Recovery and exit plans for payment institutions

DNB workshop

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28 February 2017

DeNederlandscheBank

EUROSYSTEEM

Agenda

10:00 Opening

10:15 Recovery plan and questions

11:15 Exit plan and questions

12:00 Conclusion

Timeline

- Deadline: **24 May 2017**
- End of August: feedback
- September: presentation of good practices at payment institutions seminar
- Deadline for adjustments: 15 November 2017

Recovery plans for payment institutions

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Agenda

1) Recovery plan: definition and key priorities

2) Recovery plan: objective

3) Recovery plan: elements

4) Timelines and milestones

5) Questions

Recovery plan: definition and key priorities

Definition

A recovery plan consists of measures that can be activated in a near-default situation, allowing the institution to return to business as usual status.

Key points of recovery plan

- Licence is retained
- Institution returns to business as usual
- Indicators match the broader risk framework and focus on the institution's vulnerabilities
- Scenarios are realistic
- Recovery strategies are feasible and plausible

Recovery plan: objective

Main objective

Recovery of the institution to ensure return to business as usual

Other objectives

- Gaining insight into
    1. Recovery options
    2. Capacity for recovery
    3. Possible obstacles to the execution of recovery strategies

- Being better prepared for crisis situations

Recovery plan: elements

Summary

Overview of the organisation

- Core activities
- Business model
- Possible causes for failure of business model
- Legal structure
- Governance structure
- Internal structure
- Financial statements

Documents recovery plan: objective

- Related documents.

  Example: the risks described in the risk management plan are reflected in the recovery and exit plan scenarios.

Recovery plan: elements

Governance

- Names and positions of the persons responsible for *maintaining*, *authorising*, *activating* and *advising on activation* of the recovery plan
- Description of the processes for *drafting*, *maintaining*, *authorising* and *activating* the recovery plan
- Management statement document *supporting* the recovery plan
- Composition of the *crisis management team*; Names, positions, team roles, duties in the execution of the recovery plan

- Organisation chart and notes describing the *governance structure* during the execution of the recovery plan

Recovery plan: elements

Indicators

- Indicators must match the institution's core activities. These indicators relate to e.g. capital, liquidity, profitability or payments volumes.

  Example: *Service: collecting payment institution facilitating consumer-to-web retailer payments*

  Business model: low margin on transactions combined with high payment volumes

  Indicators: payments volumes, regulatory capital, operating income per transaction

- *Limits* for each of the early warning system stages

  Business as usual: stable payment volumes

  Alert: payment volume falls for 2 consecutive months

  Recovery: payment volume falls for 4 consecutive months

- Procedure for monitoring indicators. This procedure must ensure that prompt alerts are given when limits are approaching.

Recovery plan: elements

Scenarios

- *Realistic* scenarios in which the recovery limits of one or more indicators are touched
- At least two scenarios: one with internal events and one with external events.
- Scenario descriptions include the *moment* of activation of the recovery plan, the *impact* of failure to act and the preferred *recovery strategy*.

> Example: *"As a result of increasing competition, payments volume has been declining for two consecutive months. Consequently, operating income per transaction has also declined. The board meets weekly to discuss the indicator reports. Four months later, payments volumes are still falling and operating income per transaction has deteriorated still further. Without intervention, the institution will fail due to competition. The recovery plan is activated. The selected recovery strategy is to lower prices to bring them in line with the competition.*

Recovery plan: elements

Recovery strategies

1. General description and objective
2. Roles and responsibilities
3. Dependence on internal and external stakeholders
4. Risk analysis
5. Costs and financing
6. Activities and procedures
7. Qualitative impact
8. Quantitative impact
9. Feasibility and plausibility
10. Communication

Recovery plan: elements

Recovery strategies

1. General description and objective of the recovery strategy.

Example: "*Description*: *Abolishing fixed subscription costs and increasing variable costs per transaction. This will allow the institution to offer the same benefits as new entrants, allowing new contracts to be concluded.*

Objective: recovery of payment volumes, operating income per transaction and regulatory capital to the situation of business as usual."

Recovery plan: elements

Recovery strategies

2. Roles and responsibilities for all relevant processes.

- All activities must be listed in the overview.

