

## Fortifying Financial System Resilience with The Recovery and Resolution Planning Framework

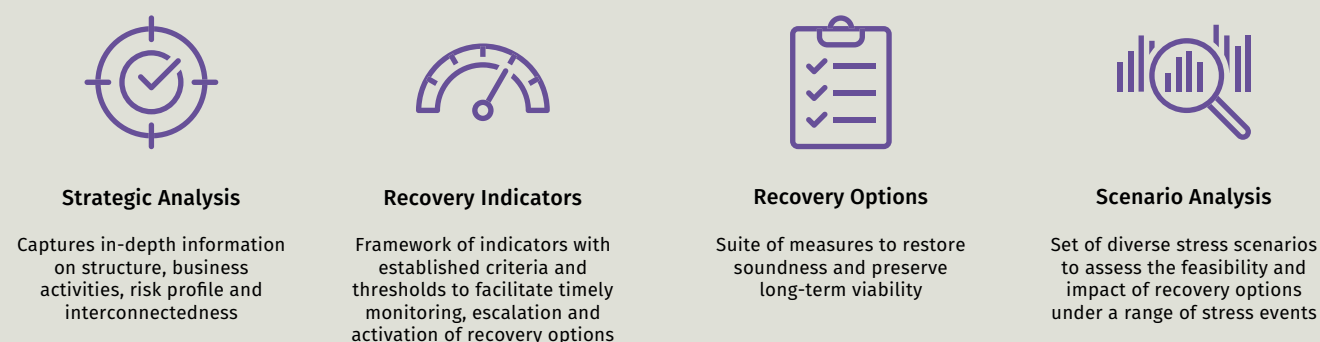
In the aftermath of the Global Financial Crisis (GFC), the G20's Financial Stability Board issued the paper on Key Attributes of Effective Resolution Regimes for Financial Institutions as the new international standard for effective resolution regimes. The objective of the standard is to ensure that national authorities are able to address the failure of financial institutions in an orderly manner, without exposing taxpayers to the risk of loss from solvency support, thus making the financial system more resilient to stress events which could undermine financial stability. With this in mind, Bank Negara Malaysia (the Bank) and Perbadanan Insurans Deposit Malaysia (PIDM) have joined efforts to develop a coherent Recovery and Resolution Planning (RRP) Framework for licensed banks and financial holding companies (hereafter referred to as financial institutions).

### Recovery Planning

Recovery plans serve as a playbook for a financial institution to react in a timely manner to a range of stress events that could threaten its solvency and long-term viability. A recovery plan is developed and owned by the financial institution, and does not take into account any prospect of support or intervention by authorities. Most importantly, it must not consider recourse to taxpayers' support.

An effective and credible recovery plan builds on a deep analysis of the financial institution's operations and identifies a suite of options that could be pursued by the financial institution to restore its long-term viability under a range of stress scenarios (Diagram 1). A financial institution should have in place credible strategies for recovering from system-wide stress events, idiosyncratic stress events, or a combination of these.

Diagram 1: Key Components of a Recovery Plan



Source: Bank Negara Malaysia

In developing their recovery plans, financial institutions are guided by the Recovery Planning Policy Document issued by the Bank in July 2021, which serves to ensure sufficient rigour and quality are observed in recovery plans. The policy document reflects a proportionate approach to recovery planning in order to recognise the heterogeneity in the nature, size, and complexity of financial institutions. Accordingly, the level of detail and depth of analysis expected in recovery plans will correspond with the risk profile of the financial institution.

The Bank views recovery planning as part of good risk management to improve the resilience of financial institutions to financial stress episodes and strengthen their preparedness to respond to adverse shocks. Recovery planning is therefore required of all financial institutions and applied at the group level<sup>1</sup> to ensure that a comprehensive assessment of risks and interdependencies within the group is captured. This in turn provides the financial institution with an assessment of its overall recovery capacity and a broader range of recovery options available which may not otherwise be possible at the entity-level. Under a phased implementation approach to recovery planning, the larger and more complex financial institutions are required to complete their recovery plans by 1Q 2023, with the remaining financial institutions to follow in 2024.

