



EBA/CP/2014/22

22 September 2014

Consultation Paper

Draft Guidelines

on the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail under Article 32(6) of Directive 2014/59/EU

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1. Responding to this Consultation

The EBA invites comments on all proposals put forward in this paper and in particular on the specific questions summarised in 5.2.

Comments are most helpful if they:

- respond to the question stated;
- indicate the specific point to which a comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed / rationale proposed; and
- describe any alternative regulatory choices the EBA should consider.

Submission of responses

To submit your comments, click on the 'send your comments' button on the consultation page by **22.12.2014**. Please note that comments submitted after this deadline, or submitted via other means may not be processed.

Publication of responses

Please clearly indicate in the consultation form if you wish your comments to be disclosed or to be treated as confidential. A confidential response may be requested from us in accordance with the EBA's rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

Data protection

The protection of individuals with regard to the processing of personal data by the EBA is based on Regulation (EC) N° 45/2001 of the European Parliament and of the Council of 18 December 2000 as implemented by the EBA in its implementing rules adopted by its Management Board. Further information on data protection can be found under the Legal notice section of the EBA website.

2. Executive Summary

Article 32(6) of the Directive establishing a framework for the recovery and resolution of credit institutions and investment firms¹ (hereafter referred to as Directive 2014/59/EU) mandates the EBA to issue Guidelines to promote the convergence of supervisory and resolution practices regarding the interpretation of the different circumstances when an institution should be considered as failing or likely to fail. A determination that the institution is failing or likely to fail constitutes one of the three cumulative conditions determining whether resolution authorities should take resolution actions. Similarly, it is one of two cumulative conditions determining that an institution is no longer viable and that resolution authorities shall exercise the write down or conversion power in accordance with Article 60 of Directive 2014/59/EU.

Article 32(4) of Directive 2014/59/EU provides a general description of the circumstances in which an institution shall be deemed to be failing or likely to fail. These Guidelines further specify those circumstances in order to ensure a consistent approach to triggering resolution, especially for cross border groups. In particular the Guidelines provide guidance on the objective elements that should guide competent authorities and resolution authorities in determining that:

- an institution infringes, or is likely to infringe in the near future, the requirements for continuing authorisation in a way that would justify the withdrawal of its authorisation by the competent authority, including but not limited to because it has incurred or is likely to incur losses that will deplete all or a significant amount of its own funds;
- an institution's assets are, or there are objective elements to support a determination that its assets will be, in the near future, less than its liabilities;
- an institution is, or is likely to be in the near future, unable to pay its debts or other liabilities as they fall due.

While the determination that an institution is failing or likely to fail remains the discretionary assessment of the relevant authority, these Guidelines set forth the elements on the basis of which this judgment should be based. The identification of single objective elements specified in these Guidelines with regard to a particular institution should neither lead to automatic determination that it is failing or likely to fail, nor automatically trigger resolution actions. On the contrary, in each case, the relevant authorities should decide whether the institution is failing or likely to fail on the basis of a comprehensive assessment of both qualitative and quantitative objective elements, taking into account all other circumstances and information relevant for the institution. Furthermore, the list of objective elements provided in these Guidelines is not

¹ Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council, OJ L 173, 12.6.2014, p.190-348.

exhaustive and does not prevent the relevant authorities from taking into account other considerations signalling that an institution is failing or likely to fail.

While Directive 2014/59/EU prescribes that the determination that an institution is failing or likely to fail is made by the competent authority, Member States may also provide that this determination can be made by the resolution authority after consulting the competent authority, provided that the resolution authority has the necessary tools and in particular adequate access to the information. For the purpose of making this determination, due to different roles and interplay with the institutions, the competent authorities and resolution authorities would likely follow different practices. However, these practices should be consistent and coordinated, as provided in these Guidelines.

On the one hand, the competent authorities should base their determination primarily on the supervisory review and evaluation process (SREP) as described in Article 97 of Directive 2013/36/EU and further specified in the EBA Guidelines for common procedures and methodologies for SREP developed in accordance with Article 107 of Directive 2013/36/EU, as well as results from the supervisory measures or early intervention measures applied by them towards a particular institution. In addition, the competent authorities should take into account the recovery options applied by institutions, and the results of valuation of institution's assets and liabilities carried out according to Article 36 of Directive 2014/59/EU.

On the other hand, the resolution authorities, when empowered under national law to determine that an institution is failing or likely to fail, and/or when consulted by the competent authorities with regard to such determination, should be in a position to carry out their autonomous assessment and base it on the objective elements outlined in Section 3 of Title II of these Guidelines. These objective elements reflect the areas and elements evaluated by the competent authorities under the SREP assessment (i.e. the institution's capital position, liquidity position and other requirements for its continuous authorisation). On the basis of these objective elements and the Overall SREP assessment, the competent and resolution authorities should consult each other and appropriately discuss the results of their assessments. Upon identifying the presence of objective elements specified in Section 3 of Title II of these Guidelines the resolution authority should ask the competent authority to provide, and the competent authority should provide explanation how the circumstances identified by the resolution authority have been reflected in the Overall SREP assessment of the institution.

