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20 June 2014

The Chief Executive
All authorized institutions

Dear Sir / Madam,

**New Supervisory Policy Manual (“SPM”)
Module RE-1: Recovery Planning**

I am writing to inform you that, following consultation with the two industry Associations, the Monetary Authority (“MA”) is today issuing the above-mentioned SPM module as statutory guidance, by notice in the Gazette, under section 7(3) of the Banking Ordinance.

Recovery (as well as resolution) planning for financial institutions has recently been the subject of considerable international focus. The Financial Stability Board’s Key Attributes of Effective Resolution Regimes for Financial Institutions (“Key Attributes”), issued in November 2011, include standards relating to the development of recovery and resolution plans for, at a minimum, financial institutions that could be systemically significant or critical if they were to fail. In particular, Key Attribute 11 covers recovery and resolution planning, involving action by both financial institutions and regulatory authorities.

RE-1 provides guidance to AIs on the key elements of effective recovery planning, and sets out the HKMA’s approach to, and expectations in, reviewing AIs’ recovery plans. The key sections of the SPM:

- require all AIs to undertake some degree of recovery planning but the extent of AIs’ recovery plans will be proportionate to the nature, scale and complexity of their operations;
- explain the need for the involvement of the Board and senior management in developing, reviewing, approving and maintaining an AI’s recovery plan;
- outline key requirements on the menu of recovery options which should be

included in an AI's recovery plan (including some key aspects that need to be considered in relation to business disposal options);

- set out aspects to be considered in identifying triggers for escalation of concerns and activation of the recovery plan;
- provide guidance on how the impact of a recovery action should be assessed;
- provide minimum requirements for stress scenarios; and
- outline minimum requirements for a communication plan should the recovery plan need to be activated.

Guidance on resolution planning will be developed in the form of a new separate module for the SPM in due course.

The HKMA will adopt a phased approach to the implementation of recovery planning for AIs, with priority given to those AIs that are assessed to be more systemically significant or critical in Hong Kong. Those AIs identified by the HKMA for inclusion in the "first wave" of AIs to generate recovery plans for review by the HKMA will be notified shortly and will be expected to submit a recovery plan within six months of that notification. Other AIs will be informed of the subsequent "waves" to which they have been ascribed and the timetable for submitting their recovery plans in due course.

On-line access to the SPM module RE-1 is available to AIs under the icon for "Supervisory Policy Manual" on the HKMA's public (<http://www.hkma.gov.hk>) and private (<http://www.stet.iclnet.hk/stet/index.htm>) websites.

Should you have any questions relating to the module, please contact Mr Martin Sprenger (msprenger@hkma.gov.hk).

Yours faithfully,

Karen Kemp
Executive Director (Banking Policy)

cc: The Chairman, Hong Kong Association of Banks
The Chairman, The DTC Association
FSTB (Attn: Mr Jackie Liu)



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This module should be read in conjunction with the [Introduction](#) and with the [Glossary](#), which contains an explanation of abbreviations and other terms used in this Manual. If reading on-line, click on blue underlined headings to activate hyperlinks to the relevant module.

Purpose

To provide guidance to AIs on the key elements of effective recovery planning, and to set out the HKMA's approach to, and expectations in, reviewing AIs' recovery plans.

Classification

A statutory guideline issued by the HKMA under the Banking Ordinance, §7(3).

Previous guidelines superseded

This is a new guideline.

Application

To all AIs

Structure

1. Introduction
 - 1.1 Background
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 - 1.4 Application
 - 1.5 Implementation

2. Recovery planning
 - 2.1 General
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- 2.5 Impact
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- 2.10 Communication plan

- 3. Supervisory assessment of recovery plans
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Annex: An illustrative template summarising factors to be assessed in relation to recovery options



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1. Introduction

1.1 Background

- 1.1.1 The financial crises in recent years have shown that preparation and planning for severe stress events by banks globally have not been adequate. In many cases, risks to viability were underestimated, and contingency planning was not sufficiently robust or detailed to equip banks in practice with a reasonable prospect of recovery.
- 1.1.2 To address this, the Financial Stability Board (“the FSB”) established standards relating to recovery and resolution planning in its Key Attributes of Effective Resolution Regimes for Financial Institutions (“the Key Attributes”) issued in November 2011. All member jurisdictions of the FSB (including Hong Kong) are expected to meet these new standards in order to ensure that both their public authorities and their financial institutions are better prepared to respond effectively to risk events and shocks that threaten to undermine the financial soundness of individual financial institutions. The Key Attributes specify that recovery and resolution plans should be put in place, at a minimum, for any financial institutions that could be systemically significant or critical if they fail.
- 1.1.3 The main objective of recovery planning is to ensure that financial institutions are well prepared to react quickly to, and to recover from, severe stress, through their own actions. Given this objective, recovery planning should focus on the possible courses of action a financial institution may feasibly take in a range of stress situations to restore its financial strength and viability and thereby maximise its prospects for survival. In view of the nature of recovery planning, no assumption should be made that any form of public support will be available in any recovery scenario, although individual financial institutions should consider their eligibility for accessing central bank facilities, in particular lender of last resort support, as part of their recovery planning.



