are invited to leverage on any capability already developed for supervisory purposes (e.g. recovery planning). However, banks are expected to be able to address the resolution-specific aspects described in this document.

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[1] DISCLAIMER

[2] Further guidance will be provided on ii) and iii) in the next cycles. Regarding iii) in case the Common Backstop is used for liquidity purposes, the SRB shall provide such liquidity to the resolved institution on a fully collateralised basis, wherever practical and wherever collateral is available.

2. SCOPE OF APPLICATION AND PHASE-IN

In line with the scope of the EfB, this guidance is aimed at banks within the SRB's direct remit, for which the strategy is resolution. While the guidance is general in nature, in line with the EfB, **its application to each bank may be adapted to individual specificities based on a dialogue between each bank and its IRT, taking into account the proportionality principle**. Banks may be requested to provide information and analysis on specific topics in addition to this guidance, where this is relevant to progress on resolution planning and for the purpose of improving the resolvability of the bank throughout the resolution planning cycle.

The EfB are subject to a gradual phase-in according to the general phase-in dates reported in Chapter 3 of the EfB. This also applies to expectations on liquidity and funding in resolution, which are expected to be fully met by the end of 2023.

As outlined in the EfB and communicated in the 2021 priority letter, EfB principle 3.1 is prioritised in 2021. The annex on liquidity to the priority letter provided further details on what is expected from banks in 2021 on this topic. This guidance is meant to complement the content of the EfB and the annex of the priority letter, by providing further guidance for the implementation of the policy in 2021.

This guidance is structured in sections covering separately each of the three areas that will constitute the benchmark for the assessment in 2021, as described in the annex of the priority letter:

- Section 3.1 focuses on the **identification of key liquidity entities** ('KLEs') and main liquidity flows in resolution;
- Section 3.2 focuses on the assessment of the **key drivers of the liquidity position** in resolution;
- Section 3.3 focuses on the methodologies for the **estimation of the liquidity position in resolution** while 3.4 provides guidance for the implementation of the *scenario analysis* to performed in 2021.

This guidance was developed to support the banks' first-time implementation of the liquidity policy (EfB 3.1) in the 2021 resolution planning cycle (RPC) and will be subject to updates over time as deemed necessary (e.g. after a horizontal review of the banks' deliverables and any relevant take-away from crisis cases).

In any case, **this document will be updated in 2022** to cover the remaining EfB principles (i.e. 3.2 and 3.3) that will be phased in over the next years.

3. Operational Guidance

3.1 Identification of key liquidity entities and main liquidity flows in resolution

1. Banks are expected to identify their key liquidity entities (KLEs) in resolution and to explain why these entities are expected to be relevant for liquidity in resolution, or not. Banks should ensure that the **scope of KLEs analysis** comprises:

- **All relevant legal entities** within the meaning of the liability data reporting (LDR) guidance. In the 2021 RPC these are: entities which (i) provide critical functions, or (ii) represent more than 3% of the TREA, or leverage exposure or operating income of the resolution group;
- **Other entities or organisational forms** that could be relevant for liquidity in resolution. Particular attention should be given to:
    - significant branches, especially outside of the Euro Area;
    - SPVs or issuing vehicles (e.g. for covered bonds); subsidiaries which do not provide CFs or reach the 3% threshold but provide access to markets of strategic importance (e.g. the USD market);
    - insurance and re-insurance companies;
    - leasing and factoring companies;
    - pension fund management companies;
    - asset management companies;
    - broker-dealer entities;
    - custodian and depository institutions.

2. In principle, for an entity or organisational form to be classified as a KLE, at least one of the three situations below should be expected in resolution:

- the entity/organisational form is expected to provide liquidity to other resolution group entities in order for them to perform their activities;
- the entity/organisational form is expected to depend on liquidity received from other resolution group entities to perform its activities; or
- the entity/organisational form performs liquidity management functions for one or more entities of the resolution group.

