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The Governor

DIRECTIVE Nº4230/2022-0030[613] OF 04/11/2022 ON MINIMUM REQUIREMENTS OF THE RECOVERY PLAN FOR BANKS

Pursuant to Law N° 48/2017 of 23/09/2017 governing the National Bank of Rwanda as amended to date, especially in its articles 6, 6bis, 8, 9, 10 and 15;

Pursuant to Law Nº 47/2017 of 23/9/2017 governing the organization of banking, especially in its articles 64 and 70;

Considering the un-uniform recovery plans that are submitted by banks when they are requested to do so, the National Bank of Rwanda which is referred to as "Central Bank "issues the following directive:

CHAPTER I: GENERAL PROVISIONS

Article One: Purpose of this Directive

This directive aims at cultivating the culture of crisis management in banks by laying down general rules for preparing recovery plans.

Article 2: Scope

This directive applies to all banks and financial holdings governed and supervised under banking law on proportionate basis.

CHAPTER II: GOVERNANCE

Article 3: Governance structure

A bank shall put in place a robust governance structure and sufficient resources to support its recovery planning process. The roles and responsibilities of each person involved in the recovery planning process shall be clearly assigned within the bank and specified in the recovery plan.

Article 4: Responsibility of the Board and Management

The Board has the responsibility of establishment, approval and oversight of the implementation of recovery plan by the management.

The recovery plan shall be reviewed whenever there are material changes to the bank's risk profile to ensure that it continues to reflect current risk profile and appetite.

The bank management shall be responsible for preparing, testing, implementing, and updating the plan.

Article 5: Recovery Planning and Risk Management

The recovery planning shall be integrated into a bank's overall governance processes and risk management framework. This includes the development, review, approval, monitoring, escalation, activation and implementation of the recovery plan.

The recovery plan shall reflect the nature, size, complexity, interconnectedness, level of substitutability and scale of the cross-border operations of the bank.

The recovery plan shall take into account specific circumstances of the bank, including its unique organizational and legal structure, business model, risk profile, characteristics of the markets the bank operates in, amongst others.

CHAPTER III: RECOVERY PLANNING PROCESS

Article 6: Recovery Options

The Bank's Recovery Plan shall outline credible recovery options to be implemented in the event of a severe stress. The objective of the plan must enable the bank to restore its business to stable and sustainable conditions. The plan includes all credible options for addressing both liquidity and capital difficulties.

The menu of recovery options shall specify measures that are within the direct control of the bank. Where the execution of any recovery option is dependent on other entities or stakeholders, for example, the parent institution, these dependencies and the processes to coordinate the execution of the recovery options, shall be clearly set out in the recovery plan.

The bank shall detail, in the recovery plan, the steps and estimated time needed to implement each recovery option, the underlying assumptions for each recovery option, as well as the circumstances which could render the option unavailable.

The bank shall evaluate each and every identified recovery option based on a series of success probability factors such as ease of execution, expected impact, feasibility and dependencies as well as timing. As part of this exercise, the bank shall quantify the expected impact of each recovery option on its capital and liquidity, calculate the timing of execution, and assess the probability of success.

As mentioned in the article 7, the nature of the trigger shall inform the potential response. However, the breach of a particular trigger does not necessarily correspond to a single recovery option. More than one option may be appropriate when a particular trigger is breached or in some cases, one option may be used in response to more than one trigger.

The plan and the options shall not assume that any government support would be available, or that the Central Bank would provide liquidity beyond pre-announced arrangements including acceptable collateral.

Recovery options include but not limited the following:

1° Raising additional capital through rights issues, private placements, the conversion of contingent capital instruments, voluntary debt to equity conversions and other capital instruments acceptable to the Central Bank;
2° The sale of investments, subsidiaries where applicable, assets, or business lines;
3° Raising money via money markets, debt issuance, or securitization or accessing additional funding or using liquid assets to generate cash;
4° Cost reductions from the suspension of dividends, bonuses and other variable remuneration, or of major projects and expenditures;
5° Changes to the business model to de-risk the business and cessation of products or services;
6° Reductions in, or restructuring of, the balance sheet;
7° Restrictions on growth, restructuring of liabilities, or running-off part of a business or product;
8° Organizational restructuring, including divesting legal entities, to simplify the bank's structure.
9° Organization restructuring or implementing a succession plan.