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- 1.1.4 Recovery planning is only one of the elements within the Key Attributes. In an extreme case where a financial institution has no reasonable prospect for recovery (i.e. the institution is no longer viable or likely to become no longer viable, and there appears little to no chance that it will be able to recover through its own actions), the focus would switch to securing an orderly resolution or liquidation of the institution.
- 1.1.5 Resolution planning is intended to facilitate the effective use of the available resolution tools by the relevant authorities. The ultimate aim is to make feasible the resolution of any financial institution without severe systemic disruption and without exposing taxpayers to loss, while protecting critical functions. Critical functions are functions performed by a financial institution for individuals or corporates in circumstances where disruption to the provision of such functions, caused by the failure of the financial institution, is considered likely to have adverse effects on financial stability or on the functioning of the real economy¹.
- 1.1.6 As a first step, resolution planning involves relevant resolution authorities devising a high level resolution strategy for a financial institution. Subsequently, the strategy will be turned into an operational plan. This process requires firm-specific input from the financial institution, in order to provide the resolution authority with the necessary information to enable it to take into full account the specificities of the financial institution when devising the appropriate resolution strategy. To this end, the HKMA would propose to collect a set of core information and analysis from AIs (or, at least, from those AIs assessed to be performing critical functions or to be otherwise systemically significant) to assist resolution planning under four key components:

¹ For more information on the concept of critical functions (and related to that, critical shared services), please refer to the FSB guidance on Identification of Critical Functions and Critical Shared Services,
http://www.financialstabilityboard.org/publications/r_130716a.pdf.



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- Critical functions analysis;
- Significant legal entities;
- Business lines and operating models; and
- Mapping of dependencies.

1.1.7 Further steps will be needed in order to ensure that the presumptive resolution strategy can be implemented. This will necessitate the collection of additional information and analysis from AIs to assist the authorities in converting the resolution strategy into an executable resolution plan. In addition, in accordance with Key Attribute 10 and Annex II of the Key Attributes, regular resolvability assessments should be conducted by authorities, to evaluate the feasibility of the resolution strategy. The aim of these assessments is to improve resolvability by identifying, and then addressing, obstacles to orderly resolution.

1.1.8 The detailed requirements for resolution planning and assessment will be set out in a separate SPM module on “Resolution Planning” (which is expected to be developed during 2014). It should be noted however that some of the core information and analysis described in paragraph 1.1.6 is equally relevant in the recovery planning phase, not least to provide the overall context for the AI’s approach to recovery planning and inform consideration of the appropriate coverage of its recovery plan. An AI will therefore be expected to provide some of this information in the recovery planning phase, i.e. before the HKMA begins resolution planning. For further details see paragraphs 2.1.3 - 2.1.4.

1.2 Legal basis

1.2.1 The objectives underpinning recovery and resolution planning are consistent with the statutory functions of the



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MA under the Banking Ordinance. Under §7(2)(g) of the Banking Ordinance, the MA shall –

“.... take all reasonable steps to ensure that any banking business, any business of taking deposits, or any other business, carried on by an authorized institution is carried on –

- (i) with integrity, prudence and the appropriate degree of professional competence; and
- (ii) in a manner which is not detrimental, or likely to be detrimental, to the interests of depositors or potential depositors.”

1.2.2 The MA must also be satisfied that an AI’s business is being carried on in accordance with (i) and (ii) as set out in paragraph 1.2.1 for the purposes of the continuing authorization criterion in paragraph 12 of the Seventh Schedule to the Banking Ordinance. In this regard the MA considers that planning for severe stress events, and the preparation and maintenance of credible recovery plans (like other aspects of contingency planning), should be regarded as an integral part of carrying on deposit-taking business in a prudent manner and in a manner which is not detrimental to the interests of depositors.

1.2.3 Furthermore, to the extent that successful deployment of a recovery plan can restore an AI to viability and thereby avoid the potential for transmission of contagion to other AIs or to the financial system more broadly, the development of such a plan will tend to promote the stability and effective working of the banking system. This is specified in §7(1) of the Banking Ordinance to be the principal function of the MA.

1.2.4 Under §63(2) of the Banking Ordinance –

“The Monetary Authority may require an authorized institution to submit (including periodically submit) such



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further information, ... as he may reasonably require for the exercise of his functions under this Ordinance and such information shall be submitted within such period (or, where such information is required periodically, within such periods) and in such manner as the Monetary Authority may require.”

- 1.2.5 Accordingly, information relating to recovery and resolution planning can be required to be provided under §63(2) of the Banking Ordinance.

1.3 Scope and coverage

- 1.3.1 This module sets out the key elements of an effective recovery plan, and describes the HKMA’s expectations with regard to AIs’ recovery planning practices. The HKMA’s approach to, and expectations in, the supervisory assessment of recovery plans is also outlined.
- 1.3.2 This module draws primarily on the FSB’s work on recovery and resolution planning, including (i) the Key Attributes and (ii) the guidance on recovery and resolution planning² issued by the FSB, drawing on experience gained to date in relation to global systemically important banks (“G-SIBs”). In particular, the FSB guidance on recovery triggers and stress scenarios³ is of most relevance to this module.
- 1.3.3 In addition, the FSB, jointly with the other standard-setting bodies, is in the process of extending its sector-specific guidance on the Key Attributes to cover a wider range of market participants in the financial sector, including financial market infrastructures, insurance companies and other non-bank financial institutions that

² https://www.financialstabilityboard.org/press/pr_130716.pdf

³ http://www.financialstabilityboard.org/publications/r_130716c.pdf



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are not part of a banking group⁴. Accordingly, an AI that performs any role in market infrastructure or undertakes activities in financial sectors other than banking should ensure that relevant international developments are taken into account when preparing its recovery plan.

1.3.4 A recovery plan may be seen as an overarching plan for dealing with severe stress events that pose risks to an AI's viability. While this module on Recovery Planning is a new module in the Supervisory Policy Manual ("SPM"), some aspects of recovery planning have already been outlined in other modules. Accordingly, this module should be read in conjunction with other relevant modules , including -

- CA-G-5: Supervisory review process;
- CG-1: Corporate governance of locally incorporated authorized institutions;
- IC-1: General risk management controls;
- IC-5: Stress-testing;
- LM-2: Sound systems and controls for liquidity risk management;
- RR-1: Reputational risk management; and
- SR-1: Strategic risk management.