3. For entities in the same resolution group which are deemed relevant legal entities within the meaning of the 2021 LDR guidance but *are not deemed* KLEs, banks are expected to duly justify why such entities would not impact liquidity management and the position of the group in resolution and how the liquidity of these entities would be managed in the event of resolution.

4. Based on the identified KLEs, **banks are expected to provide an analysis/map of the liquidity and funding set-up for the group *in resolution***, covering the following main aspects:

(i) The expected key differences between their business as usual (BaU) and the resolution funding set up;

(ii) The role of each KLE (e.g. liquidity receiver vs. provider) and its level of autonomy in managing liquidity, accessing wholesale markets and central bank funding;

(iii) The main activities providing/receiving liquidity, differentiating between maturity (i.e. short and long term) and relevant currencies[3] for each KLE;

(iv) The changes to the links and dependencies (i.e. intragroup funding arrangements) between the KLEs expected to take place in resolution (especially for cross-border groups).

[3] *Relevant currencies* should be considered those identified as material currencies under Article 415 (2) (a) CRR. In addition, banks are expected, in dialogue with the IRTs, to assess the need to include any other currency that i) could be material at resolution group level (i.e. in cases where the prudential scope of consolidation is different from the resolution group); ii) could become material in resolution (e.g. further to group restructuring and considering specific obligations that may arise); iii) could be relevant for specific KLEs.

5. Box 1: 'in resolution'

The expression 'in resolution' is used throughout the document to emphasise the specific circumstances to be considered when carrying out the analysis detailed in this guidance. 'In resolution' is meant to reflect the need to take into account the following resolution phases, along with the suggested dimensions, which are neither limited nor exhaustive:

1. The run-up to resolution: (weeks/month before resolution)
   - Significant deterioration of the bank's situation as recovery does not take place;
   - Recovery options are mostly exhausted and/or have proven ineffective;
   - The behaviour of markets, intermediaries and counterparties discounts/prices in the uncertainty surrounding the prospects of survival and the risks of unsecured exposures to an institution on the brink of failure;
   - Key drivers of liquidity needs in resolution materialise (cf. section 3.2).

2. The resolution day/week-end:
   - The bank is declared FOLTF and the PRS is executed;
   - Depending on the PRS, the contractual maturity profile (e.g. cancelling of coupon payments of written-down/bailed-in debt instruments) and overall liquidity profile of the institution is expected to be impacted.

3. The stabilisation phase (weeks/months following the resolution day/weekend):
   - Because of the asymmetry of information regarding the viability of the resolved institution, the liquidity and funding situation remains fragile and the conditions for accessing external funding reflect those of a crisis scenario;
   - Key drivers of liquidity needs in resolution persist particularly during the first weeks/months after the resolution day/weekend.

3.2 Identification of the key drivers of the liquidity position in resolution

6. Key drivers of the liquidity position in resolution[4] are factors that are expected to trigger a substantial deterioration of a bank's liquidity position in resolution. This deterioration may take place in the form of an increase in *outflows*, a *decrease* in the inflows or a decrease in the liquidity value of the *counterbalancing capacity*.

7. **Banks are expected to provide a list of key drivers of the liquidity position in resolution** at the level of the resolution group and at the level of the *main KLEs*, under different time horizons. The bank should engage with the IRT to determine which KLEs

[4] In this guidance, the term 'liquidity position' should be understood as the *net liquidity position* which at any given point in time represents the liquidity value of the counterbalancing capacity plus the inflows minus the outflows.

should be covered in the 2021 assessment, taking into account the relative importance, the complexity of the group and the proportionality principle.

8. The objective of this assessment is to perform a *qualitative* identification of the drivers of liquidity in resolution, where banks should describe the liquidity dynamics that could arise in resolution, complementing the exercise regarding the estimation of the liquidity position in resolution described in section 3.3 and 3.4 of this guidance.

