

# RESOLUTION PLANNING

## SUMMARY AND IMPLICATIONS OF FLAC INSTRUMENT REQUIREMENTS FOR DESIGNATED INSTITUTIONS - DRAFT STANDARD

FEBRUARY 2024

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# Flac instruments for Designated Institutions

On 8 December 2023, the Prudential Authority issued a draft standard *Flac Instrument Requirements for Designated Institutions*. The standard will come into effect on 1 January 2025.

The slides that follow present and discuss ...

## An overview of Flac instrument requirements for designated institutions

**An overview of Flac requirements in South Africa**

**What is Flac?**

- Flac is a new class of capital that is being introduced as part of resolution regulations in South Africa.
- The main objective of Flac is to ensure that systemically important financial institutions (SIFIs) have adequate loss absorption and recapitalisation capacity as SIFIs will be required to follow an "open resolution" strategy.

**What are Flac Instruments?**

- Flac instruments are a new class of unsecured subordinated debt instruments that are being introduced by the Resolution Authority.
- The qualifying criteria for Flac instruments includes that the instruments have a minimum initial maturity of five years.
- As shown below, Flac instruments will rank junior to other unsecured liabilities (which include unsecured deposits and other operational creditor claims) but senior to regulatory capital instruments in the creditor hierarchy.
- Flac instruments will have to be issued by the holding company - called external Flac.

**Comparison to other jurisdictions**

- Flac in SA is similar in nature to minimum requirement for own funds and eligible liabilities (MREL) in the European and Total Loss Absorbing Capacity (TLAC) applicable to G-SIFIs.
- The methods for calculating MREL and TLAC are different but both methodologies consider the RWAs and leverage ratio of the institution.

The diagram illustrates the structure of Flac instruments. It shows an 'External Flac: Holding Company' box containing 'Internal Flac: AT-1' and 'Internal Flac: Tier-2'. These are linked to a 'Flac' box, which is in turn linked to 'Unsecured Liabilities'. A vertical stack on the right shows 'Share Capital', 'AT-1', 'Tier-2', and 'Flac'.

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## Key considerations for designated institutions

**Key considerations for designated institutions**

- Will the designated institutions have management information systems capabilities required to determine the post loss balance sheet?
- Will the initial pricing of the instrument not be too high as the Flac instrument will be new in the SA investor market?
- Which data will the SARB consider when determining the market confidence premium? and what can banks do in the meantime to ensure a favourable outcome?
- The SARB will conduct a Resiliability Assessment Process (RAP) to assess the bank's resiliability. What steps can the banks take to proactively remove possible barriers to resiliability prior to the SARB's RAP?
- Will the cost of regulatory compliance not be too high for SA banks, given that banks will also be subject to depositor insurance levies and premiums as from 1 April 2024?
- The SARB introduces a requirement for bail-in playbooks that demonstrate the ability of the bank's operations to support bail-in. Will the banks have the required expertise to create these bail-in playbooks, and will these be considered during the SARB's RAP?

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## Resolvability assessments observed in other jurisdictions and how we can assist

**Resolvability assessments - what can be expected?**

The SARB will perform a Resiliability Assessment Process (RAP), the results of which will inform the resiliability rebate (up to 15%) that can reduce the additional Flac requirement. With little information being provided on how these assessments will take place, direction can be taken from other jurisdictions.

**Comparison to other jurisdictions**

- In the EU, the SRF considers the below Seven Dimension of Resiliability when performing resiliability assessments.
- In Switzerland, Finsta considers the below four resiliability categories when quantifying the resiliability rebate for Swiss banks.

The diagram shows two sets of boxes. The top set, 'Seven Dimensions of Resiliability', includes Governance, Loss absorption and recapitalisation capacity, Liquidity and funding in resolution, Operational continuity in resolution, Information Systems and Data Requirements, Communication, and Resiliability and Restructuring. The bottom set, 'Four resiliability categories', includes Operational Resilience, Financial Resilience, Resilience and Restructuring, and Valuations. Arrows indicate relationships between these categories and various aspects like Holding Structure, Operational Resilience, and Financial Resilience.