1.4 Application

⁴ For example, the Committee on Payment and Settlement Systems (CPSS) and the International Organization of Securities Commissions (IOSCO) have recently issued a consultative document on the recovery of financial market infrastructures: <http://www.bis.org/publ/cpss109.pdf>.



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- 1.4.1 All AIs are expected to develop and maintain a recovery plan commensurate with the nature, scale and complexity of their operations.
- 1.4.2 The guidance set out in this module applies to all AIs in a proportionate manner, having regard to their size, structure and business mix and the systemic risks associated with their activities. Recovery planning naturally lends itself to a proportionate approach, in that for smaller AIs with relatively fewer and simpler business lines, the recovery options will likewise tend to be less complex and potentially easier to implement.
- 1.4.3 Recovery plans are to be prepared and “owned” by AIs. Accordingly, it is the responsibility of each AI to devise and propose what it considers to be the optimal approach for covering its operations and related entities in its recovery plan, taking into account the critical functions it provides (i.e. functions which, if disrupted, would likely have a material adverse impact on the financial stability in Hong Kong – see paragraph 1.1.5). The proposed approach should then be discussed and agreed with the HKMA.
- 1.4.4 Although the exact form of recovery plan will vary from AI to AI, the recovery plan should always cover how risks posed to local operations would be contained following a shock. Such risks are not necessarily limited to risks arising locally; for an AI that is part of an overseas group, the HKMA has a legitimate concern with regard to the effects on the AI of actions taken by other entities within the same corporate group as the AI, wherever those actions might be taken. An AI’s recovery plan should therefore take into account the wider business of the group of which the AI is a member.
- 1.4.5 Set out below are some stylised examples of how the HKMA envisages that recovery planning may be undertaken for different groups of AIs. As noted in paragraph 1.4.3, an AI should discuss with, and seek agreement from, the HKMA with regard to the approach it proposes to adopt in all cases. This should occur in the



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early stages of the AI's recovery planning. The optimal approach for each AI will clearly depend upon its individual circumstances, so the examples provided below are for reference only.

Application to locally-incorporated AIs

- 1.4.6 The HKMA expects a locally-incorporated AI to undertake recovery planning on a group basis and, generally speaking, to produce one single plan. It follows that the recovery plan for a local banking group should take account of an AI's downstream operations, including local as well as overseas operations in the AI's subsidiaries and branches. Consistent with a proportionate approach to recovery planning, the extent of application to the AI's subsidiaries and branches should be commensurate with the materiality of those entities or operations to the AI's group, and with the risks those operations and entities pose to financial stability in Hong Kong.
- 1.4.7 The HKMA recognises however that a centralised, single group plan approach may not suit all locally incorporated AIs. In some cases, it may be more appropriate for a locally incorporated AI to conduct recovery planning also at the individual entity level alongside a group plan, if the entity in question has a high degree of financial and operational independence, as well as being systemically significant or critical to financial stability in Hong Kong in its own right, for example.
- 1.4.8 Some locally-incorporated AIs which are members of overseas groups may have been involved in recovery planning at group level, in response to requirements set by the group's home regulator. Where appropriate, locally incorporated AIs may draw on the recovery plan developed by their parent holding company at group level, although they will nonetheless be expected to meet the standards in this module in respect of their operations in Hong Kong.



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- 1.4.9 To be clear, even if a recovery plan has been developed at a group-level, the HKMA envisages that it will still be necessary in most cases for locally-incorporated AIs within the group to develop a local recovery plan alongside the group-level plan, in order to supplement the group plan and to ensure the local aspects are covered in sufficient detail. Such a local plan should be centred on the local operations of the AI in Hong Kong, but should be drawn up in a manner coherent with the group plan. The interaction and dependencies between the group-level and local-level plan should be detailed in the AI's recovery planning submission, including any instances where the activation of group recovery options may potentially render some options unavailable at local-level, or vice versa. The treatment of the AI's operations in the group plan should be summarised in the AI's local recovery planning submission.
- 1.4.10 For some locally-incorporated AIs which are members of an overseas group, recovery planning will not only involve looking "upwards" to the holding company, but also "downwards" to cover the subsidiaries and branches of the AI, in a manner commensurate with the materiality of those entities and operations to the AI's group, and with the risks those operations and entities pose to financial stability in Hong Kong.

Application to overseas-incorporated AIs

- 1.4.11 An overseas-incorporated AI with branch operations that are significant in the context of the operations of the banking sector in Hong Kong (this includes any AIs providing significant or critical functions in Hong Kong) will be required in most cases to prepare a local recovery plan in respect of its Hong Kong operations alongside its group plan. As with locally-incorporated AIs which are members of an overseas group, an overseas-incorporated AI may draw on its group level recovery plan as appropriate.
- 1.4.12 For AIs operating as foreign branches with limited operations locally in the context of the wider group, the



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HKMA is mindful that the recovery options that could be executed in respect of the branch itself may be somewhat restricted. While recovery planning for such AIs will inevitably have to rely considerably on group level planning and actions, it is essential that the AI demonstrates to the HKMA how the local Hong Kong aspects have been thoroughly considered and incorporated in the recovery planning process. This should include, but is not limited to:

- demonstrating how recovery actions at the group level may be triggered by the occurrence of severe stress events in Hong Kong;
- describing the process for activating the recovery plan for the AI, specifying the local Hong Kong management's role and involvement in the recovery planning process; and
- illustrating how the recovery options are expected to restore the financial soundness and viability of the operations in Hong Kong.

1.5 Implementation

1.5.1 In implementing the recovery planning standards in this module, a phased approach will be adopted with priority given to those AIs that are more systemically significant or critical in Hong Kong.