In parallel with the public consultation, the EBA shall seek the views of the EBA's Banking Stakeholder Group, in accordance with Article 37 of Regulation 1093/2010 ('the EBA Regulation'). A public hearing is planned to be held in the middle of the three month consultation, the date and venue of which will be advised in due time. Following completion of the consultation, the EBA shall review the feedback provided, shall publish a feedback statement, and shall take any feedback into account in revising the final Guidelines, where appropriate.

3. Background and rationale

1. Resolution is the final part of a sequence of supervisory actions, generally following, where possible and appropriate, the adoption of early intervention measures, and it constitutes an alternative to normal insolvency proceedings. Indeed, resolution actions can be envisaged only when an institution is considered as failing or likely to fail, where private sector solutions and supervisory actions are not likely to prevent the failure of an institution within a reasonable timeframe, and where normal insolvency proceedings would not meet the public interest test.
2. According to Article 32(1) of Directive 2014/59/EU, three conditions need to be simultaneously met before resolution actions can be taken by a resolution authority, namely:
 - 1) the competent authority or (under certain conditions) the resolution authority determines that an institution is failing or likely to fail;
 - 2) having regard to timing and other relevant circumstances, there is no reasonable prospect that any alternative private sector or supervisory action (including measures by IPS, or supervisory action, including early intervention measures or the write down or conversion of capital instruments in accordance with Article 56 taken in respect of the institution), would prevent the failure of the institution within reasonable timeframe;
 - 3) a resolution action is necessary in the public interest.
3. Article 32(6) of Directive 2014/59/EU mandates the EBA to issue guidelines to promote the convergence of supervisory and resolution practices regarding the interpretation of the different circumstances when an institution should be considered as failing or likely to fail, i.e. the first of the above-mentioned three conditions. Article 32(6) of Directive 2014/59/EU confines these Guidelines only to the first condition and therefore this document does not provide further guidance on conditions two and three presented in paragraph 2 above.
4. Article 32(4) of Directive 2014/59/EU provides that the determination that an institution is failing or likely to fail should be based on the circumstances related to the following aspects:
 - a. a current or likely infringement of the requirements for continuing authorisation in a way that would justify the withdrawal of authorisation (Article 32(4)(a) of Directive 2014/59/EU);
 - b. assets currently lower or likely to be lower than liabilities (Article 32(4)(b) of Directive 2014/59/EU);
 - c. a current or likely inability to pay debts or other liabilities as they fall due (Article 32(4)(c) of Directive 2014/59/EU);

d. a need for extraordinary public financial support, subject to exceptions specified in the Directive 2014/59/EU (Article 32(4)(d) of Directive 2014/59/EU);

and this determination can be made either by the competent authority after consulting with the resolution authority, or when national legislation provides so, also by the resolution authority after consulting with the competent authority.

5. The Guidelines focus on circumstances specified in Article 32(4)(a), (b) and (c) of Directive 2014/59/EU. These Guidelines do not specify further the extraordinary public financial support referred to Article 32(4)(d) as the other circumstance for the determination that an institution is failing or likely to fail.
6. The assessment of whether an institution is meeting requirements of its continuing authorisation is carried out on a continuous basis by the competent authorities through the supervisory review and evaluation process (SREP) as described in Article 97 of Directive 2013/36/EU and further specified in the EBA Guidelines for common procedures and methodologies for SREP developed in accordance with Article 107 of Directive 2013/36/EU, which set out the common procedures and methodologies, for the functioning of SREP including for the assessment of the organisation and treatment of risks referred to Articles 76 to 87 of that Directive and for basing decisions referred to in Articles 98, 100, 101, 102, 104, and 105 of that Directive. According to the EBA Guidelines for common procedures and methodologies for SREP, the SREP focuses on the assessment of an institution's viability and requires competent authorities to have an up-to-date view on the risk profile of the institution, governance arrangements, its business model and strategy, and the adequacy of available own funds and liquidity resources to cover the risks to which the institution is or might be exposed and consequently the overall viability of the institution.
7. The goal of these Guidelines is to foster convergence among competent authorities as well as resolution authorities on the practices regarding the interpretation of circumstances when the institution should be deemed to be failing or likely to fail as outlined in Article 32(4)(a), (b) and (c) of Directive 2014/59/EU. Due to their different roles and interplay with the institutions, the competent authority and resolution authority would follow different practices, which nevertheless should be consistent and coordinated.
8. On the one hand, the competent authorities should base their determination of whether an institution can be considered as failing or likely to fail primarily on the outcomes of SREP score as well as results from the supervisory measures or early intervention measures applied by them towards a particular institution. In addition, the competent authorities should take into account the outcome of recovery options applied by institutions, and the results of the valuation of institution's assets and liabilities carried out according to Article 36 of Directive 2014/59/EU.
9. On the other hand, the resolution authorities when determining that an institution is failing or likely to fail and/or when being consulted by the competent authorities with regard to such

determination, should be in a position to carry out their autonomous assessment and base it on the objective elements outlined in Section 3 of Title II of these Guidelines, which reflect the areas and elements evaluated by the competent authorities under the SREP assessment (i.e. the institution's capital position, liquidity position and other requirements for its continuous authorisation). On the basis of these objective elements and the Overall SREP assessment, the competent and resolution authorities should consult each other and appropriately discuss the results of their assessments. Upon identifying the presence of objective elements specified in Section 3 of Title II of these Guidelines the resolution authority should ask the competent authority to provide relevant information and an explanation how the circumstances identified by the resolution authority have been reflected in the Overall SREP assessment of the institution.