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# An overview of Flac requirements in South Africa

## What is Flac?

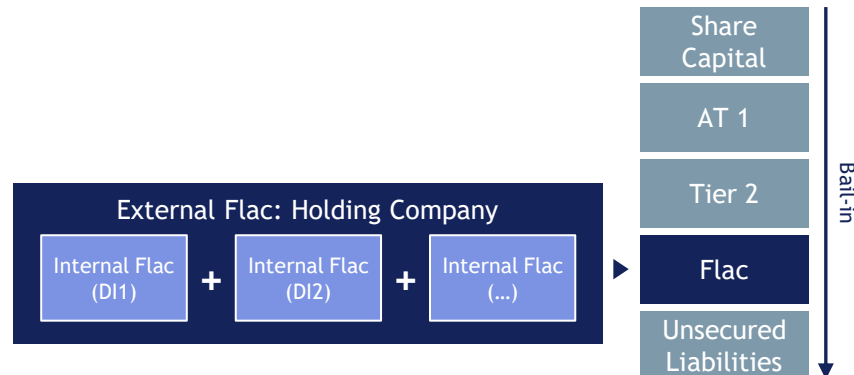
- Flac is a new class of capital that is being introduced as part of resolution regulations in South Africa
- The main objective of Flac is to ensure that systemically important financial institutions (SIFIs) have **adequate loss absorption and recapitalisation capacity** as SIFIs will be required to follow an “open resolution” strategy

## Comparison to other jurisdictions

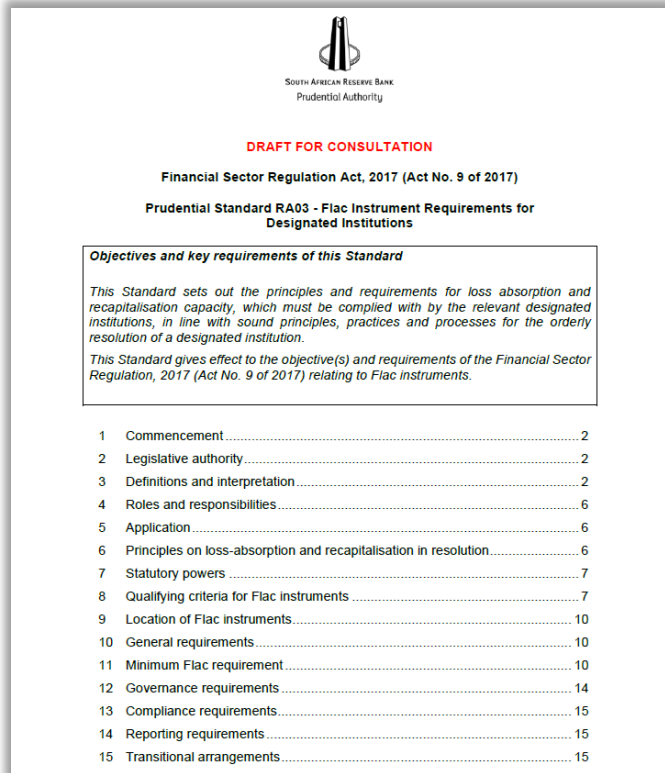
- Flac in SA is similar in nature to minimum requirement for own funds and eligible liabilities (MREL) in the Eurozone and Total Loss Absorbing Capacity (TLAC) applicable to G-SIBs
- The methods for calculating MREL and TLAC are different but both methodologies consider the RWAs and leverage ratio of the institution

## What are Flac instruments?

- Flac instruments are a new class of unsecured subordinated debt instruments that are being introduced by the Resolution Authority
- The qualifying criteria for Flac instruments includes that the instruments have a minimum initial maturity of two years
- As shown below, Flac instruments will rank junior to other unsecured liabilities (which include uninsured deposits and other operational creditor claims) but senior to regulatory capital instruments in the creditor hierarchy
- Flac instruments will have to be issued by the holding company
  - called external Flac