1.5.2 The HKMA will request initial recovery planning submissions from the first "wave" of the most systemically significant and critical AIs within 6 months of the final issuance of this module. Submissions should be made to the HKMA electronically. Individual AIs will be informed of the "wave" to which they have been ascribed, and will then be expected to discuss and agree a detailed timeframe for submitting recovery plans during the early stages of their recovery planning. The main

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practical implication to AIs for being in one “wave” or another relates only to timing.

- 1.5.3 AIs are welcome to start developing their recovery plans within an earlier timeframe, if they so wish but, in such cases, it would be advisable for them to contact the HKMA to discuss their proposed scope and approach to recovery planning prior to committing significant resources to the project.

2. Recovery planning

2.1 General

- 2.1.1 Recovery planning involves the identification of, and planning for the deployment of, a menu of recovery options which an AI could reliably execute when under severe stress to restore its financial strength and viability. Paragraph 1.5 of Annex III of the Key Attributes notes that:

“The recovery plan should include measures to reduce the risk profile of a firm and conserve capital, as well as strategic options, such as the divestiture of business lines and restructuring of liabilities.”

- 2.1.2 A recovery plan should:

- form an integral part of an AI’s risk management framework;
- identify and explain how the AI will monitor the need to trigger recovery actions;
- set out a full menu of recovery options;
- assess the impact and probable success of the recovery options;



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- identify the key steps and milestones in implementing the recovery options and the key management personnel involved in activation and decision-making; and
- map out a communication strategy to support the deployment of the recovery options.

2.1.3 To provide an overall context for the recovery plan, an AI should include some background information and analysis in its recovery plan. Such information should usefully serve to reflect the appropriate coverage and granularity of the recovery plan, as well as to put the key elements of the recovery plan, such as governance arrangements, recovery options and trigger framework, into perspective.

2.1.4 The background information and analysis required in a recovery plan will share some commonalities with the information and analysis the HKMA intends to collect for resolution planning purposes (see paragraph 1.1.6). However, the detail and depth of the background information and analysis expected for recovery planning purposes will be more high-level in comparison with that required for resolution planning. For recovery planning purposes, an overview of the AI's group structure, core business lines, significant legal entities, key financial information and risk profile are expected to be included as background information and analysis at a minimum.

2.1.5 An AI should produce a compact and succinct summary in the first chapter/section of its recovery plan, capturing the key elements as described in paragraph 2.1.2. In summarising the recovery options, the AI is expected to produce an overview table setting out the AI's complete menu of recovery options, including at a minimum the various factors listed in the illustrative template in the Annex to this module. The illustrative template can be expanded to capture any additional information which the AI considers useful.



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2.1.6 The summary should also highlight any material changes to an AI and its recovery plan since its previous recovery planning submission. The key elements of the recovery plan should then be further elaborated in the remainder of the plan in line with the guidance provided in this module.

2.2 Governance structure and oversight

2.2.1 A recovery plan is a management tool developed and owned by an AI to help manage its business and restore its viability in the event of severe stress. In order for the recovery plan to be actionable at the appropriate senior management level in the event of severe stress occurring, it is vital that the recovery plan is fully integrated into the AI's overall governance and risk management framework, from planning to execution, including:

- the development, review, approval, and ongoing maintenance of the recovery plan;
- the monitoring process for triggering the recovery plan; and
- the activation of the recovery plan.

Development, review, approval, and ongoing maintenance of a recovery plan

2.2.2 Responsibilities for the development, review and approval and for the ongoing maintenance of an AI's recovery plan should be clearly assigned within the AI. In particular, the AI should officially designate a key member of its senior management (e.g. from the risk or finance areas) with the responsibility for delivering an effective recovery plan, and to act as a key point of contact with the HKMA.



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- 2.2.3 An AI's Board is expected to review and approve the AI's recovery plan at the time of its initial formulation, and thereafter at least on an annual basis. The HKMA considers it essential that all members of the AI's Board understand how the AI's recovery plan can be effectively deployed as a management tool to restore financial viability in a crisis.
- 2.2.4 To ensure that local specificities are taken into account in a satisfactory manner in the planning process, local senior management should always have a key role in the governance of recovery planning. This should also be the case for non-locally incorporated AIs, where the responsibility for the local recovery plan may be taken up jointly with group-level management as appropriate.
- 2.2.5 If there are significant changes to an AI's business operation or its group structure, or there are any other legal or structural changes which may impact the available recovery options, the recovery plan should be promptly updated. The HKMA would expect to be notified in advance of any material changes being made to the AI's recovery plan.

Monitoring process for triggering a recovery plan

- 2.2.6 An AI should establish an adequate monitoring process to support the operation of the trigger framework in its recovery plan (see recovery triggers discussion in subsection 2.4).
- 2.2.7 An AI should have reliable management information systems in place which enable management to monitor, in a timely fashion, a series of indicators which provide information of such a nature that they may credibly serve to prompt discussion of potential recovery action and, at certain pre-defined levels or points, to trigger activation of the AI's recovery plan. The monitoring process should be embedded within the AI's risk management framework. The status of the recovery triggers should be subject to frequent regular monitoring by the AI, with the full set of information readily accessible for management



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review. In addition, the AI is expected to minimise any time lag in the reporting of its management information as far as reasonably practicable, in order to allow senior management to react to any potential trigger events at the earliest opportunity.