9. In performing this assessment, banks are expected to apply a comprehensive approach focusing on the liquidity dynamics triggered by the resolution event *without* considering a specific scenario, but **identifying the expected drivers of the liquidity position in resolution based on their business and funding structure.**

10. Banks are expected to reflect on and identify the main drivers expected to impact the components of the liquidity *position (*i.e. inflows, outflows and the counterbalancing capacity*)* in the different resolution phases:

- In the run-up to resolution (i.e. weeks / month(s) ahead of the resolution weekend);
- In the short-term after resolution (i.e. week(s) and during the stabilisation phase, thus at least for a period of six months after resolution).

11. Banks are expected to perform this assessment considering different time buckets *before* and *after* the resolution weekend (e.g. to be adapted with changes to Table 1 below, on a weekly basis when closer to the resolution weekend and monthly otherwise).

12. Every identified key driver of the liquidity position should be assessed in relation to each specific time bucket by assigning an individual relative score (e.g. high/medium/low). This individual score represents the relative importance of each driver for the liquidity position of the bank for each specific time bucket, taking into account both the relative size/importance and the probability of occurrence. The output should consist of a detailed assessment, which could be complemented by an overview table, like the example below in Table 1.

13. Banks are expected to include in their assessments, *inter alia*:

- an explanation of the methodology used for assigning the scores;
- a description of the evolution of the magnitude of each liquidity driver over the time horizon considered;
- a focus on the drivers of the liquidity position in the relevant currencies[5].

14. To identify the key drivers of the liquidity position in resolution, banks can build on the risk identification performed in the ILAAP[6] and in the Recovery Plan. However, banks are expected to consider how risks identified in a *going concern* framework will change

[5] Cf. Footnote 1.
[6] Relevant information can be retrieved in the ILAAP sections mapped to the EBA guidelines (particularly sections 7.1.2 and 7.2.1). Please see the Annex on the use of supervisory information for resolution planning.

in a resolution scenario, reflecting the effects of the failure of the bank and the resolution actions.

15. Table 1: Key drivers of the liquidity position in resolution, example of deliverable

Drivers of liquidity needs in resolution	1 week ahead resolution	Resolution weekend	1st week	2nd week	3rd week	4th week	2 month	...	6 month
Deposit outflows (corporate)	H		M	M	M	M	M		L
Deposit outflows (retail)	H		H	H	M	M	L		L
Drawdowns of committed corporate loans	M		M	M	L	L	L		L
FMI requirements	H		H	H	M	L	L		L
...									
Non-availability of wholesale funding	H		H	H	M	M	M		M

16. Box 2: non-exhaustive list of key drivers of the liquidity position in resolution

- **Deposit outflows**: ideally broken down by type to reflect different level of liquidity risks (e.g. stable vs. non-stable deposits, whether DGS covered or not, operational vs. non-operational deposits, etc.);
- **Drawdowns on committed facilities**, e.g. corporate loans liquidity and credit lines, overdrafts, credit cards;
- Liquidity and/or collateral **requirements for FMIs**;
- Loss of **access to wholesale funding** (e.g. repos, unsecured funding, short-term paper) and whether issuances are with short maturities (i.e. the need to roll-over is more frequent);
- **Rating downgrades**: impact of rating downgrade close to or non-investment grade;
- **Derivative-related outflows**: e.g. maturing FX swaps (also if causing intraday liquidity needs), collateral-related outflows;
- **Contractual obligations** triggered in resolution, such as clauses for accelerated repayments;
- Resolution-related costs, such as **restructuring costs**;
- **Reduced inflows following resolution**: e.g. defaults of creditors and investors affected by resolution (who in turn cease their payments on the asset side), lower share price (less scope for the bank to fund itself through equity);
- **Cessation of intra-group funding** in case of MPE strategy or in case of local restriction to transfer funding (please see net liquidity receivers as evidenced in the liquidity-funding map);
- **Deterioration of the overall counterbalancing capacity**.