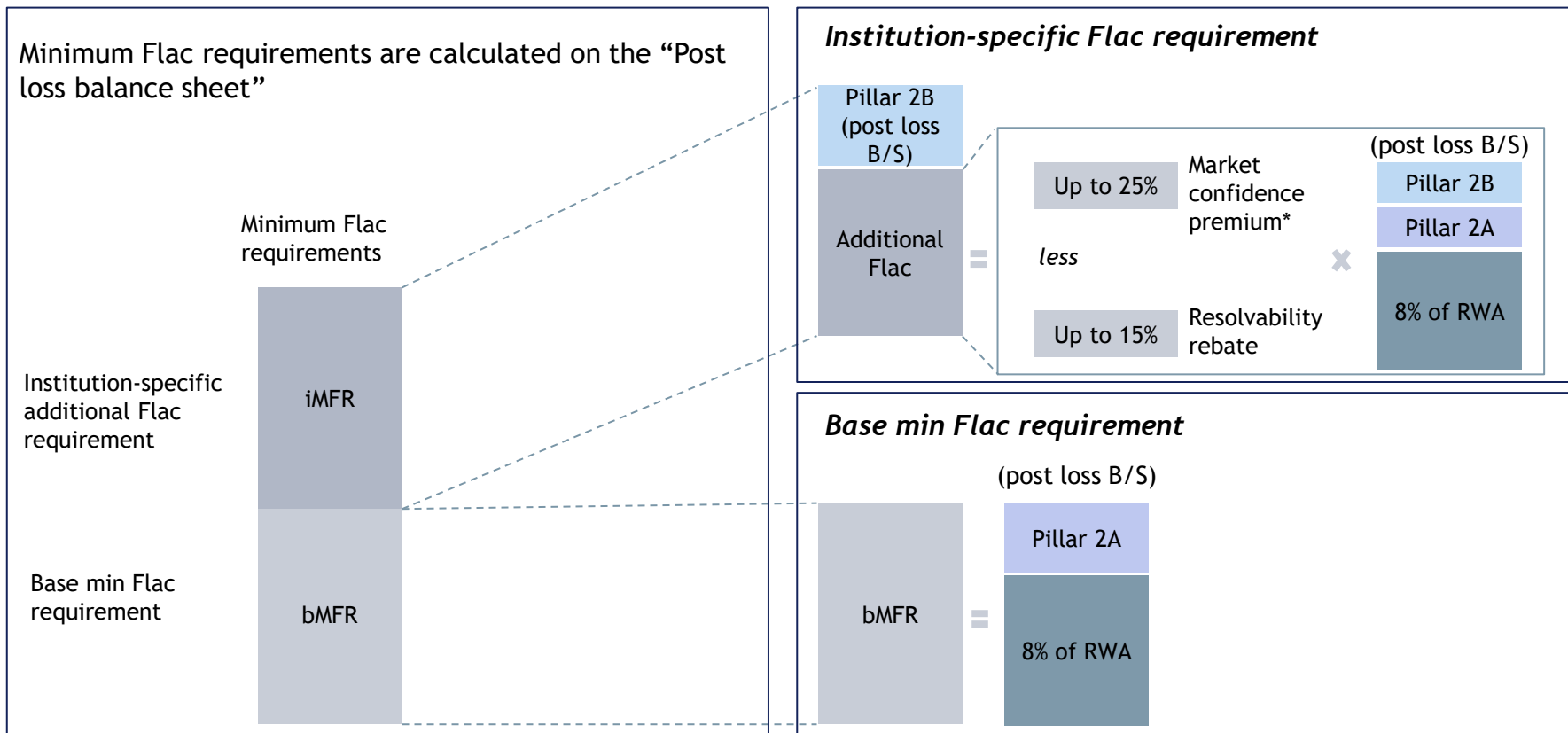


# What does the draft standard say?



- The Flac standard applies to **systemically important financial institutions (SIFIs)**.
- The standard sets out:
  1. Requirements for compliance
  2. Qualifying criteria for Flac instruments
  3. Calibration of minimum Flac requirements.
- Introduces the concept of a **post-resolution** or **post-loss balance sheet**, the SIFIs balance sheet calculated by deducting losses incurred (before and in resolution) from its assets, according to the risk weights assigned.
- Introduces two additional idiosyncratic variables in the calculation of the minimum Flac requirement, the **market confidence premium** and **resolvability rebate**.
- A **Resolvability Assessment Process (RAP)** is introduced which will assist the Resolution Authority (RA) in determining the resolvability rebate per SIFI.
- The SARB requires SIFIs to produce a **bail-in playbook** detailing how the SIFI will ensure that its operations support the bail-in of its Flac instruments in resolution and the relevant processes (including governance).
- The **phase-in period** for the base minimum Flac requirement and the Flac issuance is communicated, with the first Flac issuance being required by 1 January 2028.

# What are the components of Flac requirements?

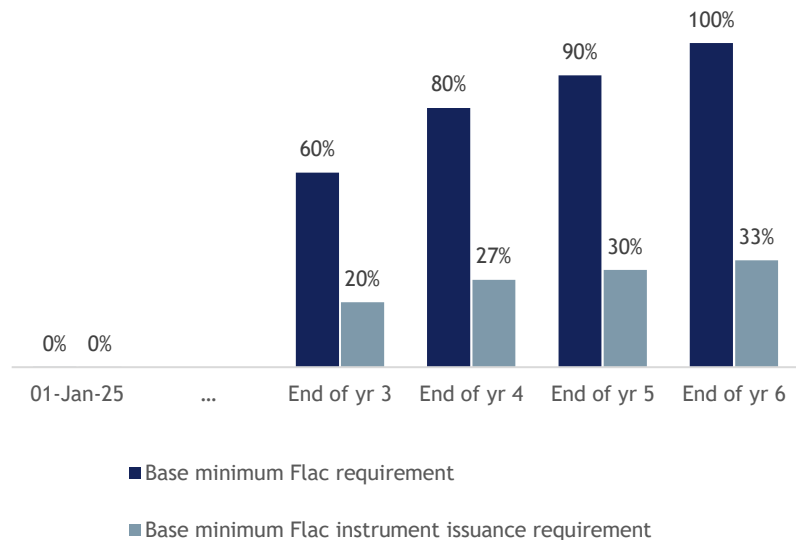


\*Institution-specific capital requirement indicating the market’s confidence in the institution operating as a going concern



# Flac requirements are set to phase-in over a 6-year period

*The phase in period allows designated institutions a minimum of three years to issue Flac instruments to the market, with a full phase in period of six years.*



## Comparison to other jurisdictions

- The **Bank of England** first communicated minimum requirement for own funds and eligible liabilities (MREL) requirements in November 2016 and required G-SIB and D-SIB banks to meet end-state MREL by 1 January 2022. The timeline for full implementation was therefore five years which approximates the six-year phase in period provided by SARB to South African SIFIs.