Activating a recovery plan

- 2.2.8 A trigger event should lead to the activation of the recovery plan, with some form of action being immediately required. However, it should not necessarily lead to an automatic deployment of the recovery options within the plan. Instead, there should be a clear process, for escalation, upon the occurrence of any trigger event to senior management to assess the scale of the threat to the AI's viability, and to agree on an appropriate course of action (see further details regarding the respective roles of the Board and senior management in paragraph 2.4.4).
- 2.2.9 The decision making mechanism for determining the appropriate course of action should be clearly and comprehensively documented in the plan, including the identity of the individuals who will be involved in the process, the level of authority for deciding upon and initiating recovery actions, and any guiding principles or strategies for driving decision making in a crisis.
- 2.2.10 Once the appropriate course of action has been decided upon, individual member(s) of senior management should be assigned responsibility for ensuring that the selected recovery options are implemented as soon as practicable, with progress being regularly reported to the Board or the relevant Board committee of the AI.
- 2.2.11 An AI should alert the HKMA promptly of the occurrence (or expected occurrence) of a trigger event, and provide an explanation of why the event occurred (or is considered likely to occur), the management actions the AI has already taken and intends to take, including both planned actions drawn from its recovery plan and any other recovery actions deemed desirable in the



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circumstances. The process for issuing this notification alert to the HKMA should be documented in the recovery plan.

- 2.2.12 In establishing the process for notifying the HKMA, an AI should have regard to any relevant statutory reporting requirements under the Banking Ordinance, for example §67 “Duty to report inability to meet obligations”, §103 “Failure to keep to liquidity ratio”, or prescribed notification requirements under the Banking (Capital) Rules, for example §3D “Authorized institutions must notify Monetary Authority of failure to have minimum capital adequacy ratio”.

2.3 Menu of recovery options

2.3.1 The main contribution of recovery planning towards improving an AI’s resilience, should be in ensuring that the AI identifies and develops, to a sufficient degree, a full set of material and feasible recovery options that could play a substantive role in preserving or restoring liquidity and capital levels (and thereby going concern viability ultimately).

2.3.2 The menu of recovery options should include options that would not normally be considered in other circumstances when risks to viability are low to moderate, for instance options that may have permanent structural or strategic implications. This could include, but is not limited to:

- selling or disposing of part (e.g. business units or subsidiaries) or all of an AI’s business and assets;
- issuance of capital instruments at short notice;
- measures to secure additional liquidity from existing or new sources;



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- debt exchanges and voluntary restructuring of liabilities;
- lowering or suspending dividends and payment of variable remuneration; and
- restricting new business activities.

2.3.3 The menu of options should be sufficiently diverse to deal with a full range of possible crisis situations. In order to maintain flexibility, the individual options should not be prioritised or ranked, as the selection of the most appropriate option will vary depending upon the type and severity of the stress being experienced.

2.3.4 The menu of options would vary among AIs, but as noted in paragraph 2.3.1 above, it should always include options for addressing capital and liquidity shortfalls. In determining its liquidity related recovery options, an AI should refer to the guidance in LM-2 “Sound systems and controls for liquidity risk management” on the development and maintenance of contingency funding plans for dealing with various types of liquidity crisis. The AI should examine whether its contingency funding plan is sufficient for recovery planning purposes, and review the need for developing more substantive options for deployment when under very severe stress.

2.3.5 On capital planning, the guidance in CA-G-5 “Supervisory review process” sets out the HKMA’s expectation that an AI’s capital plan should cover, among other things, a general contingency plan for dealing with divergences and unexpected events (e.g. raising additional capital, restricting business activities or using risk mitigating techniques for risk management purposes, etc). Similarly, an AI should make use of its capital contingency planning for devising recovery options as appropriate.

2.3.6 Inevitably, some form of disposal option, involving the disposal of part or even all of an institution or its assets, should be included within an AI’s recovery plan. If



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inclusion of a disposal option has been considered but dismissed by the AI, a clear explanation should be given in the summary in the first chapter/section of its recovery plan. Please see subsection 2.8 for further details on the level of planning expected in relation to disposal options.

- 2.3.7 The focus of recovery options should be on actions that an AI itself (or other entities within its group) can take directly. If the execution of any recovery option relies on other entities within the group, the conditions for execution – especially any conditions that are not within the direct control of the AI – should be specified in the recovery plan.

2.4 Recovery triggers

- 2.4.1 An AI should be able to demonstrate that it is able to identify when it needs to implement the recovery options detailed in its recovery plan. To support this process, the AI should develop and maintain a trigger framework (which should be fully embedded within the AI's risk management framework), to prompt recovery action in a timely manner.
- 2.4.2 Recovery triggers should be well defined and tailored to the full range of risks faced by an AI. The threshold level for triggers should be calibrated appropriately and set out clearly in the AI's recovery plan.
- 2.4.3 Triggers should comprise a mix of qualitative and quantitative metrics that are most relevant to an individual AI. The set of triggers may be based on internal early warning indicators ("EWIs") used by AIs in their existing risk management frameworks. In identifying suitable indicators for the purposes of developing recovery triggers and data sources for tracking events that may trigger its recovery plan, the AI should consider the intrinsic characteristics and qualities of the indicators that facilitate close monitoring of an evolving situation,



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such as their tractability, sensitivity and forward looking capability.

2.4.4 Generally speaking, triggers should not be aligned with automatic deployment of recovery actions. However, a trigger event should always be brought to the attention of an AI's Board, which should also be informed of the corresponding course of action determined by senior management and/or the relevant Board Committee (see further details in paragraphs 2.2.8 - 2.2.10). The main use of stress scenarios in the context of recovery planning is to ensure that an AI has considered thoroughly how different types of shock may threaten its ongoing viability. This should, in turn, ensure that the AI's planned recovery options are both realistic and far reaching enough to deal with the problems it may encounter.