10. The Guidelines are addressed both to the competent authorities and resolution authorities with the focus on assisting resolution authorities in their assessment, when entrusted under the provisions Article 32(2) of Directive 2014/59/EU, and interpreting outcomes of the supervisory assessment when being consulted following the provisions of Article 32(1)(a) of Directive 2014/59/EU.
11. These Guidelines aim to assist the authorities with their assessment. They are without prejudice to the authorities' discretion to decide, on the basis of the facts and circumstances of each specific case, whether the conditions for resolution are fulfilled.
12. The objective elements that help to make the determination that the circumstances specified in Article 32(4) of Directive 2014/59/EU are met can be of quantitative or qualitative nature.
13. These Guidelines should be read in conjunction with other regulatory products developed by the EBA , and in particular:
 - the EBA regulatory technical standards developed pursuant to Article 81(1) of Directive 2014/59/EU, specifying, among other things, the procedures, contents and conditions related to the notification that an institution is failing or likely to fail;
 - the EBA guidelines on types of tests, reviews and exercises developed pursuant to Article 32(4)(d) of Directive 2014/59/EU;
 - the EBA guidelines on triggers to apply early intervention measures developed pursuant to Article 27(5) of Directive 2014/59/EU;
 - the EBA regulatory technical standards on valuation developed pursuant to Article 36 of Directive 2014/59/EU;
 - the EBA guidelines on the common procedures and methodologies for the SREP developed pursuant to Article 107 of Directive 2013/36/EU.

4. Draft EBA Guidelines on the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail under Article 32(6) of Directive 2014/59/EU

In between the text of the draft Guidelines that follows, further explanations on specific aspects of the proposed text are occasionally provided, which either offer examples or provide the rationale behind a provision, or set out specific questions for the consultation process. Where this is the case, this explanatory text appears in a framed text box.

The text also has a number of specific questions, which respondents to the public consultation should consider in their responses.

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| Q1 | Do you have any general comments on the draft Guidelines for determining that an institution is failing or likely to fail? |
| Q2 | Do you consider the level of detail of these draft Guidelines to be appropriate? |

Status of these Guidelines

1. This document contains guidelines issued pursuant to Article 16 of Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC as subsequently amended by Regulation (EU) No 1022/2013 (hereafter referred to as the EBA Regulation'). In accordance with Article 16(3) of the EBA Regulation, competent authorities, resolution authorities and financial institutions must make every effort to comply with the guidelines.
2. Guidelines set out the EBA's view of appropriate supervisory practices within the European System of Financial Supervision or of how Union law should be applied in a particular area. The EBA therefore expects all competent authorities, resolution authorities and financial institutions to whom guidelines are addressed to comply with guidelines. Competent

authorities and resolution authorities to whom guidelines apply should comply by incorporating them into their supervisory practices as appropriate (e.g. by amending their legal framework or their supervisory processes), including where guidelines are directed primarily at institutions.

Reporting Requirements

3. According to Article 16(3) of the EBA Regulation, competent authorities and resolution authorities must notify the EBA as to whether they comply or intend to comply with these guidelines, or otherwise with reasons for non-compliance, by dd.mm.yyyy. In the absence of any notification by this deadline, competent authorities and resolution authorities will be considered by the EBA to be non-compliant. Notifications should be sent by submitting the form provided at Section 5 to compliance@eba.europa.eu with the reference 'EBA/GL/2014/xx'. Notifications should be submitted by persons with appropriate authority to report compliance on behalf of their competent authorities and resolution authorities.
4. Notifications will be published on the EBA website, in line with Article 16(3).

Title I - Subject matter, scope and definitions

Subject matter

5. Pursuant to Article 32(6) of Directive 2014/59/EU, these Guidelines intend to promote the convergence of supervisory and resolution practices regarding the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail.
6. For this purpose, these Guidelines provide guidance on objective elements that should support the determination that an institution is failing or likely to fail, in accordance with the circumstances laid down in Article 32(4)(a), (b) and (c) of Directive 2014/59/EU and, where relevant, building on the outcomes of supervisory review and evaluation process (SREP) performed in accordance with Article 97 of Directive 2013/36/EU and further specified in the EBA Guidelines for common procedures and methodologies for SREP.
7. The Guidelines also aim at assisting the resolution authorities in their assessment, when they are entrusted by their respective Member States, pursuant to Article 32(2) of Directive 2014/59/EU, with the power to determine that an institution is failing or likely to fail, and when interpreting the outcomes of the supervisory assessment when they are consulted by the competent authorities in accordance with Article 32(1)(a) of Directive 2014/59/EU.
8. These Guidelines do not purport to constrain the ultimate discretion of the competent authorities and resolution authorities in making the determination that an institution is failing or likely to fail. The identification of single objective elements, enlisted in Title III of

these Guidelines, with regard to a particular institution should not lead to the automatic determination that it is failing or likely to fail or result in an automatic application of resolution tools. Similarly, the list of objective elements specified in these Guidelines is not exhaustive and it should remain open since not all crisis circumstances can be reasonably foreseen in advance.