- In the Eurozone, the **Single Resolution Board (SRB)** required its banks to have fully implemented the MREL target by 1 January 2024.
- In Switzerland, the Swiss Financial Market Supervisory Authority (FINMA) required its G-SIBs to have fully implemented TLAC targets by 1 January 2020.

# Resolvability assessments - what can be expected?

The SARB will perform a Resolvability Assessment Process (RAP), the results of which will inform the resolvability rebate (up to 15%) that can reduce the additional Flac requirement. With little information being provided on how these assessments will take place, direction can be taken from other jurisdictions.

## Comparison to other jurisdictions

- In the EU, the SRB considers the below Seven Dimension of Resolvability when performing resolvability assessments.





- In Switzerland, FINMA considers the below four resolvability categories when quantifying the resolvability rebate for Swiss banks.


|   |                              |   |         |           |   |               |
|---|------------------------------|---|---------|-----------|---|---------------|
| 1 | Structural Disentanglement   | Holding Structure, service companies etc  |         |           |   |               |
| 2 | Operational Disentanglement  | Operational disentanglements to ensure the continuity of important operational services |         |           | Access to financial market infrastructure |               |
| 3 | Financial Disentanglement    | Intra-group financial interdependencies   |         |           |   |               |
| 4 | Implementation and Resources | Valuations  | Capital | Liquidity | Completion of bail-in                     | Restructuring |




# Key considerations for designated institutions


 Will the designated institutions have management information systems capabilities required to determine the post loss balance sheet?