2.4.5 An AI may wish to refer to the FSB guidance (referred to in paragraph 1.3.2) for examples of recovery triggers, which have been developed based on the recovery planning experience of the G-SIBs, as they are the first group of institutions to be formally designated under the FSB's framework for systemically important financial institutions ("SIFIs"), and as a result are, as a group, comparatively more advanced in the area of recovery and resolution planning. Some generic examples of triggers include:

- rating downgrade (or the expectation of a downgrade);
- widening of CDS spread;
- fall in share price;
- substantial or sustained withdrawal of deposits;
- early redemption of liabilities by counterparties;
- difficulty in obtaining funding or raising capital;



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- fall in regulatory capital and liquidity ratios; and
- negative press coverage.

2.4.6 The list of trigger events in paragraph 2.4.5 may be considered for reference, but it is possible that some of the items are not the most relevant to individual AIs. It is important that an AI tailor its recovery plan triggers to suit its own business and operations, and to allow it to capture the range of stress events of differing nature that might pose significant threat to its viability.

2.5 Impact

2.5.1 A recovery plan should conservatively estimate how far each recovery option might help restore an AI's financial soundness and viability. This includes an estimation of its impact on the AI's capital and liquidity position as well as on the AI's profitability, franchise value and, where relevant, rating.

2.5.2 When assessing impact, it is important that an AI takes a longer term perspective on viability and does not focus purely on dealing with the immediate stress situation, but looks to ensure that the longer term stability of the institution is not being jeopardised by any short-term "quick-fix". For instance, the sale of certain operations perceived by the market as "core" business at a heavily discounted price may alleviate some of the immediate stresses faced by the AI, but could have damaging effects to the AI's longer term viability, and therefore may not be the most effective recovery option for the AI.

2.5.3 In addition to estimating the potential benefit of each recovery option, an AI should also consider any side effects, or risks of disruption to its normal business operations and services, that might be brought about by the deployment of the recovery options. To the extent operations are impacted, the AI should outline how the



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continuity of its operations may be maintained while recovery actions are being implemented, for example:

- dealing room operations, including trade booking practices, hedging strategies, custody of assets;
- payment, clearing and settlement systems; and
- key management information systems, including accounting, position keeping and risk systems.

2.5.4 It is important that any additional external requirements to which an AI may potentially become subject in order to maintain its membership of any clearing and settling systems, or other financial market infrastructure, should be assessed and factored into the AI's recovery plan (for example, the plan might need to consider how to pre-fund or collateralise positions and the potential constraints on total payment flows this might create).

2.5.5 The interdependencies and interactions between recovery options, as well as any anticipated impact on the resolvability of an AI (and resolution planning, as described in paragraph 1.1.5) should be considered and set out in the recovery plan. In particular, if the execution of a particular recovery option would render any other options unavailable, or is expected to have implications for any resolution strategy devised by the resolution authority, this should be stated clearly in the recovery plan.

2.5.6 For an AI that is part of a wider banking group, impact considerations should include any effects due to its intra-group connections, the effect on the AI of a recovery plan being triggered in other parts of the group, and any other interdependence that may give rise to spillovers.

2.6 Stress scenarios



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- 2.6.1 An AI should test the effectiveness, impact and feasibility of its recovery plan against a range of stress scenarios, including idiosyncratic and market-wide scenarios, as well as a combination of both. AIs should refer to IC-5 “Stress-testing” for a description of general requirements and practices in stress testing.
- 2.6.2 The main purpose of stress scenarios and stress testing in the context of recovery planning is to ensure that an AI’s planned recovery options are both realistic and far-reaching enough to deal with a wide range of problems which it may encounter.
- 2.6.3 The scenarios should be tailored to an AI’s risk profile, reflecting the nature of the regulatory capital and liquidity requirements that are particular to the AI. It is necessary for the AI to test the adequacy of its recovery plan against a range of stress scenarios, as the availability and the suitability of its recovery options may shift depending on the nature of the stress actually encountered. In a market-wide scenario, for example, the AI should consider its recovery options in light of the fact that more than one institution may be seeking to implement similar recovery actions at the same time under stressed market conditions, making it more difficult to secure additional liquidity or capital.
- 2.6.4 On the other hand, in an idiosyncratic scenario, an AI may find that some recovery options may pose a threat to its reputation (e.g. a suspension of dividend payment). To ensure that the recovery plan remains relevant under a variety of circumstances, an AI should therefore, as mentioned in paragraph 2.6.1, test its recovery plan against three types of scenario at a minimum: an idiosyncratic scenario, a market wide scenario and a scenario with a combination of both components. AIs are encouraged to adopt more than one scenario within each of the three scenario types, as there may be a need, for example, to test responses to both fast and slow-moving events within a scenario type particularly for larger or more complex AIs.



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- 2.6.5 An AI may consider leveraging on the scenarios (as well as the impact analysis of those scenarios) developed under its existing stress testing programme as appropriate. However, the scenarios suitable for recovery planning purposes will generally be of a particularly severe nature and perhaps in most cases more severe than some of the scenarios typically used under existing stress testing programmes for assessing capital and liquidity needs. The relevance and applicability of existing stress test scenarios for the purposes of recovery planning will therefore need to be carefully considered and evaluated.
- 2.6.6 Given the severity of events to be planned for within the context of recovery planning, only some of the scenarios in an AI's existing stress testing programme are likely to be suitable for recovery planning purposes. Generally speaking, reverse stress testing scenarios, particularly those linked to specific incidents that are related to the AI's recovery triggers in its recovery plan can be a useful starting point for developing scenarios for recovery plans.
- 2.6.7 An AI should address any shortfalls in its recovery plan identified from testing the plan against stress scenarios. This exercise should, in turn, strengthen the credibility and the robustness of the AI's recovery framework.