A key benefit of recovery planning is helping financial institutions identify, in advance, impediments to recovery from severe stress events. Financial institutions that have worked on developing recovery plans, including banks in Malaysia that took part in the domestic pilot exercise in 2017/18, have found that common impediments include incompatible information systems that complicate the ability to aggregate and analyse exposures across entities and locations, poor coordination within and across entities, legal and operational complexities in untangling activities that are spread across different locations along the value chain, and market concentrations that could constrain the ability of financial institutions to de-risk their operations. By addressing these impediments early, a financial institution can react to stress events more swiftly, thus significantly improving its prospects of recovery from a stress event.

In the event a financial institution's recovery options are no longer feasible in restoring its long-term viability, the financial institution would enter into resolution.

### Resolution Planning

As the resolution authority for financial institutions that are its member institutions<sup>2</sup> (MI), PIDM spearheads the development of the resolution planning framework in Malaysia to achieve prompt and orderly resolution of any failed member bank<sup>3</sup> (Diagram 2). Resolution plans are developed by PIDM. Broadly, the resolution plan details out the implementation of the bank-specific preferred resolution strategy (PRS), identifies impediments to PIDM's resolution actions and develops remediation measures to address these impediments. More information on the resolution planning framework applicable to member banks in Malaysia can be found in PIDM's Exposure Draft on Resolution Planning Approach for Deposit-Taking Members issued on 1 August 2022.

### Resolution planning aims for PIDM member banks to be transfer-ready and resolvable

The PRS for member banks aims to make them 'transfer-ready', whilst ensuring the continuity of critical functions performed and preserving the institution's franchise value. This means ensuring that non-viable member banks can first be resolved via the transfer of shares, businesses and/or its portfolio of assets and liabilities to a private sector purchaser or a temporary bridge institution.<sup>4</sup> As an alternative or a complementary strategy, a failed member bank of PIDM or its remaining parts (bad assets) could be wound-up and liquidated. For smaller and less complex institutions, this option will be less likely to impact financial system stability and could therefore be the least costly option. In line with PIDM's mandate, the cost of resolution<sup>5</sup> would also take into account the externalities of a MI's failure to the broader financial system and economy.

<sup>1</sup> This would entail recovery plans to be developed by bank holding company or financial holding company on a consolidated basis.

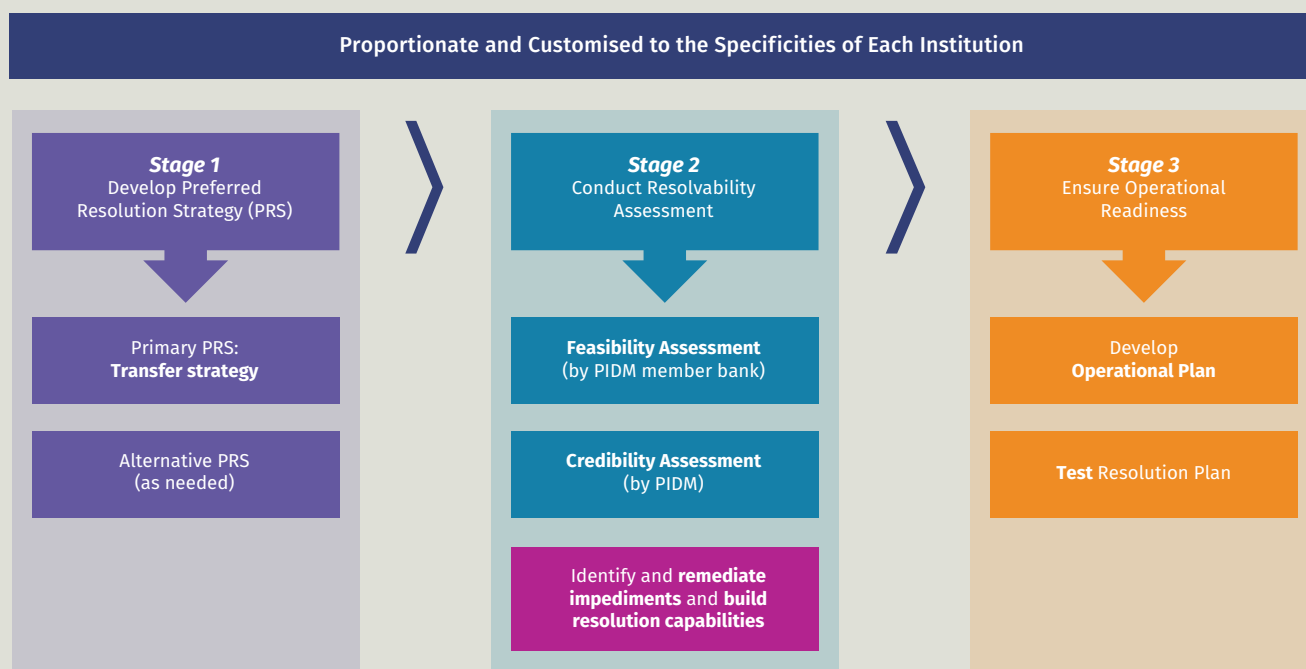
<sup>2</sup> Member Institution is a financial institution deemed to be a member institution of PIDM under PIDM Act 2011.