9. These Guidelines have to be read in conjunction with the conditions specified in Article 32(1)(b) and (c) of Directive 2014/59/EU, which specify the remaining two requirements, other than failing or likely to fail, that need to be met for taking resolution actions. As a consequence, the determination that an institution is failing or likely to fail, made by the competent authority and resolution authority in compliance with these Guidelines, does not in itself imply that all conditions to take resolution actions are met. Pursuant to Article 32(1)(b) and (c) of Directive 2014/59/EU other two conditions also require that no alternative private sector or supervisory action can be taken to remedy the situation within a reasonable timeframe and that the resolution action is necessary in the public interest.

Box 1 – Explanatory text

Below, there are some examples of situations in which an institution could be considered as failing or likely to fail by the competent authority and resolution authority, but without meeting the conditions to take resolution action in Article 32(1)(b) and (c) of Directive 2014/59/EU.

The examples are only provided to illustrate potential links between the different conditions to take a resolution action, as specified in Article 32(1) of Directive 2014/59/EU. Examples provided herein are without prejudice to resolution authorities' discretion when facing similar situations as each individual resolution decision will be based on the facts and circumstances of each particular case. The context, the specific features of the institution that is failing or likely to fail and the assessment of the relevant competent authority of the potential repercussions of its actions at that moment will determine whether the authority considers that conditions set forth in Article 32(1)(a), (b) and (c) are simultaneously met or not.

a) Institution A is a large credit institution which is likely to incur substantial losses. The extent of the losses is still unknown but there are objective elements to support a determination that the losses will deplete all or a substantial amount of own funds of Institution A. Pursuant to Article 32(4) of Directive 2014/59/EU and to these Guidelines, Institution A should therefore be considered as likely to fail. Yet, at this stage, Institution A is not experiencing liquidity difficulties. The recovery plan of Institution A envisages measures that are likely to restore its capital in the current circumstances. If the resolution authority is confident that these actions will succeed in restoring the financial situation of the institution in a sufficiently short timeframe, it may decide that resolution action is neither needed, nor appropriate given the conditions laid down in Article 32(1)(b) of Directive 2014/59/EU would not be satisfied. This decision can be revised at any time if the authorities' assessment of the situation changes or the situation further deteriorates.

b) Institution B is a medium-sized credit institution experiencing a specific and well-identified IT

problem. The IT problem, which can be resolved within less than 24 hours, leads, however, to the temporary inability to pay some debts or other liabilities as they fall due. Since Institution B is not able to pay its debts or other liabilities as they fall due, it should be considered as failing or likely to fail according to Article 32(4) of Directive 2014/59/EU and these Guidelines. Yet, this inability does not generate financial instability as the obligations that cannot be met are relatively small. In consequence, the relevant authorities consider that the institution does not satisfy conditions in Article 32(1)(b) of Directive 2014/59/EU, because it can solve the IT problem in a timely and effective way. Therefore, such a situation would not necessarily be sufficient to trigger a resolution action.

c) Institution C is a very small, not systemically important credit institution which does not perform any critical functions and it is expected to experience significant losses. Given the extent of the expected losses, the assets of the institution are likely to be less than its liabilities. In consequence, Institution C should be considered as likely to fail according to Article 32(4) of BRRD and these Guidelines. However, if the resolution authority considers that the institution can be wound down under normal insolvency proceedings, resolution action is not necessary in the public interest (Article 32(1)(c) of Directive 2014/59/EU). Therefore, such a situation would not necessarily be sufficient to trigger resolution.

10. The provisions in these Guidelines should also apply when a determination that an institution is failing or likely to fail is conducted by the relevant authority in the context of determining that an institution is no longer viable for the purpose of exercising the write down and/or conversion power in accordance with Article 60 of Directive 2014/59/EU.

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| Q3 | Do you consider the examples provided in Box 2 to be sufficiently clear and providing useful guidance? |
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Definitions

11. For the purpose of these Guidelines, the following definitions apply:

‘SREP’ means supervisory review and evaluation process as defined in Article 97 of Directive 2013/36/EU and further specified in the EBA Guidelines for common procedures and methodologies for SREP developed in accordance to Article 107 of Directive 2013/36/EU.

‘Overall SREP assessment’ as defined in the EBA Guidelines for common procedures and methodologies for SREP, is the up-to-date assessment of the overall viability of an institution based on assessment of SREP elements.

‘Overall SREP score’ as defined in the EBA Guidelines for common procedures and methodologies for SREP, is the numerical indicator of the overall risk to the viability of an institution based on the Overall SREP assessment.