2.7 Credibility of recovery options

- 2.7.1 Effective testing of an AI's recovery plan against appropriate stress scenarios as described in subsection 2.6 should form a significant input to assessing the credibility of the AI's recovery plan. In addition, the AI should focus on, and adopt, the following elements to strengthen the credibility of its recovery plan.
- 2.7.2 Timeliness of execution is a key factor for the successful deployment (and hence credibility of) the recovery options. To this end, an AI should conservatively



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estimate the timeframe within which each recovery option can be implemented and take effect, and assess whether the AI's viability could be effectively restored given the time needed.

- 2.7.3 An AI should invest sufficient effort in preparing for the options and undertake advance planning as necessary. This includes proactively identifying any obstacles and risks to executing each of the recovery options, and taking actions to enhance the readiness of options accordingly.
- 2.7.4 The period for any recovery option to take effect should obviously not be so long or protracted as to effectively lose the benefits of implementing the option to achieve recovery. The HKMA however recognises that some of the more complex and substantive recovery options (e.g. full disposal) would require a longer timeframe to take full effect. In order to ensure a recovery action delivers the desired impact of restoring a bank's viability in a timely manner, the HKMA is of the view that no recovery option should take any longer than 6 months to take effect. However, the HKMA envisages the timeframe to be considerably shorter for most options, so that the AI is well equipped in dealing with fast-moving stress events.
- 2.7.5 An AI may outline any "work-in-progress" recovery option that is not yet fully developed, or does not yet meet the 6 months timeframe, in its recovery plan. Any such "work-in-progress" option should be accompanied with a plan for further developing the option to ensure that it could be readily deployed as an effective recovery tool in future.
- 2.7.6 A credible recovery plan should not only focus on the successful execution of the individual recovery options, but also on an AI's overall recovery capacity. An AI would benefit from taking a wider view in assessing its ability to maintain continuity of its day-to-day operations while recovery options are being implemented more generally (e.g. in terms of staffing and resourcing).



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2.7.7 Last but not least, an AI's track record in implementing recovery options, or the possession of relevant experience and expertise in doing so, may serve as useful indicators to the credibility of its recovery options. In particular, an AI should document any relevant "lessons learned" in implementing recovery options from past experience to improve the credibility of its options.

2.8 Disposal options

2.8.1 As mentioned in paragraph 2.3.6, options involving disposal of a part, and/or the whole of an AI or its business or assets are generally expected to be included in all AIs' menus of recovery options.

2.8.2 The availability, feasibility and value of disposal options could vary significantly depending on the prevailing market conditions at the time the need to activate the disposal option occurs. Whilst it is recognised that the effect of disposal may carry more uncertainty when compared to other options, an AI is nonetheless expected to plan ahead in order to ensure that a disposal is feasible. This should include, at a minimum:

- possible options for disposal, specifying which part of the (or the entire) AI or its business or assets may be considered for disposal/sale;
- decision making process for determining disposal options;
- process for determining the value of a disposal option;
- due diligence information necessary for the disposal, and the expected time for retrieving the information necessary for executing the disposal;



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- operational issues (e.g. staff, infrastructure issues);
- any legal or regulatory issues (e.g. requirement for approval/change of control);
- profile of potential purchasers and local market capacity;
- worst case scenario whereby the disposal option is no longer desirable or helpful; and
- for partial disposal options, a feasibility assessment of separating the part intended for disposal from the rest of the AI's operations, with an analysis of the anticipated impact of the disposal on the remaining entities in the AI's group.

2.8.3 In making any assumptions around marketability within its disposal options, an AI should be mindful that, in all likelihood, the disposal will take place under unfavourable conditions when the AI is likely to be pressured to conduct a "fire sale". Therefore any assumptions should be made in an extremely conservative manner.

2.9 Eligibility for central bank facilities

2.9.1 Although an AI should not assume that any public support will be forthcoming for the purpose of its recovery planning, the HKMA may be able to provide liquidity support to locally incorporated AIs experiencing funding difficulties on a short-term basis. In particular, the HKMA may act as a Lender of Last Resort in accordance with the *Policy statement on the role of the Hong Kong Monetary Authority as a Lender of last resort* ("the LOLR policy statement")⁵. It would assist the HKMA in fulfilling its role as a LOLR if an AI could include

⁵ <http://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2009/lolr.doc>



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information in its recovery plan to facilitate an initial assessment of its eligibility for LOLR support. In particular, a locally incorporated AI should:

- give consideration to the circumstances in which it may require access to LOLR support;
- undertake and maintain a stocktake of its collateral eligible for LOLR, along with an analysis of its potential drawing capacity;
- estimate the time required to prepare relevant documentation for the HKMA to carry out any due diligence examination; and
- outline the steps the AI would take before requesting access to LOLR (e.g. how it may go about using its liquidity related recovery options to seek funding from other sources before seeking LOLR support, and how it will estimate the level of liquidity support needed).

2.9.2 The preparation outlined above is intended to help both the AI and the HKMA plan ahead and prepare for a swift application for, and decision-making on the provision of, LOLR support respectively. However, an AI should note that this preparation in and of itself should not be regarded as any form of “ex-ante” application for, or approval of, LOLR support. In view of the nature of LOLR support, any decision on its provision to an AI will necessarily have to be made when the given situation arises, with due consideration to the AI’s potential impact on system-wide stability, and will be subject to the AI’s satisfactory fulfilment of the pre-conditions as set out in the LOLR policy statement.

2.9.3 As noted in the LOLR policy statement, it would not normally be the policy of the HKMA to provide LOLR support to branches of foreign banks operating in Hong



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Kong⁶. This recognises the fact that the liquidity of a branch cannot readily be divorced from that of the bank as a whole.

2.9.4 It would therefore be strongly advisable for an AI which is a foreign bank branch to identify liquidity facilities provided by other overseas central banks for which it may be eligible, and consider the conditions for accessing those facilities as appropriate.