3.3 Methodologies to estimate the liquidity position in resolution

17. Banks are expected to develop methodologies to '(…) *estimate ex ante, under different assumptions, the liquidity and funding needed for the implementation of the resolution strategy*'[7]. In developing such methodologies, banks can leverage any capability already developed for other purposes (e.g. internal stress testing, recovery planning, liquidity risk framework developed for supervision, etc.). However, these **methodologies should be resolution-specific.** The objectives and the key characteristics of developing such methodologies are described in the SRB EfB. This document aims at:

- providing additional clarity to banks as to which aspects these methodologies are expected to address (sections 3.3.1 to 3.3.10); and
- setting high-level horizontal principles for the resolution planning scenario assessment (section 3.4).

18. In line with the objective of the assessment, **banks should focus on showing their capabilities to run these analyses** capturing all the relevant dimensions and on the identification of the dynamics and factors most contributing to the determination of the liquidity position. Banks should consider that this is not a pass/fail exercise and that the estimation of a negative liquidity position is an acceptable outcome.

19. Banks are expected to develop a methodological framework for the estimation of the liquidity position in resolution taking into account, where relevant, the following (non-exhaustive) list of aspects.

3.3.1 Impact of the resolution strategy and of the resolution tools

20. In the case of banking union (BU) groups under **SPE strategy**, the estimations of the liquidity position shall be done for the whole resolution group, including entities not located in the BU (in the EU and outside the EU). For SPE groups, a critical element to be assessed is the transferability of liquidity across the group entities and the existence of legal, regulatory and operational obstacles to such liquidity flows (*cf. section 08*).

21. In the case of groups under **MPE strategy**, the estimations of the liquidity position shall be done separately for each resolution group with a point of entry (PoE) in the BU[8]. In case of resolution, each resolution group should be separable from the others and the liquidity is expected to be managed at the level of each resolution group without assistance from entities not included in the scope of the resolution group. In practice, this means that one resolution group should not assume funding from other resolution groups in resolution (i.e. in the run-up to and post resolution).

22. Additionally, regardless of whether the group has an SPE or an MPE strategy, **banks are expected to consider the impact of resolution tools on future cash flows**, and provide an estimate of the liquidity needed to implement the resolution strategy. As explained under section 3.4.5, the focus of the exercise may differ given the nature

[7] EfB, section 2.3.2.

of the tool: methodologies should take into account, for instance, coupon payment cancellation of bailed-in liabilities and liquidity needed for the stabilisation phase; the deductions of contractual inflows/outflows related to assets sold in the event of asset separation; the liquidity required to successfully complete the transfer, in the event of the sale of business tool.

3.3.2 Counterparties' behaviour in resolution

23. Banks are expected to be able to calibrate their methodologies to **consider behavioural factors** impacting non-contractual items, such as:

- open maturity items (e.g. deposit outflows, repos);
- the roll-over of existing funding and the obtainment of new funding;
- drawdown of committed credit lines.

Banks are expected to justify the calibration of relevant parameters (i.e. run-off rates, rollover assumptions, haircuts, etc.) for the above aspects.

3.3.3 Financial obligations related to access to critical FMIs

24. Banks are expected to leverage the work performed as part of the FMI contingency planning to account for **FMIs liquidity needs in resolution**. Banks are expected to provide an aggregated estimation of liquidity needs for FMIs and estimate the maximum liquidity that may be required to ensure continuity of access to FMIs, FMI intermediaries and other related service providers necessary for continued access to FMI services.

25. In FMI contingency plans, banks are expected to specify in what form the increased liquidity needs are expected to materialise (e.g. increased market demand for liquidity, increased margin, additional default fund contributions, pre-funding, better quality collateral), as well as the assumptions and models underpinning the calculation of the estimated liquidity needs under stress. Banks should be able to map such requirements to the relevant KLE.