Article 7: Recovery Triggers

The bank shall identify and develop criteria and procedures that are clearly defined and calibrated to trigger timely activation and implementation of recovery options within the recovery plan. The recovery plan should clearly indicate the actions to be taken upon the occurrence of a trigger event.

In formulating the recovery triggers, the bank shall consider stress scenarios that are sufficiently severe to threaten the going concern and survivability of the bank and its group.

Triggers for recovery planning shall be incorporated into bank's overall risk management frameworks. Recovery triggers shall be at minimum (but not limited) aligned with existing liquidity or capital contingency plan as well as aligned to other early warning indicators within the bank's risk governance framework. The early warning indicators identified in the other plans, may be helpful in crafting triggers, but management shall evaluate these indicators in the context of the recovery plan and consider whether different or additional triggers are appropriate.

The number and nature of triggers shall be appropriate for the bank's size, risk profile, activities, and complexity. As such, triggers most suitable for a bank shall include those that are not only plausible to occur, but are also severe enough that they could reasonably be expected to threaten the bank's ongoing viability if the bank does not implement recovery options. The nature of the trigger shall inform the response.

Triggers shall be appropriately calibrated to leading indicators to enable timely activation of the recovery plan and include escalation procedures tied to the governance process and pre-established actions designed to confirm that a breach of a trigger is brought to the attention of senior decision-makers. For example, falling below regulatory minimum capital levels may not be an appropriate trigger, as the bank may not be able to implement timely corrective actions after breaching these levels. For this, recovery triggers should be above regulatory limits where they exist.

In addition to triggers, the recovery plan shall include less severe monitoring thresholds or early-warning indicators that serve to heighten awareness and identify potential financial stress for the bank.

The bank may consider potential quantitative and qualitative triggers.

The quantitative triggers shall focus on the extend or speed of changes in different indicators such as:

1º Capital indicators

These identify any significant actual and likely future deterioration in the quantity and quality of capital. Examples of capital indicators include:

i. CET 1 capital ratio;
ii. Tier 1 capital ratio;
iii. Total capital ratio; and
iv. Leverage ratio.

2º Liquidity indicators

These inform the bank of a potential or actual deterioration in its capacity to meet its short and long-term funding needs. Examples include:

i. Decrease in liquidity ratios (LCR, NSFR, loans to deposits ratio…);
ii. Withdrawal of deposits and other funding;
iii. Cost of wholesale funding;
iv. Increase of collateral requirements;

3° Profitability Indicators

These capture any income-related situation that could lead to a rapid deterioration of profitability through losses or lower retained earnings. Examples of profitability indicators include:

i. Return on assets;
ii. Return on equity;
iii. Severe operational losses;
iv. Cost of capital

4° Asset quality indicators

These indicators measure the asset quality evolution of the bank and include:

a) Significant Increase of watch list;
b) Significant migrations to NPL;
c) NPL growth rate;
d) Decrease in NPL coverage ratio;
e) Default of significant counterparties;
f) Significant draws on lines of credit by customers;
g) Investment performance;
h) Significant of write off loan without proper recovery.

5° Market based Indicators

These indicators capture market participants' expectations of a rapid deterioration in the bank's financial condition that could disrupt its access to funding and capital markets. Such indicators may be:

1° Equity-based, capturing fluctuations in share price;
2° Debt-based, capturing expectations of wholesale funding providers, for example, fluctuations in the rates payable on debt;
3° Credit ratings-based, involving the external ratings of the bank and its peers;
4° Decrease in interbank or treasury rates;
5° Widening of the bank's credit default swap spread;
6° Significant market share loss;
7° Stock price or market valuation;
8° Foreign Currency Exposure .

6° Operational based indicators

i. Idiosyncratic events that result in a severe financial loss (e.g., cyber-attack or other events). Recovery options should address the financial, not operational, impact of these events;
ii. Loss of staff;
iii. Successful continuous frauds.

7° Macroeconomic Indicators

These capture signs of severe deterioration in the economic conditions where the bank operates or where it has concentrations of exposures. These may be global, regional or sectoral, depending on the profile of the bank. Examples include:

i. Variations in the gross domestic product (GDP) of relevant countries;
ii. Fluctuations in prices of relevant asset classes levels of public debt.