2.10 Communication plan

2.10.1 Managing communications, both internally and externally, will be a key element to the successful implementation of recovery planning.

2.10.2 A communication plan should be devised to accompany the deployment of the recovery options in an AI's recovery plan. The communication plan should recognise that there will be differing communication needs, depending on the specific action to be taken, with regard to the audience for communication; the detail and timing of information to be provided to stakeholders; and the level and form of communication among other things.

2.10.3 The communication strategy to accompany the deployment of each of the recovery options should include, at a minimum:

- the identification of key stakeholders which may vary under each recovery option;
- the strategy or approach to communication, including the preferred channel and form of communication; and
- the assignment of the personnel responsible for communication.

⁶ There are, however, two circumstances where the HKMA might provide financial assistance to a branch with funding problems. See details in the LOLR policy statement.



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2.10.4 Given that the deployment of a recovery option could itself potentially pose a threat to an AI's reputation, an AI should refer to the guidance on reputational risk management in RR-1 "Reputational risk management", and assess whether any action needs to be taken to address such risks.

2.10.5 In considering disclosure of information with regard to the deployment of an AI's recovery plan, the AI should be mindful of any provisions contained in law, regulations or listing rules regarding the disclosure of unpublished price sensitive information (or "inside" information) (such as, for example, Part XIVA of the Securities and Futures Ordinance) which may be applicable to them in the relevant circumstances.

3. Supervisory assessment of recovery plans

3.1 General

3.1.1 This section sets out the HKMA's approach to, and expectations in, reviewing AIs' recovery plans.

3.2 Assessment approach

3.2.1 The HKMA will review, on a regular basis, the effectiveness and credibility of an AI's recovery plan, and the extent to which the plan reflects and is aligned with the guidance in this module, during its off-site reviews and/or on-site examinations of the AI. In conducting its review, the HKMA will have regard to the following:

- the degree of integration of the recovery planning process into the AI's risk management framework;
- the robustness of the AI's governance framework, including the level of understanding and involvement of the AI's senior management in the recovery plan;



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- the clarity of the escalation process and decision making mechanism upon trigger of a recovery plan, and the communication plan with stakeholders, including the HKMA;
- the capability of the AI's management information system to enable timely monitoring of recovery triggers, and to provide full sets of information in a timely manner;
- the appropriateness of recovery triggers, stress scenarios and recovery options developed in respect of the recovery plan;
- the credibility of the assumptions underpinning the recovery plan;
- the comprehensiveness of the recovery plan, in particular whether a suitably broad range of recovery options has been considered;
- the execution readiness and feasibility of each recovery option; and
- whether the recovery planning process is adequately resourced by the AI in terms of staffing and expertise, with sufficient Board and senior management ownership and oversight.

3.2.2 The HKMA will expect AIs to submit their recovery plans for its review regularly, and whenever the HKMA deems it necessary. In reviewing and interpreting individual AIs' plans, the HKMA will be mindful of the need to take into account the nature, scale and complexity of the AI's operations, and to take a proportionate approach to the review.

3.2.3 In order to arrive at a comprehensive assessment of an AI's recovery planning, the HKMA may request additional information from the AI where the HKMA deems it necessary.



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- 3.2.4 Board and senior management understanding is essential to an AI's recovery planning process, as the AI has to be able to utilise the plan swiftly and effectively to manage a crisis situation. As part of the supervisory assessment process, the HKMA will therefore engage in discussion with the Board and/or senior management on the AI's recovery planning, and the policies and processes supporting it.
- 3.2.5 The HKMA may ask to see additional materials to help gauge the level of Board and senior management understanding of the recovery plan and of the degree of its integration into an AI's risk management framework. This may include, for example, relevant materials presented to the AI's Board for the review and sign off of the recovery plan, or in respect of information for monitoring the status of the AI's trigger framework.
- 3.2.6 The HKMA will review the execution readiness and the feasibility of each recovery option. For any recovery option that has not been fully developed such that it could be readily deployable (i.e. a "work-in-progress" recovery option as referred to in paragraph 2.7.5), an AI will be asked to present a development plan for conducting the further work necessary to ensure that the recovery option could be readily deployed in future.
- 3.2.7 To ensure that an AI's recovery plan is comprehensive, the HKMA may ask the AI to test its recovery options against scenarios determined by the HKMA. The AI may also be requested to explore additional recovery options not considered in its original recovery plan submission, if its menu of recovery options is assessed to be incomplete.
- 3.2.8 AIs that are members of overseas banking groups should be prepared to submit the relevant sections of their group level recovery plan to assist the HKMA's assessment of recovery planning in relation to their Hong Kong operations. In any case, the envisaged effect of planned actions at the group level on local operations



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should have already been summarised in the AI's own recovery plan submission.

3.3 Actions following supervisory assessment

- 3.3.1 Following the HKMA's review of an AI's recovery plan, any shortfalls and gaps identified should be addressed by the AI in a timely manner. The AI should set out a remedial plan to lay out the necessary remedial actions along with an indicated timeframe for their completion.
- 3.3.2 The HKMA will maintain an ongoing dialogue with the Hong Kong banking industry on recovery planning practices, and will update this guidance as appropriate.



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Annex: An illustrative template summarising factors to be assessed in relation to the recovery options

Recovery option	Brief description	CET1 impact	RWA impact	Liquidity impact	Other impact	Timing to realisation of benefits	Risks/hurdles to implementation	Ownership within AI
Option 1								
Option 2								
...								

Estimation of impact under various scenarios (firm-specific, market wide stress, combination...)

Any other expected impact from deploying the option, (e.g. balance sheet, franchise value, rating etc.) may be included as relevant

What are the key risks? Circumstances under which the option might become too risky/difficult to deploy?

Who (or which area) is responsible for deploying this option? Who needs to be involved?