Scope and level of application

12. These Guidelines are primarily addressed to the competent authorities and resolution authorities when they assess whether an institution is failing or likely to fail, according to Article 32(1)(a) of Directive 2014/59/EU. Where relevant, the Guidelines also apply to institutions, where they determine themselves to be failing or likely to fail, exclusively in accordance with Article 81(1) of Directive 2014/59/EU. In this respect, the parts of these Guidelines that make reference to the other two conditions for resolution (set forth in Article 32(1)(b) and (c) of Directive 2014/59/EU) do not apply to the institutions.
13. The scope of these Guidelines is expanded beyond the scope set forth by Article 32(4) of Directive 2014/59/EU as Title III covers also consultation and information exchange between the competent authority and resolution authority for the purpose of making a determination that an institution is failing or likely to fail. Pursuant to Article 16 of Regulation (EU) No 1093/2010 the EBA may issue guidelines in order to establish consistent, efficient and effective supervisory practices within the European System of Financial Supervision. The additional guidance provided in Title III is limited to information exchange between authorities established in the same Member State and its provisions are without prejudice to rules for exchanging information between authorities across jurisdictions. In Member States which do not exercise the option to empower the resolution authority to determine that the institution is failing or likely to fail the provisions in paragraphs 36-37 should not apply.

Title II – Criteria for determination that an institution is failing or likely to fail

1. General criteria

14. The objective elements that should be taken into account by the competent authorities and resolution authorities in determining that the institution is failing or likely to fail should cover the following areas and elements:
- capital position of an institution;
 - liquidity position of an institution;
 - other requirements for continuing authorisation (including governance arrangements and operational capacity).
15. The above-mentioned areas and elements are covered in the SREP assessment conducted by the competent authorities. They are also reflected in the objective elements specified in Section 3 of Title II of these Guidelines to be used by the resolution authorities in determining whether the institution is failing or likely to fail.

16. The objective elements listed in these Guidelines should be carefully analysed on a comprehensive basis by the competent authorities and resolution authorities. The determination that the institution is failing or likely to fail should remain an expert judgement and should not be automatically derived from the list of objective elements. This is especially true as regards the interpretation of the elements which may be affected by factors not directly related to the financial position of the institution.
17. In most cases it is expected that several factors set out in these Guidelines, not merely one, would inform the determination that an institution is failing or likely to fail. Nevertheless, there might be situations where meeting just one condition, depending on its severity and prudential impact, would be sufficient to trigger resolution.
18. Without prejudice to paragraph 17, some of the indicators included in these Guidelines, such as macro-economic developments and market indicators should always be used in conjunction with other input factors for determining that the institution is failing or likely to fail. When the relevant authorities use the external indicators referred to in paragraphs 24(h)-(j) and 27(j)-(k) of these Guidelines, any actual determination relating to the institution having failed or being likely to fail must be supported by an objective assessment of the institution's actual financial position, to cater for the risk of market speculation.

2. Determination done by the competent authority

19. When determining that an institution is failing or likely to fail the competent authority should base its determination on the outcomes of the SREP and, where available, consider the following additional sources of information:
- the results of the application of supervisory measures and early intervention measures;
 - the results of implementation of the recovery options by an institution;
 - the results of a valuation of the institution's assets and liabilities, to the extent they are consistent with Article 36 of Directive 2014/59/EU;
 - the notification received from an institution that it considers itself as failing or likely to fail.
20. In particular, the following should be considered as objective elements indicating that the institution is failing or likely to fail:
- a. Overall SREP score of "F" assigned to an institution based on the considerations stipulated in the EBA Guidelines for common procedures and methodologies for SREP;
 - b. Overall SREP score of "4" assigned to an institution based on the considerations stipulated in the EBA Guidelines for common procedures and methodologies for SREP and failure to comply with the supervisory measures applied according to Articles 104-105 of Directive

2013/36/EU, or early intervention measures, applied according to Article 27(1) of Directive 2014/59/EU;

- c. the institution has activated its recovery plan and failed in the implementation of the relevant recovery options chosen from its recovery plan, in particular when the activation of the recovery plan was imposed on an institution by the competent authorities as an early intervention measure under Article 27(1)(a) of the Directive 2014/59/EU;
- d. the results of valuation of institution's assets and liabilities, to the extent they are consistent with Article 36 of Directive 2014/59/EU, supporting a determination that the assets of the institution are less than its liabilities or that this is likely to occur in the near future. Depending on the assessment of the competent authority, elements of the valuation results may also be used in the determination whether institution infringes or is likely to infringe in the near future the regulatory own funds requirements from Directive 2013/36/EU and Regulation (EU) No 575/2013 in a way that would justify the withdrawal of its authorisation;
- e. the notification received by the competent authority in accordance to Article 81(1) of Directive 2014/59/EU, from the institution which considers itself as failing or likely to fail.

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| Q4 | Do you have any comments on the proposed specification of circumstances which should be taken into account by the competent authority in determining that an institution is failing or likely to fail? |
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3. Determination done by the resolution authority

21. When the resolution authority, on its own initiative or when being consulted by the competent authority, assesses whether the institution can be considered as failing or likely to fail, it should consider the objective elements in relation to the institution's capital position, liquidity position and other aspects with respect to the requirements for continuing authorisation, as described in the following paragraphs.

22. All these objective elements should be taken into account also when reviewing the relevant outcomes of SREP performed by the competent authorities and provided to the resolution authorities as specified in paragraph 36.