Qualitative triggers are also an important component, though the use of such triggers in recovery plans is currently much less widespread than quantitative triggers. The indicators could include, in respect of the bank: requests from counterparties for early redemption of liabilities; difficulties in issuing liabilities at current market rates; an unexpected loss of senior management; and adverse court rulings.

Article 8: Breach of a Recovery Trigger

Breach of a recovery trigger shall not automatically lead to the bank activating the recovery plan. However, it may lead to an assessment of whether action is needed. Depending on the nature of the breach, that assessment may need to involve senior management. The bank shall respond in a way that is most appropriate to the circumstances. This may include taking no action for the time being (while keeping the situation under review).

Article 9: Testing and Feasibility Checks

To demonstrate its capacity to restore its viability and financial position, a bank shall have processes in place to check that its recovery options are credible and could be activated in time. This should include both scenario analysis and simulation-type exercises.

A bank shall have a clear vision of the feasibility of each recovery option in a range of stress scenarios, including a market-wide crisis. This includes consideration of:

1° the impact of each option, including its intended benefits and possible side-effects;
2° the time it may take to implement and how long before the expected benefits materialize;
3° potential obstacles to implementation;
4° the feasibility of undertaking multiple recovery options at once;
5° any interdependencies between recovery options.

Article 10: Stress Scenarios

A recovery plan shall be based on a range of clearly articulated, severe but plausible, bank-specific, market-wide, and systemic stress scenarios, and combinations of these.

The recovery plan shall specify a variety of scenarios of macroeconomic and financial distress that the bank may use to test the effectiveness of the recovery triggers as warning signals of emerging stress and the credibility of the recovery options under different circumstances. Below are key features of Stress Scenarios:

1º Realism

Scenarios shall be based on severe but plausible events that would threaten to cause the bank to fail.

2º Variety

The range of scenarios should cover risk events of different scale and nature, including:

i. Systemic scenarios affecting financial stability;
ii. Stresses affecting the bank's market segment;
iii. Stresses relevant to the bank's specific structure and risk profile.

3º Timescale

The scenarios shall cover both fast-moving and slow-moving events.

4º Components

The scenarios shall range in severity and include a number of components, such as:

i. significant capital and liquidity impacts;
ii. fraud or severe losses through a rogue trader;
iii. rating downgrades;
iv. a crisis or significant changes in key currencies;
v. decreasing GDP growth rates;
vi. significant deposit withdrawal;
vii. significant changes in commodity prices;
viii. the failure of other banks.

Article 11: Consolidated recovery plan

A bank in-group shall undertake recovery planning on a consolidated basis, taking into consideration the holding company and subsidiaries as well as any material non-bank financial institutions.

Article 12: Required Reports and Management Information Systems

The recovery plan should require reports that provide senior management or the board (or an appropriate board committee) with sufficient data and information to make timely decisions regarding the appropriate actions necessary to respond to a trigger breach, or to monitor progress of actions taken under the recovery.

A bank shall plan appropriately so that the information necessary for implementing recovery options will be available for decision making when the bank is in a stressed condition. This shall include timely and reliable management information systems to provide management or the board (or an appropriate board committee) relevant information to enable them to make decisions as to the best course of action in the event of a trigger breach.

The bank shall maintain management information systems that are capable of producing information necessary for recovery planning. Such information shall be produced in a timely manner, whenever requested by the Central Bank.

Article 13: Operational continuity

The bank should ensure that it has in place appropriate contingency arrangements that enable its critical functions and critical shared services to continue to operate while recovery measures are being implemented. This may include but is not limited to arrangements to enable the functioning of IT systems, clearing and settlement facilities and supplier and employee contracts, and arrangements to ensure continued rights of use and access to operational assets such as property and office space.

Article 14: Communication

Bank recovery plans shall therefore include a communication plan setting out a clear strategy for providing timely information during the recovery process to external and internal stakeholders, including the authorities, financial markets, depositors, the general public and staff. Where it is obvious that an institution is in trouble, announcing the activation of recovery options could bolster market confidence.

All communications need to be appropriate to the situation and the class of stakeholder, and they should aim to manage negative reactions to the recovery options.

