



## Recovery and resolution planning – What it really means?

In November 2011, the G20 leaders will endorse recommendations to address the moral hazard posted by Systemically Important Financial Institutions (SIFIs), including the requirement for an adequate, credible recovery and resolution plan (RRP) from any firm which is assessed by its home authority to have a potential impact on financial stability.

The global SIFIs are required to complete their draft recovery plan by December 2011 followed by a draft resolution plan by June 2012. All SIFIs falling within national frameworks and rules will be subject to local deadlines.

### Questions you need to ask

- Does corporate strategy reflect the pressure of regulatory reforms on the business model and operating structures, including the likely impact on client, counterparty, and investor behavior?
- Have we understood the systemic risk associated with our core businesses and critical operations, including the way in which we currently aggregate/manage risk and provide operational support cross-border?
- Have we identified the key financial and operational dependencies between legal entities and banking products/services that could restrict recovery optionally and resolution flexibility?
- Have we determined how the pricing structures will flex with any future changes in operating structures and/or capital surcharges?

### How can we help you?

KPMG has worked with global financial institutions to help identify, quantify, and challenge recovery actions and align the capital and liquidity impact (e.g., although selling assets below book value may create liquidity, it can also lead to capital shortfalls).

We have helped clients:

- Build stronger capital and liquidity management/allocation frameworks
- Identify the hand-off points between setting risk appetite, managing “business as usual” stress, and implementing the recovery strategy
- Develop a wide-ranging trigger framework with early warning indicators and delegated authorities
- Improve the ability to provide a forward-looking view of stress before and after management actions
- Challenge the robustness of the recovery plan and link to resolution planning

### Recovery planning

In principle, the recovery plan remains under the control of management; however, it is a key supervisory tool to identify options to recover financial strength and viability under severe stress.

The objective is to identify credible recovery options that can be implemented quickly under a range of idiosyncratic and marketwide stress scenarios, addressing both capital shortfalls and liquidity pressures. Any lack of credible options will lead to greater reliance on capital and liquidity buffers and stress testing.

Recovery planning is a logical extension of current processes for managing capital and liquidity under stress. However, it requires additional analysis around core asset disposals and radical de-risking steps that may result in franchise damage. The optionality that is derived from the current business model should have a bearing on risk appetite and strategy setting.

## Questions you need to ask

### Governance

- *How have we assessed the robustness of our RRP?*
- *How have we embedded RRP within risk appetite, the holistic approach to capital and liquidity management, and our crisis management arrangements?*
- *How are we prioritizing structural change that creates or preserves RRP optionality/flexibility?*

### Recovery options and triggers

- *Does the trigger framework and menu of recovery options address local regulatory concerns and demonstrate an ability/intention to act quickly?*
- *What stress scenarios have been envisaged when framing recovery options?*

### Credit exposures

- *Are we vulnerable to counterparty failure through internal and external counterparty exposures, including indirect exposure via market infrastructure?*
- *What impact will market infrastructure reforms have on funding and revenue (e.g., payment services)?*

### Resolution

- *Have we evaluated the optimal solutions for improving resolvability across staff, premises, intellectual property, IT systems and data, etc.?*
- *Do key third-party contracts create the necessary resolution flexibility and is internal service provision subject to SLAs?*

## Resolution planning

The data and information provided to the authorities enables them to create an iterative guide for achieving orderly resolution in the event that recovery measures are not feasible or are ineffective.

Current operating structures that facilitate a viable separation of legal entities and banking products/services are more resolvable and thus allow for greater flexibility within the resolution strategy.

Resolution authorities recognize a range of practical obstacles to resolution, e.g.:

- A lack of comprehensive data on the position of each legal entity
- A reliance on service providers threatening the continuity of systemically important operations
- Intragroup transactions that impede actions to separate legal entities
- Continuation of essential services that a payments operation provides

## How can we help you?

We have leveraged our global experience in RRP to assist a number of large, complex financial institutions to understand their systemic risk and identify the key barriers to resolvability. Furthermore, we have shared with them regulatory insights and practical experience as administrators to failed financial institutions to shape and challenge target operating structures.

To retain strategic focus and quickly highlight key conflict between the commercial structure and resolvability, we are able to focus data gathering through:

- Templates that capture key financial and operating dependencies
- Product and functional experience that efficiently documents the end-to-end dependencies across your products/services

Our methodology is also designed to embed evolving resolution thinking and drive out:

- Opportunities to work with regulators/trade bodies in shaping future requirements
- New business opportunities and threats as operating structures and stakeholder behaviors change
- A more informed view of product level performance and cost
- A rounded evaluation of proposed options for change including capital, liquidity, and tax implications
- A greater understanding of end-to-end processes and their operational risks

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