 How will the introduction of Flac affect the pricing of other capital instruments in the market? Does the SA market have a wide enough investor base, or will SA banks have to raise the Flac off-shore which is generally more expensive?

 Will the cost of regulatory compliance not be too high for SA banks, given that banks will also be subject to depositor insurance levies and premiums as from 1 April 2024?

 Which data will the SARB consider when determining the market confidence premium? and what can banks do in the meantime to ensure a favourable outcome?

 The SARB will conduct a Resolvability Assessment Process (RAP) to assess the banks' resolvability. What steps can the banks take to proactively remove possible barriers to resolvability prior to the SARB's RAP?

 The SARB introduces a requirement for bail-in playbooks that demonstrate the ability of the bank's operations to support bail in. Will the banks have the required expertise to create these bail-in playbooks, and will these be considered during the SARB's RAP?

# TNP can assist with Flac and other resolution planning requirements

## Advisory support



- Advisory services on optimal group structures to facilitate an orderly resolution
- Subject matter expertise to assist in priming the market for the new class of capital instruments (Flac) and support with their structuring and pricing

## Automation support



- Support to automate the mapping critical suppliers to critical business processes

## Scenario analyses



- Support for the development of a scenario analysis framework with focus on resolution planning

## Independent reviews



- Management information systems capabilities
- Scenario analyses frameworks and simulations
- Valuations methodologies
- Organisation resolvability assessments
- Review of SLA arrangements

## Project management



- Project planning and scoping including budget requirements to implement the resolution requirements

## Resolution playbooks



- Preparation of resolution / bail-in playbooks
- Independent review of resolution / bail-in playbooks

## CONTACT THE AUTHORS



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**Who are we?**

# True North Partners in a nutshell: Our approach, team and client base

## *Unique consulting boutique*

A global independent firm based out of London with additional offices in Frankfurt, Madrid, Amsterdam, Johannesburg and Dubai

## *An international team*

Our ~125 people strong team comes from diverse backgrounds, bringing in valuable sought-after experience

## *Financial services specialists*

Our teams bring deep expertise of **risk, finance and strategy** domains within financial services