Process	Activity	Responsibility
Activation of recovery plan	Advise on activation of recovery plan	SB
	Activate recovery plan	CEO
	Communicate activation of the recovery plan internally	CEO
	etc.	[...]
Preparing for execution of recovery plan	Update customer base	Sales department
	Update financial projections	Finance department
	etc.	[...]
Execute recovery plan	Contact customers	Communications manager
	Adjust contracts with existing customers	Sales department
	Update website with adjusted prices	ICT department
Deactivate recovery plan	Communicate de-activation of the recovery plan internally	CEO
	etc.	[...]

Recovery plan: elements

Recovery strategies

3. Dependence on internal and external stakeholders

Stakeholder	Description	Measure
Existing customers	Merchants may object to price adjustments.	Possibility of price adjustments must be included in contracts.
Shareholders	[...]	[...]
etc.	[...]	[...]

“Existing customers: merchants may object to price adjustments. To prevent legal proceedings, the possibility of adjusting prices must be included in contracts.

Ideally, price adjustments should be announced well in advance, and business relationships with large customers should be fostered."

Recovery plan: elements

Recovery strategies

4. Risk analysis

- Risks that may arise during execution of the recovery strategy.

Risk	Probability	Risk mitigation
Large customers switch to other payment institutions	High	Price agreements
etc.	[...]	[...]

"Higher costs per transaction are detrimental to large merchants, increasing the likelihood of them switching to another payment institution.

This is a high-impact risk, as these merchants account for a major part of payment volumes.

The risk is mitigated by making price agreements with the main customers."

Recovery plan: elements

Recovery strategies

5. Costs and financing

- Total costs including quantitative substantiation
  Example: additional staff costs can be substantiated by providing a description of the duties, required number of FTEs, hourly wages of additional FTEs, insourcing and outsourcing costs, etc.

- Financing
  Example: capital endowment, provision, etc.

Recovery plan: elements

Recovery strategies

6. Activities and procedures for each process

Process	Procedure	Moment
Activation of recovery plan	Advise on activation of recovery plan	Day 1
	Activate recovery plan	Day 1-2
Prepare for execution of recovery plan	etc.	[...]
Execute recovery plan	Continuation of critical functions/contracts	[...]
	Terminate non-critical contracts	[...]
Deactivate recovery plan	etc.	[...]

"Activating the recovery plan: within one day after the Supervisory Board's advice to activate the plan, the CEO will do so by notifying the management in person. Then all managers will inform their staff simultaneously. If a manager is absent, a deputy will take their place and inform staff. After staff has been informed, the crisis management team meets to discuss the next steps... etc."

Recovery plan: elements

Recovery strategies

7. Qualitative impact on various categories

Category	Impact
Merchants	[...]
Staff	Low
Local economy	[...]
etc.	[...]

"*Staff: impact is low, since external staff are insourced for the adjustment of contracts and no internal staff is laid off.*"

Recovery plan: elements

Recovery strategies

8. Quantitative impact on indicators

- Starting point: indicators reset to business as usual.
- Assumptions must be substantiated.

Indicators	Impact	Achieved within
Payments volume	+ €5-7 million	6-8 months
Operating income per transaction	+ €0.001	6-8 months
Regulatory capital	[...]	[...]

"Payments volumes: since we will adjust our prices to the level of the competition, after taking measures we expect to be able to continue on our business as usual growth path: average growth of €7 million per six months. To be on the safe side, we will assume a €5-7 million impact in a 6-8 month period.

Recovery plan: elements

Recovery strategies

9. Feasibility and plausibility of recovery strategies

- Assessment of the feasibility and plausibility of recovery strategies for each scenario.
- Impact of a combination of recovery strategies

Scenario	Strategy	Feasibility	Plausibility
Increasing competition	Price adjustment	High	High
Increasing competition	Price adjustment and fixed costs economies	etc.	etc.
etc.	[...]	[...]	[...]

"Price adjustment: feasibility is high, since interim price adjustments have been laid down by contract, low staff resources are required and no restructuring is required.

Plausibility is also high, since increasing competition necessitates adjusting the business model to bring back payments volumes to the business as usual level. To beat the competition, price levels must be adjusted to competitors' levels."

Recovery plan: elements

Recovery strategies

10. Communicate activation of the recovery plan

- Internal and external stakeholders
- Stakeholder contacts
- Which information is communicated?
- When is the activation of the recovery plan communicated?

Stakeholder	Description	Responsibility	Moment
Merchants	Inform merchants of price adjustments and effective date.	CEO	Week 1
Staff	Inform staff about the activation of the recovery plan, the moment of activation, any internal changes ensuing from it and any consequences for staff.	CEO	Week 1
etc.	[...]	[...]	[...]