3.1. Capital position

23. Following Article 32(4)(a) and (b) of Directive 2014/59/EU an institution should be considered as failing or likely to fail if it does or if there are objective elements to support a determination that in the near future it will:

- infringe own funds requirements, including requirements imposed according to Article 104(1)(a) of Directive 2013/36/EU, for the continuing authorisation in a way that would

justify the withdrawal of its authorisation by the competent authority including but not limited to because it has incurred or is likely to incur in losses that will deplete all or a significant amount of its own funds; or

- have assets which are less than its liabilities.

24. When assessing the assets and liabilities of the institution in the near future and whether the institution will comply in the near future with the own funds requirements, the resolution authority should base its determination on objective elements including *inter alia*:

- a. elements, risks and indicators assessed within the SREP process as far as these are known to the resolution authority;
- b. Overall SREP score of “4” assigned to an institution by the competent authority assigned on the considerations stipulated in the EBA Guidelines for common procedures and methodologies for SREP and failure to comply with supervisory measures applied according to Articles 104-105 of Directive 2013/36/EU, and early intervention measures, applied according to Article 27(1) of Directive 2014/59/EU;
- c. activation of the recovery plan by an institution and subsequent failure in the implementation of the relevant recovery options chosen from its recovery plan, in particular when the activation of the recovery plan was imposed on an institution by the competent authorities as an early intervention measure under Article 27(1)(a) of Directive 2014/59/EU;
- d. results of valuation of institution’s assets and liabilities, to the extent that they are consistent with Article 36 of Directive 2014/59/EU, supporting a determination that assets of the institution are less than its liabilities or that this is likely to occur in the near future. Depending on the assessment of the resolution authority, elements of the valuation results may also be used in the determination whether the institution infringes or is likely to infringe in the near future the own funds requirements from Directive 2013/36/EU and Regulation (EU) No 575/2013 in a way that justifies a withdrawal of its authorisation;
- e. the results of national / Union / Single Supervisory Mechanism (“SSM”) asset quality review indicating a significant decrease in asset value.

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| Q5 | Do you reckon that a significant decrease in asset value can be predefined in a quantitative manner? If yes, which threshold would you suggest for that purpose? |
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Additional elements that should be considered, where relevant to the characteristics of the institution, by the resolution authorities when carrying out this determination include:

- f. threats to viability stemming from a significant increase in the cost of funding of the institution to a level which is unsustainable for the institution;

- g. the likely materialisation of the institution's significant off-balance sheet items (i.e. contingent liabilities) in the near future, causing substantial loss threatening capital position;
- h. significant adverse developments in the macro-economic environment that could threaten the institution's financial position and its viability, including relevant development in interest rates, real estate values or economic growth. Such developments should significantly adversely affect the business model of the institution, the outlook for its profitability and its future viability;
- i. indicators reflecting a market belief that the solvency of the institution is severely impaired and its financial position and viability threatened, as reflected in, *inter alia*, a collapsing price-to-book level or a rapidly increasing level of the economic leverage². The development of both ratios could be compared with the institution's peer group duly considering distortions that may arise from differences in accounting standards;
- j. a significant non-temporary deterioration in the absolute and relative evolution of market indicators including, where available, equity based indicators (for instance share price) or debt based indicators (for instance credit default swaps or subordinated debt spreads) indicating that an institution is likely to incur losses that could threaten its viability.

25. The extreme case of inadequate capital position would be when the institution has insufficient assets to cover its liabilities. The likelihood of such a situation can be assessed from the circumstances and events listed in paragraph 24.

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| Q6 | Do you have any comments on the proposed specification of objective elements related to capital position which should be taken into account by the resolution authority in determining that an institution is failing or likely to fail? |
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3.2. Liquidity position

26. Following Article 32(4)(a) and (c) of Directive 2014/59/EU an institution should be considered as failing or likely to fail if it does or if there are objective elements to support a determination that in the near future it will:

- infringe regulatory liquidity requirements, including requirements imposed according to Article 105 of Directive 2013/36/EU, for continuing authorisation in a way that would justify the withdrawal of its authorisation by the competent authority; or
- be unable to pay debts and liabilities as they fall due.

² The economic leverage as measured as the ratio of total assets to market value of equity.

27. Certain objective elements should be considered for the purposes of determination that the institution is likely to be unable to meet regulatory requirements for liquidity or to pay its debts and liabilities as they fall due. These elements include *inter alia*:

- a. elements, risks and indicators assessed within the SREP process as far as these are known to the resolution authority;
- b. Overall SREP score of “4” assigned to an institution by the competent authority based on the considerations stipulated in the EBA Guidelines for common procedures and methodologies for SREP and failure to comply with supervisory measures applied according to Articles 104-105 of Directive 2013/36/EU, and early intervention measures, applied according to Article 27(1) of Directive 2014/59/EU;
- c. activation of the recovery plan by an institution and subsequent failure in the implementation of the relevant recovery options chosen from its recovery plan, in particular when the activation of the recovery plan was imposed on an institution by the competent authority as an early intervention measure under Article 27(1)(a) of Directive 2014/59/EU;
- d. significant adverse developments affecting the evolution of the institution's liquidity position and funding profile, and its compliance with minimum requirements for liquidity as stipulated in Regulation (EU) No 575/2013 and additional requirements imposed under Article 105 of that Regulation, or any national minimum requirements for liquidity;
- e. significant non-temporary adverse evolution of the institution's liquidity buffer and its counterbalancing capacity. The assessment of the counterbalancing capacity dynamics should consider, where relevant:
 - highly probable liquidity inflows, including received committed credit and liquidity lines;
 - any forecasted contractual inflows;
 - the capacity to renew funding;
 - the access to long term funding;
 - extraordinary and large reduction or termination of liquidity lines from counterparties;
- f. a non-temporary increase in the costs of funding of the institution to an unsustainable level, especially reflected by an increase of the costs (for instance reflected in spreads) of unsecured refinancing in relation to comparable institutions;

- g. a significant adverse evolution of the institution's current and future obligations. The assessment of the evolution of the institution's obligations should consider, where relevant:
- expected and exceptional outflows of liquidity, including requests from counterparties of the institution for early redemption of liabilities and emerging signs of potential runs;
 - expected and exceptional collateral requirements, as well as the evolution of haircuts on collateral by clearing houses and other counterparties;
 - any contingent obligation, including those arising from granted credit and liquidity lines;
- h. the position of the institution in the payment, clearing and settlement systems and any indication that the institution is experiencing difficulties to fulfil its commitments or to execute payments in payment, clearing and settlement systems;
- i. developments that would be likely to severely impair the institution's reputation, and in particular significant rating downgrades by one or several rating agencies, if they lead to substantial outflows, the inability to renew funding or to the activation of contractual triggers based on the external ratings.

Additional elements that should be considered, where relevant to the characteristics of the institution, include:

- j. significant adverse developments in the macro-economic environment that could threaten the institution's financial position, including development in interest rates, real estate values or the economic growth forecasts. The macro-economic developments should specifically affect, directly or indirectly, the liquidity position of the institution in a significantly adverse way;
- k. signs of non-temporary deterioration in the absolute and relative evolution of market indicators, including where available, equity-based indicators (such as share price, book-to-market equity ratio, etc.), or debt-based indicators (including credit default swaps, subordinated debt spreads, etc.) indicating that an institution is likely to incur losses or face liquidity problems that could threaten its viability.

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| Q7 | Do you have any comments on the proposed specification of objective elements related to the liquidity position which should be taken into account by the resolution authority in determining that an institution as failing or likely to fail? |
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3.3. Other requirements for continuing authorisation

28. According to Article 32(4)(a) of Directive 2014/59/EU an institution shall be considered as failing or likely to fail when it infringes, or in the near future is likely to infringe, the requirements for the continuing authorisation in a way that would justify the withdrawal of its authorisation by the competent authority. Pursuant to Article 18 of Directive 2013/36/EU, the competent authority may withdraw the authorisation of a credit institution *inter alia* when the institution: (i) no longer meets the prudential requirements set out in Parts Three, Four or Six of Regulation (EU) No 575/2013 or imposed under Article 104(1)(a) or Article 105 of Directive 2013/36/EU; (ii) can no longer be relied on to fulfil its obligation towards its creditors, and in particular, no longer provides security for the assets entrusted to it by its depositors; or (iii) commits one of the breaches referred to in Article 67(1)(a)-(p) of Directive 2013/36/EU.

29. For the purpose of letters (i)-(iii) above the resolution authority should consider *inter alia* whether and how serious weaknesses identified in the institution's governance arrangements, as well as in its operational capacity have material impact on the institution's reliability and capacity to provide banking/investment services.

Governance arrangements

30. Certain objective elements should indicate that the institution has serious weaknesses in its governance arrangements which may, in most cases in conjunction with other objective elements related to capital and liquidity, justify withdrawal of the authorisation. These elements include *inter alia*:

- significant misstatements in regulatory reporting or financial statements, especially resulting in a refusal of opinion or providing qualified opinion by the external auditor;
- a prolonged deadlock in the institution's management body which leads to its inability to make critical decisions;
- an accumulation of material deficiencies in key areas of the governance arrangements, which together have serious prudential impact on the institution.

Box 2 - Explanatory text

Below there are examples of material deficiencies in key areas of the institution's governance arrangements which, when accumulated, may have serious negative prudential impact on the institution, justifying withdrawal of its authorisation:

- inadequate strategic planning and formalisation of risk tolerance/appetite and its risk management framework, leading to the inability to identify, manage and report the risks the institution is or might be exposed to;
- material weaknesses, deficiencies or issues that were properly and/or timely reported to the management body;
- inadequate internal control mechanisms;
- major reputational depreciation outcome from the non-compliance with "fit and proper" criteria of individuals with key functions in the institution;
- major reputational depreciation arising from a lack of transparency in the conduct of business and operations or incomplete/inaccurate disclosure of information;
- major litigation or disputes in the nomination and succession of individuals performing key functions in the institution;
- major non-compliance with remuneration requirements.

