ALERT MEMORANDUM

OCC Finalizes Guidelines for Recovery Planning

October 13, 2016

On September 29, 2016, the Office of the Comptroller of the Currency ("OCC") adopted final guidelines[1] ("Final Guidelines") establishing recovery planning standards for insured national banks, insured Federal savings associations, and insured Federal branches of foreign banking organizations ("FBOs") with average total consolidated assets of $50 billion or more ("Covered Banks"). While the Final Guidelines incorporated some changes and clarifications in response to comments received on the Proposal, the OCC principally adopted the guidelines as proposed.

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The Final Guidelines are generally consistent with the recovery plan guidelines issued by the Board of Governors of the Federal Reserve System ("Federal Reserve") in 2015.[2] While the Federal Reserve's guidelines applied only to the eight largest U.S. bank holding companies, the Final Guidelines apply more broadly to institutions at a much lower threshold of asset size. As shown in Appendix A to this memorandum, only six of the 23 banks that meet or exceed the $50 billion threshold are owned by holding companies currently subject to Federal Reserve's recovery planning requirements. As a result, the Final Guidelines affect more institutions and, accordingly, could have a greater supervisory impact going forward.

[1] 81 Fed. Reg. 66,791 (Sept. 29, 2016). The Final Guidelines will be an appendix to the OCC's safety and soundness regulations. 12 C.F.R. pt. 30. The OCC issued the proposed guidelines in December 2015 (the "Proposal"). 80 Fed. Reg. 78,681 (Dec. 17, 2015).

[2] Federal Reserve SR Letter 14-8 (Sept. 25, 2015) (Consolidated Recovery Planning for Certain Large Domestic Bank Holding Companies) ("SR Letter 14-8").

Overview

Under the Final Guidelines, Covered Banks are required to create and maintain recovery plans that detail the Covered Bank's strategy for remaining a going concern while experiencing severe stress. The recovery plans must:

- include a detailed description of the Covered Bank's organizational and legal structure, which includes identifying material entities, critical operations, core business lines, and core management information systems;
- provide a detailed discussion of stress triggers, i.e., quantitative or qualitative indicators of the risk of severe stress, which must be escalated to senior management or the board of directors to initiate a response;
- include credible options the Covered Bank could undertake to restore its financial strength; and
- be integrated into the Covered Bank's existing corporate governance and risk management functions.

Key Takeaways

Extension of Formal Planning Processes. The Final Guidelines continue a trend of requiring formal planning processes as a means of implementing risk management frameworks designed to survive a variety of stress scenarios.

- While the Comprehensive Capital Analysis and Review (CCAR) and Dodd-Frank Act Stress Test (DFAST) are obvious examples of this regulatory focus, resolution planning and, now, bank recovery planning similarly incorporate scenario-based planning processes to achieve the stated supervisory goal of improving resiliency before resolution is necessary.
- Resolution planning ostensibly is designed to achieve an orderly solution to the problems created by the insolvency of a large, complex financial institution. However, as resolution planning has evolved, it has required significant restructuring of internal and external interconnections, along with legal entity "rationalization" and pre-planning of capital and liquidity support in an effort to prevent, as well as simplify, any future resolution. The recently released Public Sections for the October 1, 2016 resolution plan submissions by the largest U.S. domestic financial institutions simply confirm this evolution towards mandatory restructuring.[3]
- The Final Guidelines create another mandatory planning process that likely will lead to further restructuring of interconnections, legal entities and internal financial support. As with Resolution Planning Requirements, the Final Guidelines will also lead to additional compliance projects and costs.
- Fortunately, Covered Banks should be able to incorporate many elements of their resolution plans into their recovery plans. While the OCC cautions filers that recovery plans must comply with the Final Guidelines, and that resolution plans are unlikely to meet those requirements, the OCC's recognition that filers should leverage their resolution plans to ensure alignment and consistency is a positive development.
- Given the restructuring required by resolution planning, it will be helpful for the OCC to work closely with the Federal Deposit Insurance Corporation ("FDIC") and the Federal Reserve to ensure that the recovery planning and resolution planning requirements are coordinated and that the inevitable efforts to mitigate potential obstacles are consistent. Otherwise, the OCC could place Covered Banks and their affiliates in the impossible position of mediating differing and conflicting requirements.