26. The assessment of banks should be consistent with the metrics reported in the FMI report, specifically in Tab 33 'Key Metrics', where the following should be provided: credit lines, peak of (intraday) liquidity, collateral requirements, estimated additional liquidity or collateral requirements in a stress situation.

3.3.4 Intraday liquidity needs

27. The methodologies of banks should allow for the estimation of **key intraday liquidity metrics** in the different phases of resolution at an aggregated level and at material currency level[9]. In line with BCBS[10] standards, such metrics should include the ones used by the banks in their business as usual, i.e.:

- Daily maximum intraday liquidity usage;

[9] The assessment of capabilities related to intraday liquidity needs will not be a priority for the 2021 RPC.
[10] https://www.bis.org/publ/bcbs248.pdf

- Available intraday liquidity at the start of the business day;
- Total value of gross daily payments made and received.

3.3.5 Financial obligations related to operational continuity

28. Banks are expected to ensure that their estimations take into account the financial means necessary to continue providing services needed to support the performance of critical functions and core business lines[11]. Banks need to consider, among others, payments to critical and essential suppliers; shared service centres; payment of salaries; and fees, licences or other expenses to keep critical and essential IT systems fully operational.

3.3.6 Impact of rating agencies' actions

29. Banks are expected to consider the **impact of rating downgrades** on the liquidity position (e.g. additional requirements from counterparties, FMIs, etc.) and their ability to obtain funding via regular market transactions. In practice, ECAIs (External Credit Assessment Institutions) might assign different rating downgrades, however, the default assumption is that, in the *run-up to* the *resolution* phase, the rating will be non-investment grade[12].

3.3.7 Liquidity value of different asset classes

30. The methodologies of banks are expected to provide the liquidity value of the assets that can be used to generate liquidity in resolution[13]. **Banks should be able to estimate the liquidity value to be generated from marketable and non-marketable assets** either through the sales of the assets, through repurchasing agreements or pledged as collateral in central bank facilities which are part of ordinary monetary operations.

31. Banks are encouraged to develop automated processes to calculate the liquidity value after the application of haircuts to the different asset classes. The framework used to calculate the liquidity value should be flexible enough to facilitate changing haircut parameters at short notice. For central bank eligible assets, banks are expected to rely on the haircuts communicated by the central banks when those are publicly available. For all the other assets, banks could build on experience from past crises, liquidity stress testing[14] and consequently use expert judgment to define the haircuts. Haircuts are expected to be conservative enough and more conservative than BaU in order to consider the special conditions of resolution and the reluctance that some investors

[11] For core business lines (CBL) that do not have any critical function, the bank can consider the assumptions of the business reorganisation plan to assess whether the CBL would be kept post-resolution.
[12] The credit rating of an entity corresponds normally to the credit quality of its senior unsecured debt instruments.
[13] **Some aspects under this topic overlap with EfB principle 3.3, which is not prioritised in the 2021 RPC**. However, as the estimation of the liquidity position is largely impacted by assumptions taken to address some of these aspects, if a detailed analysis is not possible, banks are expected to provide the key methodological assumptions required for the estimation exercise.
[14] As mentioned in para. 38 of this document, benchmark references on haircuts could be retrieved for e.g., from the Methodological Note of the ECB Sensitivity analysis of Liquidity Risk – Stress Test 2019.

could have to engage with the bank. Banks are expected to pay particular attention to capabilities to estimate the liquidity value of non-marketable assets with due regard to the characteristics of these assets (e.g. credit quality, currency, type of customer, etc.).

3.3.8 Legal, regulatory and operational obstacles to the transferability of liquidity between KLEs

32. In developing a framework for the estimation of the liquidity position in resolution, banks are expected to consider potential obstacles to the transfer of liquidity between KLEs, in particular when located in different countries, due to local regulatory requirements (e.g. prudential liquidity requirements at individual level, intragroup large exposure limits), legal (e.g. ordinary company law15, reserve requirements and prohibition on transferring liquidity available locally out of the country) or operational obstacles (e.g. access to FMIs, local liquidity needs to ensure continuity of their critical functions).