## *Broad client base*

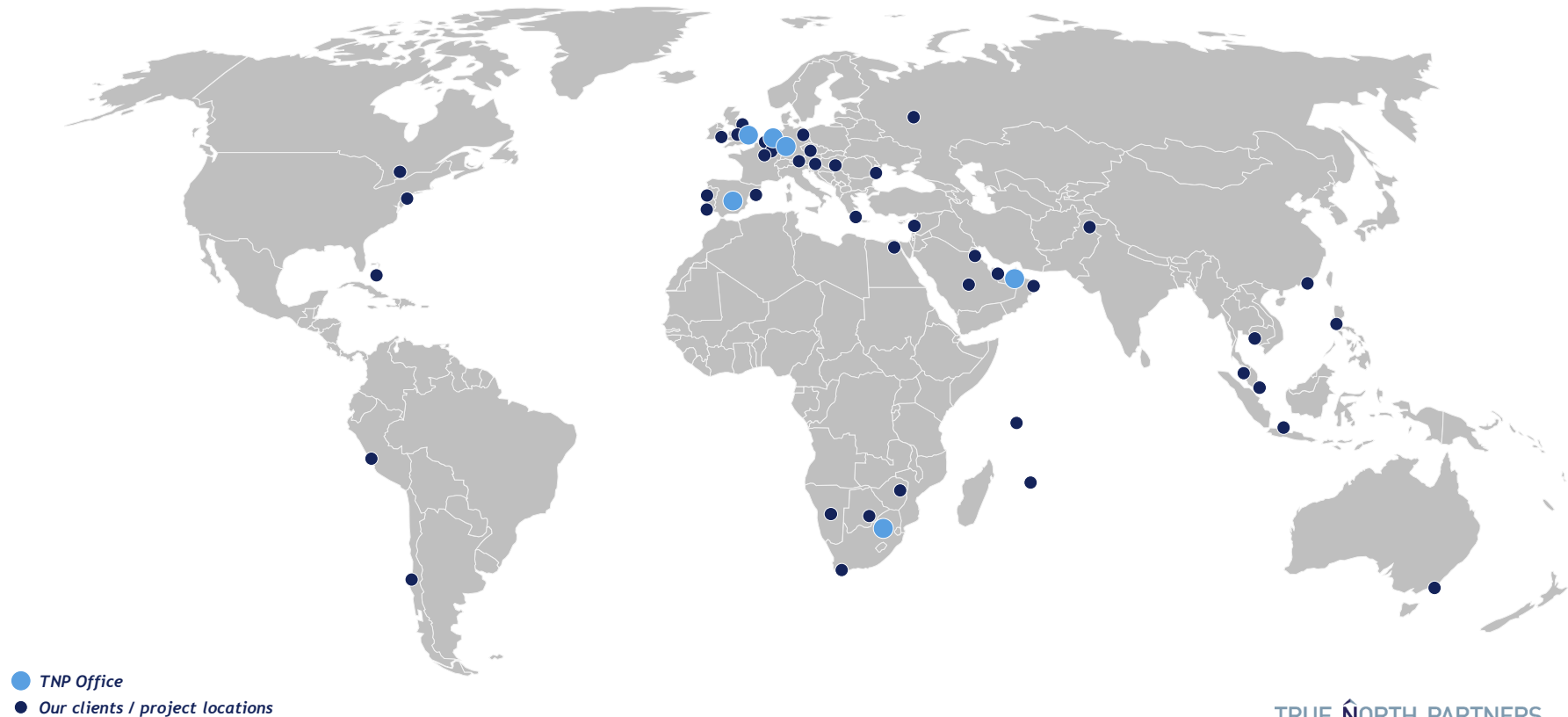
Our clients are **global and regional players** in the financial services industry and rely on our expertise and guidance in navigating their firms.

## *Partner-centric business model*

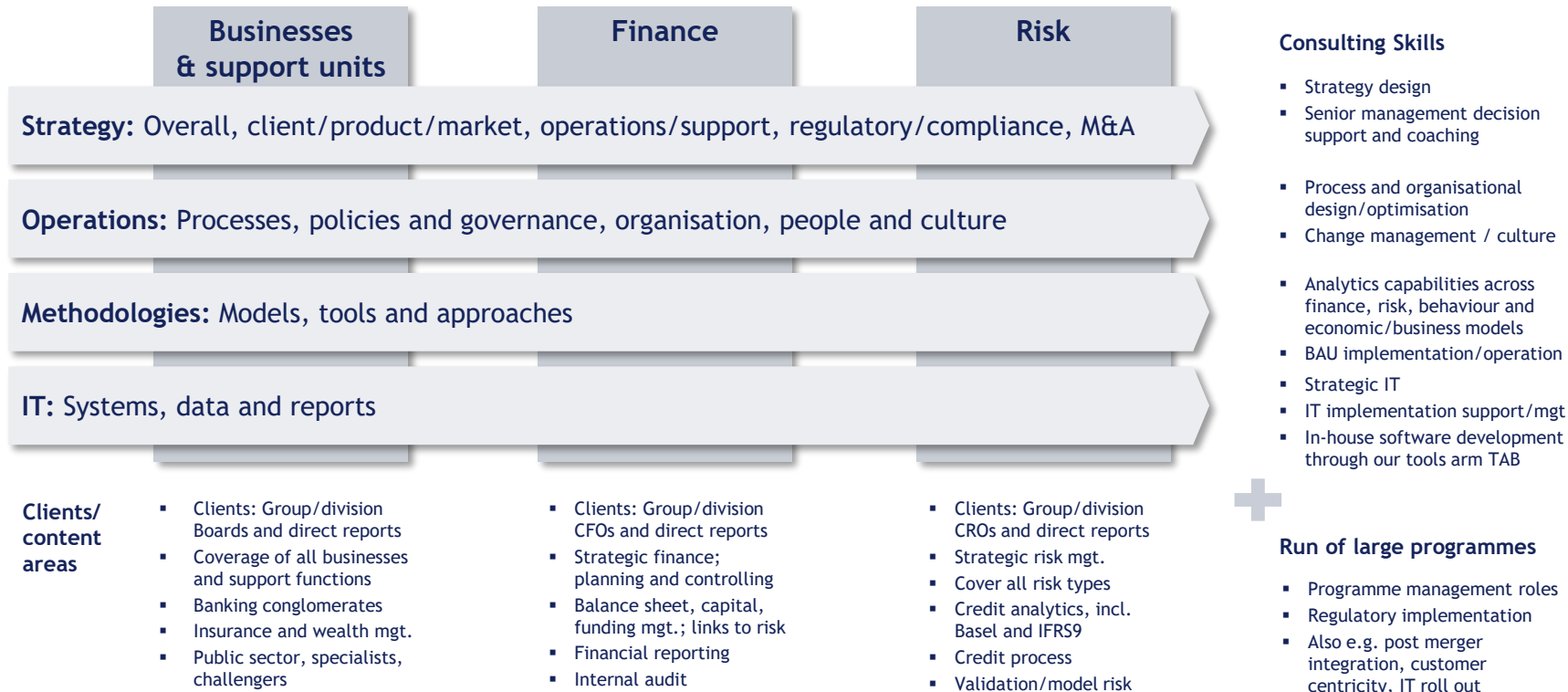
We are committed partners to our clients - providing support outside of formal engagements