[3] These are available at https://www.fdic.gov/regulations/reform/resplans/.

Compliance Deadlines. The Final Guidelines are effective on January 1, 2017. In response to comments, the Final Guidelines include phased-in compliance dates for Covered Banks to develop and maintain recovery plans, based on a Covered Bank's total consolidated assets:[4]

- a Covered Bank with average total consolidated assets of at least $750 billion must comply within six months of the effective date, or July 1, 2017;
- a Covered Bank with average total consolidated assets greater than or equal to $100 billion but less than $750 billion must comply within 12 months of the effective date, or January 1, 2018;
- a Covered Bank with average total consolidated assets greater than or equal to $50 billion but less than $100 billion must comply within 18 months of the effective date, or July 1, 2018; and
- an institution with less than $50 billion in average total consolidated assets as of the effective date that subsequently becomes a Covered Bank either (i) by passing the $50 billion threshold or (ii) because the OCC, under its reserved authority, has determined that it is "highly complex or otherwise presents a heightened risk" that warrants the application of the Final Guidelines,[5] must comply within 18 months of becoming a Covered Bank.

Enforcement. To maintain maximum supervisory flexibility, the OCC issued the Final Guidelines under Section 39 of the Federal Deposit Insurance Act. Section 39 authorizes the OCC to prescribe safety and soundness guidelines as either regulations or guidelines.

- By issuing the recovery plan standards as guidelines, if a Covered Bank were to fail to meet the prescribed standards, the OCC retains the discretion to determine whether the institution must submit a remediation plan identifying the steps it would need to take to comply with the standards rather than initiate enforcement proceedings.[6]

Narrower Focus. The OCC limited the scope of recovery plans to a demonstration of how a Covered Bank would restore its financial strength and viability. The Proposal would have required recovery plans to address both financial and operational effects of the stress.

- This was in response to comments pointing out that the restoration of operational strength and viability already—and properly—is addressed in business continuity and other types of existing planning requirements.

Use of Single Plan? Although the OCC encourages Covered Banks to leverage existing processes and planning, the OCC stated that it is unlikely that a Covered Bank's resolution plan or a parent company's recovery plan could meet the requirements of the Final Guidelines.

- The OCC recognizes that many Covered Banks have developed resolution plans in compliance

[4] "Average total consolidated assets" are defined as the average total consolidated assets of the bank or the Covered Bank, as reported on the Covered Bank's Consolidated Reports of Condition and Income for the four most recent consecutive quarters. 81 Fed. Reg. at 66,800. If a Covered Bank were to drop below the $50 billion threshold, it must still comply with the Final Guidelines until the OCC specifically determines it is exempt. 81 Fed. Reg. at 66,800.

[5] The OCC indicated that it does not expect to use this authority frequently and does not intend to apply the Final Guidelines to community banks. *See* 81 Fed. Reg. at 66,793.

[6] *See* 12 U.S.C. § 1831p-1(e)(1)(A)(i)-(ii).

with Section 165(d) of the Dodd-Frank Act as well as the FDIC's resolution plan requirements (collectively, the "Resolution Plan Regulations").[7] The OCC encourages Covered Banks to ensure alignment and consistency between their recovery and resolution plans and to create a comprehensive framework for evaluating severe stress.

- While the Final Guidelines do not resolve the issue, the preamble to the Final Guidelines (the "Preamble") strongly implies that a Covered Bank likely will not be able to use its resolution plan to meet the recovery plan requirements. As noted above, recovery plans must meet the requirements of the Final Guidelines and resolution plans are prepared for different purposes under different standards.
- In a footnote in Preamble, the OCC states that a Covered Bank may use its parent's recovery plan as the Bank's plan if:
  - the parent's assets are substantially comprised of the assets of the Covered Bank (the OCC indicates 95% as a threshold); and
  - the parent's recovery plan satisfies the Final Guidelines.[8]
- This extremely high threshold for use of a parent's plan raises the question as to whether a Covered Bank could insist on using its parent's recovery plan as its own plan, if the first prong of the test were not met. Would the OCC consider permitting a Covered Bank whose assets were 94% of the parent's assets to use the parents plan, or is this 95% minimum intended to be a bright line?