33. Banks are expected to consider the above-mentioned aspects in their methodologies, applying a conservative approach whenever uncertainty (e.g. the actions of local regulators) prevents a precise determination of the availability of a specific liquidity source.

3.3.9 Legal and operational obstacles to pledge available collateral in a timely manner[16]

34. In developing a framework for the estimation of the liquidity position in resolution, banks are expected to consider any **legal and operational obstacles to pledge collateral** (e.g. consent of the debtor, non-recognition of the law of the contract). Banks are expected to consider the timing required to mobilise different asset classes and be able to reflect this impact in the estimation of their liquidity position. Banks are expected to apply a conservative approach whenever uncertainty prevents a precise determination of the availability of collateral.

3.3.10 Contractual suspension or termination that counterparties may exercise

35. In developing a framework for the estimation of the liquidity position in resolution, banks are expected to consider potential liquidity needs arising from the **suspension or termination of contracts in resolution** (e.g. termination of a contractual netting set for derivatives). In particular, banks are expected to assess the risk of additional liquidity needs arising in resolution following the termination of OTC derivatives (OTCD) or Securities Financing Transactions (SFT) contracts under third-country laws in the absence of a contractual recognition of the resolution authorities' powers to suspend termination rights ('Stay powers').

3.4 Guidance for the liquidity scenario exercise for 2021

[15] General corporate standards in continental law typically impose limits on new lending to insolvent institutions, regardless of the intentions of prudential authorities.
[16] Ibid.

Banks are expected to develop methodologies to '(…) *estimate ex ante, under different*

36. In 2021, **banks are expected develop a methodology to estimate the liquidity position in resolution and apply it to a minimum of two resolution scenarios**: a slow-moving and a fast-moving scenario, triggered by an idiosyncratic event, involving a mix of solvency and liquidity depletion.

37. Banks are invited to use their expert judgement, experience from previous crises and relevant literature[17] to calibrate specific assumptions for the scenarios. Benchmark references on run-off rates and haircuts can be retrieved in the *Methodological Note of the ECB Sensitivity analysis of Liquidity Risk – Stress Test 2019*[18]. However, banks are reminded that this methodology was developed to reflect a stress that, while severe, was not meant to reflect a resolution scenario and as such needs to be adapted to the resolution context.

38. While the *scenario work* developed by banks for recovery planning can be used as a starting point, banks are expected to apply their methodologies to *resolution-specific* scenarios. Scenarios should be tailored to each bank's business model and should respect the principles described in the following paragraphs.

3.4.1 The length of the crisis affects the liquidity dynamics

39. In **a *slow-moving* scenario**, banks are expected to assume they will enter into resolution no earlier than *12 months* after the start of the crisis. In a ***fast-moving* scenario**, it is assumed that the bank enters into resolution in no more than *3 months* after the start of the crisis.

40. The length of the crisis affects the expected group structure before resolution, the liquidity position and balance sheet at the point of resolution especially in the way banks are able to implement recovery options (cf. 3.4.4):
    - A *fast-moving* scenario entails that a bank has limited time to implement its recovery plan, should not assume major changes in its business model and its organisational structure and should consider recovery options that strictly take less than three months to be executed.
    - A *slow-moving* scenario, however, means that the bank benefits from more time to implement more structural changes such as initiating, if stated as recovery options, the sale of some businesses and reorganisation.

41. The analysis should simulate the liquidity position at different phases of resolution, i.e. in the run up-to resolution, at the moment of the failing-or-likely-to-fail (FOLTF) declaration and the forecasting of the liquidity position for a period no shorter than 6 months following resolution, in all relevant currencies[19].

