Bank of England PRA

Please note: This letter has been prepared for the website. Square brackets show where this letter may differ slightly, along with formatting from those versions sent directly to firms.

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Dear CEO – also for attention of Board,

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Non-systemic firms' recovery planning thematic review: Industry feedback

Events in the financial sector over the last two years have highlighted the importance of banks and building societies' resolvability and recovery planning. Banks and building societies' recovery capabilities are particularly relevant to support financial resilience under stress and ensure that the financial sector can continue to support businesses and households. Over the last eighteen months we reviewed the recovery planning capabilities of c70 non-systemic UK banks and building societies. This letter sets out the areas for improvement, planned next steps, and effective practice examples.

For the executive, recovery planning helps the firm to understand its vulnerabilities and the actions it can take under stress. Preparing the plan in advance of a stress allows the firm to ensure it has tested its thinking, capabilities and processes and saves time.

For the board, the recovery plan gives an insight into the management actions that the executive may take under a stress. It facilitates executive oversight and effective challenge. Recovery plans give the board an understanding of how a firm can detect an impending stress; what recovery options the firm has at its disposal; and how much capital and liquidity the firm could generate under various scenarios.

Our review found that although many firms understand the basics of recovery planning, there are significant areas for improvement, most notably related to the development of recovery scenarios and the calculation of recovery capacity.

While the sample of firms that we reviewed has been restricted to UK headquartered firms, we also expect PRA regulated international banking subsidiaries operating in the UK to consider the actions outlined in this letter.

Areas for improvement

Recovery scenarios

Scenario testing is important to help firms demonstrate their recovery plan is suitable for use in a range of different stress types, and it should test how different elements of the plan (choice of indicators and their calibration, governance and deployment of plan, optimal options strategy) would interact and work. Our review found that a number of firms did not use scenarios of sufficient severity, which will limit the effectiveness and value of the testing.

- Firms should ensure scenarios are sufficiently severe and bring the firm close to its point of non-viability (PONV). Firms should provide analysis outlining how they define and calculate their PONV.
- Recovery capacity calculations for each scenario should reflect the parameters of the stress: for example, macro/ market conditions, firm’s operational capabilities, and consideration given to dependencies/ interdependencies between recovery options.

Recovery capacity

It is useful for firms to understand their recovery capacity under a range of different stresses. A well calculated recovery capacity analysis gives firms and their boards an insight into the strengths and weaknesses of their capital and liquidity generating capabilities under various scenarios. Our review found that firms are not calculating their recovery capacity effectively, nor are they adequately showcasing it in an understandable and usable way. This reduces the accuracy and reliability of the recovery capacity calculations.

- Firms should look to understand and utilise the methodology for calculating recovery capacity correctly. Supervisory statement (SS)9/17 – Recovery planning,[1] provides a helpful guide on how this can be achieved. Recovery capacity is calculated individually for each stress scenario with the calculated benefits and timelines being adjusted to take into consideration the parameters of the modelled stress. Total recovery capacity, timelines, optimal options available and deliverable benefits likely vary considerably depending on the scenario.
- Recovery capacity should also be quantified in terms of Common Equity Tier 1 (CET1) capital, Leverage Ratio, and Liquidity Coverage Ratio (LCR) percentage points and relevant nominal amounts for each scenario. The impact on balance sheet and profitability should also be considered.

[1] www.bankofengland.co.uk/prudential-regulation/publication/2017/recovery-planning-ss.

Next steps

We will engage collectively with firms and trade associations as appropriate to discuss the findings of this letter in 2024 H2 and we will include this as a topic for discussion at the June CEOs conference. Firms are expected to consider the actions outlined above and update their recovery plans to meet expectations outlined in SS9/17.

From October 2025, non-systemic firms must meet the rules and expectations introduced in our new policy statement (PS)5/24 – Solvent exit planning for non-systemic banks and building societies[2] and our expectations set out in supervisory statement (SS)2/24 – Solvent exit planning for non-systemic banks and building societies.[3] Firms may wish to consider leveraging their work on recovery planning when implementing their solvent exit approach.

Yours faithfully

Laura Wallis

[2] **www.bankofengland.co.uk/prudential-regulation/publication/2024/march/solvent-exit-planning-for-non-systemic-banks-and-building-societies-policy-statement**.

[3] **www.bankofengland.co.uk/prudential-regulation/publication/2024/march/solvent-exit-planning-for-non-systemic-banks-and-building-societies-ss**.

Appendix: Effective practice examples

The following section provides examples of effective practice noted by the PRA among the non-systemic firms' population. Firms may find these useful for their own recovery planning.

Recovery capacity

A useful and simple way for firms to present and analyse their overall potential recovery capacity is to create a separate recovery capacity section. The section could include:

- a simple table outlining all a firm's available options in rows alongside benefit calculations for those options for each modelled scenario in the columns;
- a column outlining the benefit calculation for options in BAU or scenario agnostic terms;
- analysis outlining where the benefit calculations are different between scenarios and why this is the case; and
- numbering outlining prioritisation of options dependent on scenarios, timelines, ease of deployment, and dependencies/ interdependencies.

A firm's recovery capacity over time can be illustrated in simple stacked cumulative benefit charts that include:

- the firm's capital/ liquidity position over time pre deployment of options;
- the impact of firms available and credible recovery options stacked on top and in their preferred sequencing; and
- firm regulatory minimums and risk appetite/ indicator levels.

These approaches have helped some firms to showcase their recovery strategy and prioritisation for deployment of options as well as showcasing how the firm's indicators are well calibrated.

These charts could be replicated for the scenarios section, though the potential recovery capacity highlighted in the recovery capacity section may be somewhat different to the capacity shown in the scenarios. This is because potential total recovery capacity may be different from a firm's deployed recovery capacity in a specific scenario, for example a firm may have multiple available options that could help it to recover, and it may not want/ need to deploy all of its available options.

Recovery indicators

Some firms utilise the European Banking Authority (EBA) minimum recovery indicators as an initial starting point and further develop their indicator framework with reference to the firm's key risks and vulnerabilities, as outlined in other regulatory documents such as the Internal Capital Adequacy Assessment Process (ICAAP)/ Internal Liquidity Adequacy Assessment Process (ILAAP). Some of the EBA minimum indicators may not be relevant and firms can outline where this is the case and propose alternatives where necessary.

We have also noted that some firms utilise a range of indicator types and are not limited to fixed point-in-time indicators. For example, a number of firms use forward looking indicators based on their financial projections and deviations from business plan.

Another useful indicator we have observed is the movement-type indicator which flags fast movements in metrics that may not necessarily breach indicator/ risk management levels but nonetheless could highlight impending stress.

Stress scenarios

The scenario testing section can be used to highlight and test the various elements of the firm's recovery plan. Firms can use recovery scenario testing to showcase:

- the quality and calibration of the indicator framework;
- the clarity and timeliness of governance processes leading to deployment of the recovery plan;
- the recovery strategy and optionality available in each scenario;
- the firm's ability to recover from a variety of severe stresses.

Firms can underscore the severity of the modelled scenarios by linking this back to their reverse stress testing (RST) and their ICAAP/ ILAAP scenarios. Some firms have found it necessary to increase the severity of these stresses considerably in order to bring the firm closer to its point of non-viability (PONV).

Firms can highlight the severity of their scenarios by also providing analysis outlining what their PONV is and how the scenarios design has taken this point into consideration.