<sup>3</sup> Member banks include all commercial banks licensed under the Financial Services Act 2013 and all Islamic banks licensed under the Islamic Financial Services Act 2013, including locally incorporated subsidiaries of foreign banks operating in Malaysia. The resolution planning framework currently excludes insurer members which will be developed at a later stage, where appropriate.

<sup>4</sup> A bridge institution is a subsidiary of PIDM set up to assume the business, assets, affairs and liabilities, including critical functions, of a non-viable member bank so as to allow the functions of the bank to continue seamlessly, thus maintaining public confidence in the financial system.

<sup>5</sup> Comprises assessment of both qualitative and quantitative costs.

Diagram 2: A Three-Stage Iterative Approach to Resolution Planning for Member Banks



Note: An Operational Plan is part of the Resolution Plan.

Source: Perbadanan Insurans Deposit Malaysia

As with recovery plans, an assessment of the feasibility and credibility of resolution plans and execution details will be carried out by MIs and PIDM, respectively, to identify potential impediments that may hinder the prompt and effective implementation of the PRS and develop mitigating measures. The purpose of this is to ensure that the formulated plans are workable in practice, covering areas such as operational continuity, data, management information systems (MIS) and valuations, continued access to financial market infrastructure, legal structures, and issues surrounding resolution funding, communications and governance.

As an outcome of the resolution planning process, PIDM may require member banks to take specific measures to improve their resolvability. This would be done in consultation with the Bank as the primary supervisory authority.