Recovery plan: elements

Annexes

- Contact details of relevant staff
- Relevant underlying documents (organisation chart, policy documents)

Thank you very much
for your attention.

Any questions?

Exit plans for payment institutions

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Agenda

1) Exit plan: definition and key priorities

2) **Exit plan: objective**

3) Exit plan: elements

4) Timeline

5) Questions

Exit plan: definition and key priorities

Definition

An exit plan contains measures that can be activated in a near-default situation, allowing the institution either to resolve its activities in an orderly fashion or to transfer them to another institution.

Key points of exit plan

- Licence is revoked
- Customer deposits are secured
- Critical activities are maintained
- All financial obligations are met
- Indicators match the broader risk framework and focus on the institution's vulnerabilities
- Scenarios are realistic
- Exit strategies are feasible and plausible

Exit plan: objective

Main objective

Orderly resolution of activities or transfer of activities to another institution.

Other objectives

- Gaining insight into
    1. Exit options;
    2. Possible obstacles to the execution of exit strategies.

- Being better prepared for crisis situations

Exit plan: elements

Summary

Overview of the organisation

- Core activities
- Business model
- Possible causes for failure of business model
- Legal structure
- Governance structure
- Internal structure
- Financial statements

Purpose of exit plan Documents

- Related documents.

  Example: the risks described in the risk management plan are reflected in the recovery and exit plan scenarios.

Exit plan: elements

Governance

- Names and positions of the persons responsible for *maintaining*, *authorising*, *activating* and *advising on activation* of the exit plan
- Description of the processes for *drafting*, *maintaining*, *authorising* and *activating* the exit plan
- Management statement document *supporting* the exit plan
- Composition of the crisis management team
  Names, positions, team roles, duties in the execution of the exit plan
- Expertise needed to implement exit plan;

  Names and positions (e.g. financial, legal and IT experts).
- Organisation chart and notes describing the *governance structure* during the execution of the exit plan.

Exit plan: elements

Indicators

- Indicators must match the institution's core activities. These indicators relate to e.g. capital, liquidity, profitability or payments volumes.

  Example: *Service: collecting payment institution facilitating consumer-to-web retailer payments*

  Business model: low margin on transactions combined with high payment volumes

  Indicators: payments volumes, regulatory capital, operating income per transaction

- *Limits* for each of the early warning system stages

  Business as usual: stable payments volumes

  Alert: payment volume falls for 2 consecutive months

  Recovery: payment volume falls for 4 consecutive months

  Exit: payment volume falls for 7 consecutive months

- Procedure for monitoring indicators. This procedure must ensure that prompt alerts are given when limits are approaching.

Exit plan: elements

Scenarios

- *Realistic* scenarios in which the exit limits of one or more indicators are touched;
- At least two scenarios: one with internal events and one with external events.
- Scenario descriptions include the *moment* of activation of the exit plan, the *impact* of failure to act and the preferred *exit strategy*.

> Example: *"Financial crisis leading to customers going bankrupt, causing payments volumes, operating income per transaction and regulatory capital indicators to deteriorate. The recovery strategy aimed at reducing fixed costs has insufficient effect: payments volumes have been deteriorating for seven consecutive months and the exit limit for the regulatory capital indicator has been touched. The crisis is expected to continue. Without action the institution will fail, so the exit plan is activated. Given the crisis, other parties will probably not be interested in taking over loss-giving activities, so the exit strategy is activated."*

Exit plan: elements

Exit strategies

1. General description and objective
2. Roles and responsibilities
3. Dependence on internal and external stakeholders
4. Risk analysis
5. Costs and financing
6. Activities and procedures
7. Qualitative impact
8. Feasibility and plausibility
9. Communication

Exit plan: elements

Exit strategies

1. General description and objective of the exit strategy

> “*<u>Description</u>: activities are fully resolved because a recovery of the indicators is not plausible. When the exit strategy is activated, the institution's capital buffer still allows for orderly resolution.*
>
> *<u>Objective:</u> continuation of critical activities as long as required, meeting all financial obligations and orderly resolution of the institution's activities."*

Exit plan: elements

Exit strategies

2. Roles and responsibilities for all relevant processes.

- All activities must be listed in the overview.