Corporate Governance. In the Final Guidelines, the OCC provided greater flexibility to the corporate governance requirements set out in the Proposal.

- In response to comments, the OCC clarified that a Covered Bank's board is responsible only for "oversight" of the preparation of the plans and not for "developing" the plans.
- Similarly, the OCC clarified that the board's annual approval of the recovery plan need only address significant changes to the plan, rather than all changes.

Elements of the Recovery Plan

For purposes of the Final Guidelines, a "recovery plan" is a plan that identifies triggers and options for responding to a wide range of severe internal and external stress scenarios and for restoring a Covered Bank to financial strength and viability in a timely manner.

— The options should maintain the confidence of market participants.

— Recovery plans may not assume or rely on extraordinary government support. However, in response to a comment requesting clarification of how the prohibition would apply to a Covered Bank that is controlled by a foreign government, the OCC stated in the Preamble that there may need to be exceptions in such instances. The OCC did not incorporate this into the Final Guidelines but instead advises such a Covered Bank to consult with its OCC examiner.

— Where appropriate, recovery plans should be consistent with a Covered Bank's resolution plans and corporate governance and risk management processes.

— Recovery plans are to be specific to the unique characteristics of a Covered Bank, including its size, risk profile, activities, and complexity,

[7] 12 C.F.R. pt. 381 and pt. 243; 12 C.F.R. § 360.10.

[8] *See* 81 Fed. Reg. at 66,797.

including the complexity of its organizational and legal entity structure.

In response to comments, the OCC clarified that it does not expect that recovery plans will mirror the length or detail of resolution plans and requires only that the plan be sufficiently detailed to meet the requirements of the Final Guidelines.

Overview of Covered Bank

— The Final Guidelines require that recovery plans provide a detailed description of the Covered Bank's organizational and legal structure, including its material entities, critical operations, core business lines and core management information systems.[9] Like resolution plans, the recovery plans must describe the interconnections and interdependencies:

  - across business lines within the Covered Bank;
  - with affiliates in a bank holding company structure;
  - between a Covered Bank and its foreign subsidiaries; and
  - with critical third parties.[10]

— In the discussion of interconnections and interdependencies, Covered Banks need to assess whether disruptions of their identified interconnections or interdependencies would have a material impact on the funding or operations of the Covered Bank. These could include disruptions to:

  - relationships with respect to credit exposures, investments or funding commitments;
  - guarantees, including an acceptance, endorsement, or letter of credit issued for the benefit of an affiliate during normal periods, as opposed to during a period of stress; and
  - payment services, treasury operations, collateral management, information technology, human resources or other operational functions.

Triggers

— Under the Final Guidelines, recovery plans need to identify "triggers"—quantitative or qualitative indicators of risk or of the existence of severe stress that should be escalated to senior management or the board of directors ("or an appropriate committee" of the board) to initiate a response. The selection of triggers should reflect the specific vulnerabilities of each Covered Bank. While an operational event may constitute a trigger, the recovery plan need only discuss the financial consequences of the event, not its operational consequences. In adopting the Final Guidelines, the OCC noted that operational issues flowing from stress events are addressed in other planning, such as through disaster recovery and business continuity plans.[11]

— The triggers should address a continuum of increasingly severe stress, and the number and nature of the triggers should be appropriate for the Covered Bank's characteristics.

  - Quantitative triggers should include capital and liquidity triggers. In addition, Covered Banks could use a rating downgrade, access to credit and borrowing lines, equity ratios, profitability, asset quality or macroeconomic indicators as quantitative triggers.

9 The Proposal did not define a number of terms, including "core business line", "critical operation" and "material entity". Commenters requested clarification, and the Preamble states that a Covered Bank may use "concepts and terms used elsewhere" if it indicates the sources of the key terms. *See* 81 Fed Reg. at 66,794. These sources include, but are not limited to, the Resolution Plan Regulations and the heightened standards issued by the OCC in 2014. 79 Fed. Reg. 54,418 (Sept. 11, 2014).