### Coordination of Recovery Planning and Resolution Planning

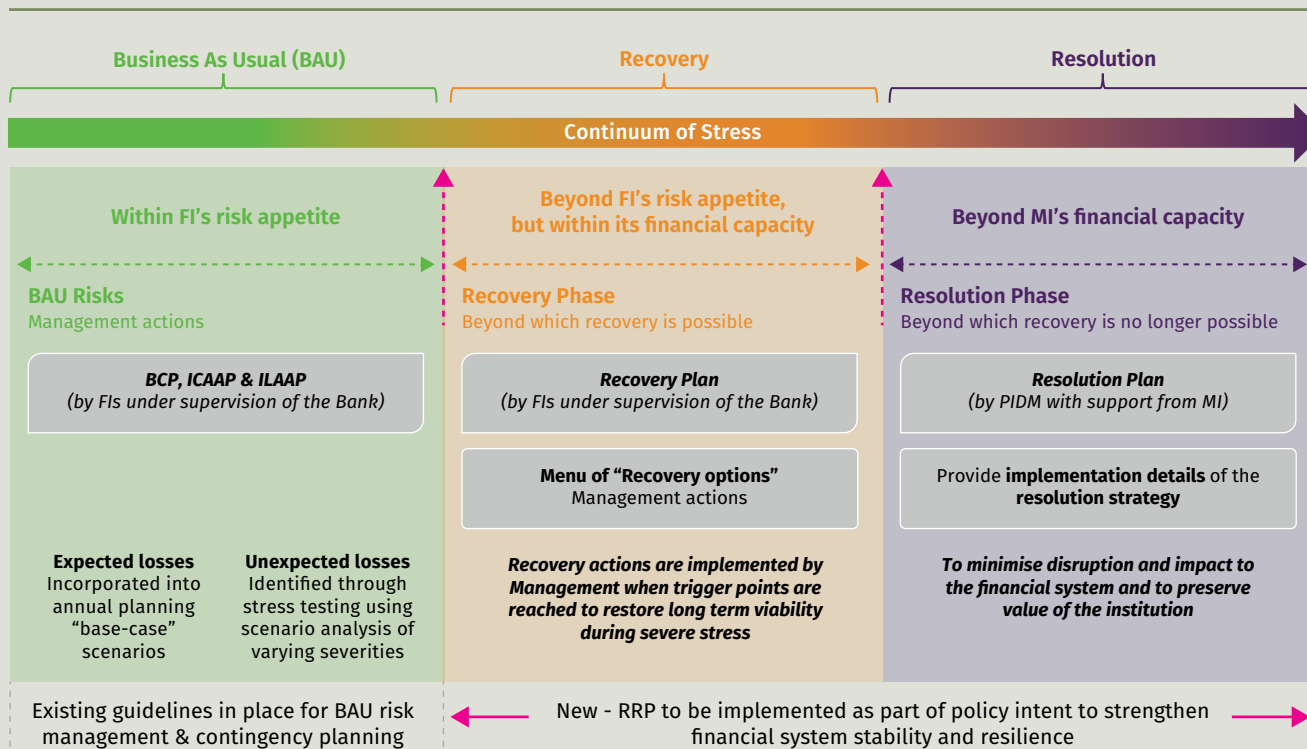
Recovery planning and resolution planning complement each other to ensure that a suite of crisis preparedness strategies is in place for financial institutions to weather significant stress from unexpected events and in turn, preserve financial stability. The Bank and PIDM coordinate closely in the development and implementation of the recovery and resolution planning framework, recognising that these are resource-intensive efforts. This has ensured streamlined policies that minimise regulatory burdens on the industry. For instance, PIDM leverages the strategic analysis performed by member banks for recovery planning to also inform the development of resolution plans. Resolution plans are also guided by the principle of proportionality based on consistent considerations of the nature, size and complexity of a member bank. In addition, resolution plans will be phased in to closely follow the implementation of recovery plans to benefit from coordinated engagements with banks as well as measures taken to address common impediments to both plans.

Such coordination between the Bank and PIDM also facilitates more seamless cross-border cooperation with home and host authorities in other jurisdictions where Malaysian financial institutions have significant overseas presence. The Bank and PIDM continue to work closely with counterparts in other jurisdictions, including through crisis simulation exercises and joint reviews of group recovery and resolution plans, to further strengthen cross-border cooperation arrangements.

### More than just a compliance exercise...

When seen as an extension of a financial institution’s risk management process along a continuum of stress (Diagram 3), measures taken by financial institutions to address impediments to recovery and resolution plans (e.g. reducing organisational complexity and market concentrations, improving data capabilities and strengthening the monitoring of recovery triggers) are expected to reinforce sound risk management practices and effective oversight by financial institutions during business-as-usual (BAU) times. Financial institutions have also found opportunities to improve operational efficiencies and strengthen decision making processes. Similarly, addressing transferability issues can unlock strategic value for member banks in good times, particularly for institutions considering mergers and acquisitions. In times of severe stress, a shorter reaction time for corrective actions to be taken will crucially preserve a financial institution’s viability and shareholders’ value.

Diagram 3: Interlinkages Between the Existing Risk Management Practices, Recovery Plan and Resolution Plan



Note: BCP refers to Business Continuity Plan; ICAAP refers to Internal Capital Adequacy Assessment Process; ILAAP refers to Internal Liquidity Adequacy Assessment Process; FI refers to financial institution; MI refers to a member institution of PIDM.

Source: Perbadanan Insurans Deposit Malaysia

### References:

Financial Stability Board (2014). 'Key Attributes of Effective Resolution Regimes for Financial Institutions'.

Bank Negara Malaysia (2021). 'Policy Document on Recovery Planning'.

Perbadanan Insurans Deposit Malaysia (2022). 'Exposure Draft on Resolution Planning Approach for Deposit-Taking Members'.