CHAPTER IV: CONTENT OF RECOVERY PLAN AND ITS ASSESSMENTS

Article 15: Minimum content recovery plan

Without prejudice to what is required in this Directive or the banking law, the bank recovery plan shall include but not limited to the following information:

1° A summary of the key elements of the plan and a summary of overall recovery capacity;
2° a summary of the material changes to the bank since the most recently filed recovery plan;
3° a communication and disclosure plan outlining how the firm intends to manage any potentially negative market reactions;
4° a range of capital and liquidity actions required to maintain or restore the viability and financial position of the bank;
5° an estimation of the timeframe for executing each material aspect of the plan;
6° a detailed description of any material impediment to the effective and timely execution of the plan, including consideration of impact on the rest of the group, customers and counterparties;
7° identification of critical functions;
8° a detailed description of the processes for determining the value and marketability of the core business lines, operations and assets of the bank;
9° a detailed description of how recovery planning is integrated into the corporate governance structure of the institution as well as the policies and procedures

governing the approval of the recovery plan and identification of the persons in the organization responsible for preparing and implementing the plan;

10° arrangements and measures to conserve or restore the bank's own funds;

11° arrangements and measures to ensure that the bank has adequate access to contingency funding sources, including potential liquidity sources, an assessment of available collateral and an assessment of the possibility to transfer liquidity across group entities and business lines, to ensure that it can continue to carry out its operations and meet its obligations as they fall due;

12° arrangements and measures to reduce risk and leverage;

13° arrangements and measures to restructure liabilities;

14° arrangements and measures to restructure business lines;

15° arrangements and measures necessary to maintain continuous access to financial markets infrastructures;

16° arrangements and measures necessary to maintain the continuous functioning of the bank's operational processes, including infrastructure and IT services;

17° preparatory arrangements to facilitate the sale of assets or business lines in a timeframe appropriate for the restoration of financial soundness;

18° other management actions or strategies to restore financial soundness and the anticipated financial effect of those actions or strategies;

19° preparatory measures that the bank has taken or plans to take in order to facilitate the implementation of the recovery plan, including those necessary to enable the timely recapitalization of the institution;

20° a framework of indicators which identifies the points at which appropriate actions referred to in the plan may be taken

Article 16: Submission of the recovery plan to the Central Bank

A copy of the recovery plan approved by the Board of Directors shall be submitted to the Central Bank not later than the calendar year 30 June after its assessment and review. For Level I banks, the submission shall be on an annual basis. For level II banks as well as cooperative banks and development banks, the submission shall be once in two years.

However, the Central Bank may, request the bank to submit a recovery plan to the Central Bank anytime if the situation so requires.

Banks shall submit their first recovery plan in accordance with this directive, not later than **30th June 2023.**

Article 17: Assessment of the recovery plan

In assessing the recovery plan, the Central Bank shall consider the following:

1° The completeness of the plan by assessing the extent to which a recovery plan satisfies the requirements of this Directive;

2° The quality of the recovery plan based on its clarity, comprehensiveness and relevance of information contained in the recovery plan;

3° the internal consistency of the plan on individual basis or on consolidated basis

The Central Bank shall be satisfied that:

1° the implementation of the arrangements proposed in the plan is reasonably likely to maintain or restore the viability and financial position of the bank or of the group, taking into account the preparatory measures that the bank has taken or has planned to take;

2° the plan and specific options within the plan are reasonably likely to be implemented quickly and effectively in situations of financial stress and avoiding to the maximum extent possible any significant adverse effect on the financial system.

Where the Central Bank assesses that there are material deficiencies in the recovery plan, or material impediments to its implementation, it shall notify the bank or the parent of its assessment and require the bank to submit, within a period set by the Central Bank, a revised plan demonstrating how those deficiencies or impediments are addressed.

CHAPTER V: MISCELLANEOUS AND FINAL PROVISIONS

Article 18: Review of the recovery plan by the auditor

The internal audit function shall review the recovery plan. The review of the recovery plan shall be included in the audit plan.

Article 19: Corrective Measures

A bank that do not comply with the requirements of this directive is punishable by administrative sanctions provided for in the regulation on administrative and pecuniary sanctions

Article 20: Commencement

This Directive comes into force on the date of its signature.

Done at Kigali 04/11/2022.

Digitally signed by BNR(GOVERNOR)

RWANGOMBWA John
Governor