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[17] Section 1.2 of this recent ECB paper provides a survey on deposits-run-off rates in past crises. https://www.ecb.europa.eu/pub/pdf/scpops/ecb.op250~c7a2d3cc7e.en.pdf

[18] https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.ECB_sensitivity_analysis_of_liquidity_risk-stress_test_2019-methodological_note_20190206~6771e88926.en.pdf

[19] cf. footnote 1.

42. The length of the scenario affects the period that should be considered for the run-up to resolution:

- in the fast-moving scenario, this should account for the last month before the FOLTF declaration;
- in the slow-moving scenario, this should account for the 3 months before the FOLTF declaration.

3.4.2 Scenarios should lead the bank to a FOLTF situation

43. **The trigger of the crisis is for the bank to decide**. Banks could assume that the stress factors used in the supervisory exercises (e.g. in the idiosyncratic crisis scenario of the recovery plan) take on extreme values, so that the assumed recovery options do not succeed and the bank enters into a run-up to FOLTF.

44. **Banks shall determine a plausible scenario of failure where liquidity** (and not solvency, at least not primarily/exclusively) **would be a key element of the FOLFT declaration**. The legislation does not set an automatic trigger for a FOLTF decision, as such banks should be able to make such determination based on their expert judgement taking into account the criteria for the FOLTF determination set under Article 18(4) SRMR and Title 2 of the EBA/GL/2015/07.

3.4.3 Scenarios should assume an overall severe liquidity deterioration

45. While it is for the banks to model the exact trajectory to the FOLTF declaration, as a simplification, banks should assume that when the FOLTF declaration takes place the relevant liquidity indicators are severely deteriorated.

46. At the point of FOLTF, banks are expected to have **already used a significant part of their liquidity-generating actions and counterbalancing capacity (CBC)**. The recovery options exercised and the level of CBC at the point of FOLTF should reflect the characteristics of the scenario: in general, it should be expected that a slow-moving scenario would allow the bank to exercise more recovery options than a fast-moving crisis.

47. When relevant for their business and/or funding model, banks are expected to consider:

- high unexpected outflows of deposits, in particular in the run-up to resolution and in the days following the resolution weekend;
- unavailability of wholesale funding, and impossibility to issue debt in the run-up to and in the weeks after resolution;
- increased liquidity requirement from FMIs in the run-up to resolution;
- severe reduction of HQLA.

3.4.4 Use of recovery options should be assumed under conditions

48. In general, **scenarios can assume the exercise of recovery options** that are compatible with the crisis scenario and with a situation of deep distress (e.g. issuance of securities should not be assumed).

49. The use of the recovery options should be realistic and take into account the time horizon of the scenario. In principle, the recovery plan already provides information on the timing of each recovery option. No recovery options is assumed to be used in the days immediately before and after resolution. Banks are also invited to consider additional options not included in the recovery plan, which would be specific to resolution (e.g. discontinuation of activities).

50. Banks and IRTs should discuss which recovery options should be assumed to be exercised by the bank in the simulations and to what extent, considering not only their implementation timeframe but also the likelihood of their successful completion under the resolution situation. A rough implementation timetable might be helpful in order to consider potential interdependencies.

3.4.5 Scenarios should take into account the PRS

51. Banks are expected to be able to estimate the **liquidity needed for the implementation of the resolution strategy**, and the liquidity position at resolution group level and for the main KLEs of the group, assuming a successful implementation of the PRS.

52. Banks are expected to assess the impact of the PRS and the resolution tools on the subsequent liquidity cash flows where relevant (e.g. due to the cancellation of future coupons/interests payments on bailed-in liabilities) under the envisaged scenarios and the reactions of relevant counterparties (e.g. FMIs, funding providers, depositors, etc.).

53. For banks with **a transfer tool as PRS**, a successful implementation may lead to a complete or partial sale of business or asset separation, with remaining parts being wound down. The primary focus should be on building capabilities to estimate liquidity needs to ensure a successful transfer of the assets/shares of the bank to the buyer. In the post-resolution period, after successful execution of the sale of business, the entity may cease to exist and/or become part of another group, and the projections regarding, for instance, the balance sheet position or inflows/outflows will depend on the acquirer. That may have an impact on KLE/risk driver analysis, and on the liquidity projections post resolution.