10 81 Fed. Reg. at 66,801. Although the Final Guidelines refer only to "affiliates in a bank holding company structure", presumably Federal savings associations and insured Federal branches must discuss the interconnections and interdependencies with their affiliates as well.

11 *See* 81 Fed. Reg. at 66,793.

- Qualitative triggers could include:
  - an unexpected departure of senior leadership;
  - a significant decline in reputation or market standing;
  - an adverse legal ruling; or
  - a significant operational event that inhibits the Covered Bank's ability to access critical services or to deliver products or services to its customers.

— The Final Guidelines emphasize the importance of using quantitative triggers over qualitative triggers, although the Proposal treated them more or less equally. In the Final Guidelines, the OCC described the above examples of qualitative triggers, which appear in both the Final Guidelines and the Proposal, as resembling stress scenarios (see below) more than triggers. Nonetheless, the Final Guidelines allow Covered Banks the option of including qualitative triggers. If a Covered Bank does so, it should carefully consider how to explain how they are separate and distinct from stress scenarios.

Stress Scenarios

— Covered Banks are required to design multiple severe stress scenarios that could threaten the viability of the Covered Bank's critical operations or cause the Covered Bank to fail were one or more recovery options not implemented in a timely manner.

— The Final Guidelines explain that stress scenarios are distinct from triggers. Stress scenarios should be events, while triggers are benchmarks that, if met, tell the Covered Bank that it is under stress. The OCC does note that scenarios used for supervisory stress testing "may be appropriate" for identifying triggers, but that, if used, these scenarios need to be evaluated to ensure that they are "significantly severe" to require recovery.[12] The Final Guidelines provide examples—for instance, trading losses caused by a rogue trader would be a stress scenario, while Tier 1 capital falling below 6% would be a trigger.[13]

— A key distinction between the recovery plan stress scenarios and resolution plan stress scenarios is that the recovery plan stress scenarios must not be so severe as to preclude mitigation actions that would prevent the Covered Bank from entering resolution. The purpose of the recovery plan is to demonstrate the ability of the Covered Bank to restore its financial strength so that it remains viable as a going concern. Scenarios could range from those that cause significant financial hardship to those that bring the Covered Bank close to default, but not into resolution.

— Covered Banks are required to use a combination of market-wide and idiosyncratic or bank-specific stresses. Examples of market-wide stresses include:

- fraud;
- a portfolio shock;
- a significant cyber-attack or other wide-scale operational event;
- an accounting and/or tax issue; and
- a reputational crisis.

— Examples of market-wide stress scenarios include:

- disruption of domestic or global financial markets;
- failure or impairment of systemically important financial industry participants;
- significant changes in debt or equity valuations, currency or interest rates; and
- widespread interruptions of critical infrastructure.

[12] *See* 81 Fed. Reg. at 66,795.

[13] *See* 81 Fed. Reg. at 66,796.

— Whichever kind of stress scenarios are presented, they should produce capital shortfalls, liquidity pressures or other significant financial losses.

Options for Recovery

— Recovery plans must identify a range of credible options the Covered Bank could undertake to restore its financial strength. Covered Banks must include a description of the decision-making process for implementing each option, including detailed steps and any timing considerations in their recovery plan. The Final Guidelines afford Covered Banks flexibility in selecting potential recovery options. Options may include, but are not limited to:

- conservation or restoration of liquidity and capital;
- the sale, transfer or disposal of significant assets, portfolios or business lines;
- the reduction of risk profile;
- the restructuring of liabilities;
- the activation of emergency protocols;
- succession planning; and
- organizational restructuring including divestiture of legal entities.