In South Africa, True North Partners (SA) Pty Ltd (Company No. 2014/243723/07, Director: Urbanus Vermeulen) is a **Level 1 B-BBEE service provider**.

TNP has a global footprint, with offices based in London, Frankfurt, Amsterdam, Madrid, Johannesburg and Dubai



# Our experience: We cover finance, risk and strategy within financial institutions, with a broad range of consulting skills to deliver



# Partners: Resolution planning and related topics



## Niru Govender

20+ years: Risk & Strategy, Standard Chartered Bank, Standard Bank

M.Phil, Cambridge University, B.Sc. Honours in Financial Engineering, University of the Witwatersrand, B.Sc. In Mathematics & Statistics, University of Kwa-Zulu Natal

- Project experience in risk frameworks, policies, capital, risk- appetite and -profile management, operational and credit modelling, resolution regulations
- Experience in the UK, Singapore, Hong Kong, South Africa
- Strong banking experience across risk disciplines



## Andries Schutte

20+ years - Financial and risk management experience and a qualified actuary

Bcom Insu. and Actu. Sci., Bcom Hons in Fin. Mgmt, FIA, FASSA, CERA Univ. Pretoria

- His client portfolio covers financial institutions in South Africa, UK, Dubai, Mauritius, Namibia. He has also advised companies in mining, telecoms and construction
- His recent project work focused on internal regulatory capital models by advising the regulator



## Dr. Etienne Hofstetter

20+ years - Risk & Banking: TNP, Abbey/Santander, Barclays, KPMG Advisory, Hymans Robertson (Partner)

PhD and MSc in Physics (Mainz, Lausanne), Post-doc research (Imperial College London)

- Risk management experience in banking industry, consulting and academia
- Experience in capital management, group-wide economic value management/profitability, pricing/valuation, stress testing, IFRS9, portfolio management, IRRBB, liquidity
- Experience in the UK, EU, RSA, Middle East & Asia



## Vijay Krishnaswamy

20+ years - TNP (Partner), ANZ, Standard Chartered, KPMG Germany, FSA, Hymans Robertson (Partner)

BSc in Mathematics, MBA in Finance, FRM

- Partner at Hymans Robertson before transferring to TNP
- Previously, Vijay supported the FSA's risk assessment of UK banks and the implementation of firm-wide stress testing. He set up the FSA's model governance and validation framework
- He worked in the industry on a range of risk, finance and front office topics