54. For banks with the **bail-in strategy** as PRS, the banks should be in a position to estimate their liquidity position in the post-resolution phase with more detail than in the case of transfer strategies. Furthermore, banks should assume that liquidity risk is likely to be higher after the application of bail-in compared to a sale of business strategy when the acquirer is expected to provide liquidity support post resolution.

3.4.6 Scenarios should take into account post-resolution environment

55. The methodologies of banks should allow for a forecast of the liquidity position for 6 months after the resolution weekend. As such, banks are expected to be able to discuss and describe the expected counterparty behaviours post resolution using their expert judgment and the industry's experience in past crises. Banks can consider counterparty behaviours observed in past crises and tailor them to this scenario**. It is for the bank to elaborate and justify post-resolution counterparty behaviours** (e.g. outflows rates, haircut rates and conditions attached to secured funding, etc.).

56. The following high-level assumptions should be considered:

- After the application of the PRS (i.e. during the stabilisation phase) some business reorganisation initiatives could be required to ensure the long-term viability of the institution while maintaining the critical functions provided by the bank. This point should also be reflected in the banks' Business Reorganisation Plan.
- The scenario should consider possible actions that can be implemented to improve the overall liquidity situation of the institution (i.e. recovery options that would remain available). Banks should also consider measures that were not considered relevant for recovery, but which could be for resolution (e.g. discontinuation of activities or winding down of certain entities).
- Notwithstanding the successful resolution, due to the asymmetry of information regarding the sustainability of its business model and/or the quality of its asset portfolios, the bank remains under stress for some time after resolution (e.g. access to unsecured debt markets is expected to remain limited).
- All (partially) bailed-in instruments should be assumed to be downgraded to 'defaulted' and the issuer rating should be assumed to be downgraded to 'sub-investment grade' immediately after resolution. Potential rating upgrade over time should be considered subject to an improving liquidity position, while acknowledging potential LCR breach post resolution (cf. 3.3.6).

3.4.7 Presentation of the results of the estimations

57. Banks are expected to deliver **an analytical note** presenting the outcome of the simulations for the two scenarios. At this stage, no predefined template is being considered and the way in which the analysis is presented is for the bank to choose. However, banks are expected to present the quantitative elements of the simulations in a table.

58. Banks are encouraged to take inspiration from existing liquidity templates with maturity ladders, such as the Additional Liquidity Monitoring Metrics (ALMM) C.66 report both in terms of item granularity (detailing sources of outflows, inflows, counterbalancing capacity) and maturity buckets.

59. At a minimum, the maturity buckets to be considered should be aligned with those used for the assessment of the key liquidity drivers. For each of these time buckets, banks are expected to provide:

- details of **outflows** by type – liabilities from securities issued, from secured lending and capital market transactions, covered and non-covered deposits for each customer type, committed facilities, FX-swaps and derivatives, among others – for both contractual and open-maturity items;
- details of **inflows** by type – monies due from secured lending and capital market transactions, loans and advances for each customer type, FX-swaps and derivatives, among others – for both contractual and open-maturity items;
- details of the **CBC** by type – cash, central bank reserves, level 1, 2A and 2B assets, among others.

60. The outcome of the simulations should include for each scenario:

- the evolution across the three resolution phases of the liquidity position and its main components (inflows, outflows and the CBC) for each time bucket;
- a stylised balance sheet for each scenario across the three resolution phases;
- the evolution of the relevant liquidity ratios (e.g. the LCR) and the liquidity required to restore the ratios;
- a view on how the main KLEs[20] contribute to the net liquidity position;
- a focus on the evolution of liquidity needs in each material currency;

Simulation reference data should be at year-end 2020 or a more recent period.

[20] Cf. para. 7.