Process	Activity	Responsibility
Activation of exit plan	[...]	[...]
Prepare for execution of exit plan	Overview of purchasing contracts (e.g. rental contract)	Purchasing department
	Update financial projections based on unwinding of activities.	Finance department
	etc.	[...]
Execute exit plan	Termination of contracts, non-critical activities (e.g. newspaper subscriptions, advertising contracts, etc.)	Purchasing department
	etc.	[...]
Deactivate exit plan	[...]	[...]

Exit plan: elements

Exit strategies

3. Dependence on internal and external stakeholders

Stakeholder	Description	Measure
Staff	A sufficient number of staff must be available for execution of the resolution activities.	Crisis management team is composed, required expertise determined and staff plan drafted.
Merchants	[...]	[...]
Shareholders	[...]	[...]
etc.	[...]	[...]

“Staff: the composition of the crisis management team and the required expertise are described in the 'Governance' chapter of this exit plan." This safeguards the involvement of the management and the required expertise for resolving the activities. The staff plan describes the required number of FTEs for each department during resolution. Discussion sessions between staff and managers are held to monitor that the minimum required number of FTEs during resolution is safeguarded."

Exit plan: elements

Exit strategies

4. Risk analysis

- Risks that may arise during execution of the exit strategy.

Risk	Probability	Risk mitigation
Merchants find it difficult to transfer to another payment institution.	Average	Providing support to merchants
Continuation of customer accounts foundation as long as required is at risk	Low	Maintain a provision
etc.	[...]	[...]

"Customer accounts foundation: the continuation of the customer accounts foundation as long as required is at risk. The institution can mitigate this risk by maintaining a provision for the continuation of the foundation's activities during resolution of the institution's activities. Consequently, the likelihood of this risk occurring is low."

Exit plan: elements

Exit strategies

5. Costs and financing

- Total costs including quantitative substantiation
  Example: early termination of non-critical contracts (rental, staff, etc.), legal advice, staff costs, rental costs, energy costs, etc.

- Financing: there must be sufficient funds available to resolve activities in an orderly fashion (for example: enough to pay critical staff until the end).

  Example: sale of assets, provisions, liquid assets, etc.

Exit plan: elements

Exit strategies

6. Activities and procedures for each process

Process	Procedure	Moment
Activation of exit plan	Advise on activation of exit plan	Day 1
	Activate exit plan	Day 1-2
Prepare for execution of exit plan	Update overview of purchasing contracts	Week 1
	Update customer base	Week 1
Execute exit plan	Terminate non-critical contracts	[...]
Deactivate exit plan	etc.	[...]

"Update overview of purchasing contracts: following activation of the exit plan, [responsible person] updates the overview to allow termination of non-critical purchasing contracts as soon as possible."

Exit plan: elements

Exit strategies

7. Qualitative impact on various categories

Category	Impact
Merchants	Average
Staff	[...]
Local economy	[...]
etc.	[...]

"Merchants: big impact on small merchants as they often depend on a single payment institution.

However, substitution options are plenty, and transfer is easy.

Small impact on large merchants as they often have agreements with multiple payment institutions.

Exit plan: elements

Exit strategies

8. Feasibility and plausibility of exit strategies

- Assessment of the feasibility and plausibility of exit strategies for each scenario.

Scenario	Strategy	Feasibility	Plausibility
Financial crisis	Resolution of activities	High	High
Financial crisis	Transfer of activities to another institution	Low	Low
etc.	[...]	[...]	[...]

"Transfer of activities to another institution: feasibility and plausibility are low, as the activities are loss-giving, further economies are not an option and the financial crisis is expected to continue. In this scenario it is not very likely that another institution would be willing to take over the activities.

Exit plan: elements

Exit strategies

9. Communication about exit plan activation

- Internal and external stakeholders
- Stakeholder contacts
- Which information is communicated?
- When is the activation of the exit plan communicated?

Stakeholder	Description	Responsibility	Moment
Merchants	Inform merchants of termination of activities and effective date.	CEO	Week 1
Staff	Inform staff about the activation of the exit plan, the moment of activation, any internal changes ensuing from it and any consequences for staff.	CEO	Week 1
etc.	[...]	[...]	[...]

Exit plan: elements

Annexes

- Contact details of relevant staff
- Relevant underlying documents (organisation chart, policy documents)

Timeline for recovery and exit plans

- <u>Deadline</u>: **24 May 2017**
- End of August: feedback
- September: presentation of good practices at payment institutions seminar
- Deadline for adjustments: 15 November 2017

Thank you very much
for your attention.

Any questions?