## Borja Sánchez

14+ years: Finance, Risk, Capital and Balance Sheet Management & ILAAP, ICAAP, PwC Advisory (Director), Leadership Roles at Commercial Banks

Masters in Economics and Law at UC3M, Madrid  
Masters in Corporate Finance (Wharton)  
Masters in Data Science (MIOTI)

- Project experience in capital and balance sheet management, ILAAP, Asset Allocation, risk adjusted pricing
- Experience in Central and Southern Europe



# SMEs: Resolution planning and related topics



**Monika Mars**

20+ years - Risk & Regulation, TNP, MM Advisory, McKinsey, PwC

MSc in Economics, Member of IIF SteerCom on Gov. and Industry Practices & the Working Groups on Risk Mgmt & Cross-Border Resolution

- Areas of focus are risk & capital management, the Basel capital adequacy and liquidity framework and related regulatory developments, recovery and wind-down/ resolution planning.
- Experience in EU, the US, ME, RSA, Asia & Australia
- Worked with several supervisors on a range of topics & policy drafting



**Colin Cameron**

20+ years: Operational Risk, Standard Chartered Bank, Standard Chartered Bank and Danske Bank. Other senior roles were at GE and Barclays

- Development and implementation of scenario analysis for stress testing, OCIR / BCP testing and Exco crisis management exercises
- Accountable person for primary engagement with regulators: PRA, FCA, EBA, FSA
- Understanding of leading practice and industry benchmarks in the risk and operational excellence working with peer banks, and external agencies



**Graham Bruce**

20+ years: Risk & Strategy, Standard Bank, Parker Fitzgerald

- With over 20 years of experience as senior finance practitioner advising clients, in Europe, Africa and Asia, on all aspects of strategy, balance sheet, capital optimization and structured finance whose clients include Standard Bank of South Africa, Commerzbank, CBA, Rabobank, Sumitomo and Barclays Group
- Excellent understanding of CFO and CRO agendas and impacts of new regulation on firm's capital and liquidity profiles



**Adeline Willis**

20+ years: Senior risk and regulatory compliance experience in the banking industry

MSc. Finance and Investment from Cass Business School and SII Certificates

- Recovery, resolution and resolvability assessment framework within the UK and EU
- Risk identification and control remediation professional
- Successful design and delivery of risk/governance frameworks
- Project/Programme challenge, oversight, and assurance

# TNP Consultants with Resolution Planning experience



**David Peters**

20+ years: Risk, Strategy & Compliance Oversight, TNP (Head of Middle East)  
Promontory Financial Group (Managing Director)

M.A. in International Economics & Studies from Johns Hopkins University

- Project experience in risk governance and metrics, recovery & resolution planning, non-financial risk, financial crime and risk frameworks for new institutions
- Experience in Canada, U.S., Singapore, South Africa, Australia, Japan, Korea, Hong Kong, India, Malaysia, and Mexico



**Sonsoles Caballero**

12+ years - Finance, ALM & Treasury

Master in Economics, Solvay Brussels School of Economics & Management.  
Professional Risk Manager certificate, PRMIA

Prior to work in TNP Sonsoles was working in ING Belgium where she spent big part of her career in several roles around Finance

- Experience in Liquidity topics, short-term liquidity management, ratios (such as LCR, NSFR management and forecasting etc)
- Liquidity Stress Testing and Funding Gap



**Sinikiwe Ngcobo CA(SA)**

10 years - Finance, Capital Management (Absa Group), Recovery and Resolution Planning (Standard Bank Group)

BCom Chartered Accounting Honours, University of Johannesburg, Member of the South African Institute of Chartered Accountants (SAICA)

- Experience in emerging regulations, recovery and resolution planning, operational resilience and capital management
- Crisis management frameworks enhancement, implementation and governance



**Mathew Nagel**

15+ years: Risk and balance sheet management experience: TNP, African Bank, Absa, Nedbank

BSc in Industrial Engineering, University of the Witwatersrand

- Project experience in credit risk management, ICAAP and ILAAP, stress testing, risk appetite, economic capital and pricing, strategic capital management, external/market reporting, and multiple other regulatory topics



**Thank you.**