Impact Assessments

— For each recovery option, the Final Guidelines require an assessment of how the recovery option would impact the Covered Bank. The impact assessments should specify the procedures the Covered Bank would use to maintain financial viability of its material entities, critical operations and core business lines and include an analysis of its internal operations and access to market infrastructure.[14]

- The assessment should address the effect on the Covered Bank's capital, liquidity, funding and profitability, as well as the impact on material entities, critical operations and core business lines (including the reputational impact).
- The recovery plan also is required to identify obstacles that could impede the execution of each option, including timing issues presented by the impediments, and to develop mitigation strategies for addressing the identified obstacles.

Additional Recovery Plan Requirements

— In addition to the requirements discussed above, the Final Guidelines also require Covered Banks to provide other information and to develop and implement certain procedures to facilitate recovery efforts in the event of a severe stress event:

- Escalation Procedures. The Covered Bank must develop a process for escalating decision-making to senior management or the board of directors, as appropriate, in response to the breach of a trigger. Any breach of a trigger must be escalated. The procedure must identify the departments and personnel responsible for making and executing these decisions.
- Communication Procedures. The Covered Bank must develop a process for notifying the OCC of any significant breach of a trigger and any action taken or to be taken in response to a breach. The procedure should also describe how the Covered Bank will notify persons within the organization, as well as external parties other than the OCC, of its actions under the recovery plan.
- Management Reports. The Covered Bank must develop a procedure to provide senior management or the board of directors (as appropriate) with sufficient data and information to make timely decisions regarding the appropriate response actions. The procedure must identify the types of reports that the Covered Bank will provide to management and the board of directors.

[14] Market infrastructure refers to clearing and settlement facilities and payment systems.

- Other Information. The Covered Bank must include in its recovery plan any other information that the OCC requires in writing directly to the Covered Bank regarding the Bank's recovery plan.

Responsibilities of Management and Boards of Directors

— Under the Final Guidelines, management must review the recovery plan at least annually, on its own schedule within the year, and in response to any material event.

  - As part of the review, management should, if and when appropriate, revise the plan to better reflect changes to the Covered Bank's risk profile, complexity, size and activities, as well as changes in external threats.
  - Management also must consider the relevance and applicability of the stress scenarios and revise them if necessary.

— The board of directors is responsible for overseeing the Covered Bank's recovery planning process.

  - The board of directors must work with management to develop and execute the recovery plan. In the Final Guidelines, the OCC clarified that such development and execution need not constitute more than a board's traditional oversight role.
  - The board or an appropriate committee of the board must review and approve a recovery plan annually and as necessary to address significant changes. In response to comments, the Final Guidelines permit an appropriate committee of the board, in lieu of the board itself, to do so.
  - In addition, the recovery plan must be reviewed as necessary to address significant changes, rather than any changes, as would have been required under the Proposal.

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Appendix A

The table below lists insured national banks, insured Federal savings associations and insured Federal branches of FBOs with total consolidated assets of $50 billion or more as of June 30, 2016.[15] Those whose parents are subject to SR Letter 14-8 are in **bold**. Those that are owned by FBOs are *italicized*.

Institution Name	Total Assets ($ thousands)
JPMorgan Chase Bank, National Association	2,051,004,000
Wells Fargo Bank, National Association	1,699,435,000
Bank of America, National Association	1,657,878,000
Citibank, National Association	1,365,660,000
U.S. Bank National Association	433,462,707
PNC Bank, National Association	350,224,267
Capital One, National Association	278,660,795
TD Bank, National Association	255,726,562
HSBC Bank USA, National Association	206,205,993
Charles Schwab Bank	153,862,000
Chase Bank USA, National Association	146,939,176
Morgan Stanley Bank, National Association	135,608,000
MUFG Union Bank, National Association	115,974,811
Citizens Bank, National Association	112,992,135
BMO Harris Bank National Association	107,492,162
Capital One Bank (USA), National Association	103,536,674
KeyBank National Association	99,137,730
Santander Bank, N.A.	84,976,159
USAA Federal Savings Bank	75,544,003
The Huntington National Bank	73,864,004
Synchrony Bank	64,615,426
Bank of China (two New York branches)	63,591,947
ZB, National Association	59,451,244

[15] *See* FDIC Institution Directory, https://www5.fdic.gov/idasp/advSearchLanding.asp.