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| Q8 | Do you have any comments on the proposed specification of the circumstances, related to governance arrangements, which should be taken into account by the resolution authority in determining that an institution is failing or likely to fail? |
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Operational capacity to provide regulated activities

31. Certain objective elements may negatively impact the institution's operational capacity to provide banking and investment services, even without infringing own funds and liquidity regulatory requirements. Such circumstances and events, when they are not contingent and cannot be removed in a timely and efficient way, should be considered in the assessment of whether the institution is failing or likely to fail. The indicators of the negative circumstances and events include *inter alia*:

- the institution can no longer be relied on to fulfil its obligations towards its creditors, and in particular, no longer provides security for the assets entrusted to it by its depositors;
- the institution becomes unable to make or receive payments, and thereby unable to conduct its banking activities;

- due to operational risks the institution loses market and depositors confidence leading to the situation where the institution is no longer able to carry out its business activities (as evidenced by the unwillingness of its counterparties and other stakeholders to transact with or provide capital to the institution and, where relevant, of existing counterparties seeking to terminate their contracts, including a bank run).

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| Q9 | Do you have any comments on the proposed specification of the circumstances, related to the institution's operational capacity to provide regulated activities, which should be taken into account by the resolution authority in determining that an institution is failing or likely to fail? |
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Title III – Consultation and information exchange between competent authority and resolution authority

General rules

32. Without prejudice to Article 90 and Article 32(2) of Directive 2014/59/EU, in order to facilitate timely flow of information for the purpose of assessing whether the institution is failing or likely to fail the competent authority and resolution authority should exchange information according to rules set out in paragraphs 36-38.
33. Before making the determination that the institution is failing or likely to fail on the basis of the outcomes of SREP and of the objective elements specified in these Guidelines, the competent authority and resolution authority should appropriately discuss the results of their assessment.
34. Upon identifying the presence of objective elements specified in Section 3 of Title II of these Guidelines the resolution authority should request the competent authority to provide explanation how the circumstances identified by the resolution authority have been reflected in the Overall SREP assessment of the institution.

Information provided by the competent authority

35. According to Article 27(2) of Directive 2014/59/EU the competent authority is required to inform the resolution authority about the determination that the conditions for application of early intervention measures have been met. In addition, pursuant to Article 81(2) of Directive 2014/59/EU, the competent authority should inform the resolution authority of taking any crisis prevention measures³ or any actions referred to in Article 104 of Directive 2013/36/EU.

³ According to Article 2(1)(101) of Directive 2014/59/EU crisis prevention measure' means the exercise of powers to direct removal of deficiencies or impediments to recoverability under Article 6(6), the exercise of powers to address or remove impediments to resolvability under Article 17 or 18, the application of an early intervention measure under Article 27, the appointment of a temporary administrator under Article 29 or the exercise of the write down or conversion powers under Article 59.

36. To facilitate this the competent authority should also provide the resolution authority with the outcomes of SREP, in particular, every time when the competent authority based on the outcomes of SREP assigns an Overall SREP score of “4” or “F” based on the considerations stipulated in the EBA Guidelines for common procedures and methodologies for SREP, it should notify the resolution authority and provide it with the following information in respect to the particular institution:

- a. summary of the Overall SREP assessment together with all SREP scores;
- b. the complete set of indicators used in the regular monitoring of key indicators supporting SREP as stipulated in the EBA Guidelines for common procedures and methodologies for SREP;
- c. all details on the applied supervisory measures and early intervention measures, as well as a description of the institution’s compliance with them;
- d. details on the recovery options applied by the institutions.

Information provided by the resolution authority

37. Upon the identification of objective elements specified in Section 3 of Title II of these Guidelines the resolution authority should provide the competent authority with a written analysis of its findings.

38. The competent authority should be informed in each case when the resolution authority:

- decides to exercise the power to require the institution to contact potential purchasers in order to prepare for the resolution of the institution, pursuant to Article 27(2) of Directive 2014/59/EU;
- requests the independent valuation of institutions’ assets and liabilities to be carried out, or decides that the provisional valuation will be taken by the resolution authority, pursuant to Article 36 of Directive 2014/59/EU;
- receives results of valuation of institutions’ assets and liabilities, pursuant to Article 36 of Directive 2014/59/EU, from the independent valuer or determines the result of the provisional valuation conducted by the resolution authority.

Title IV - Final Provisions and Implementation

These Guidelines should be implemented into national supervisory practices by competent authorities and resolution authorities by [date].

5. Accompanying documents

5.1 Cost-Benefit Analysis / Impact Assessment

Introduction

Article 32(6) of Directive 2014/59/EU requires the EBA to develop Guidelines that promote the convergence of supervisory and resolution practices regarding the interpretation of the different circumstances when an institution is considered failing or likely to fail.

As per Article 16(2) of the EBA Regulation (Regulation (EU) No 1093/2010 of the European Parliament and of the Council), any guidelines developed by the EBA shall be accompanied by an Impact Assessment (IA) annex which analyses 'the potential related costs and benefits'. Such annex shall provide the reader with an overview of the findings as regards the problem identification, the options identified to remove the problem and their potential impacts.

This annex presents the IA with cost-benefit analysis of the provisions included in the Guidelines described in this Consultation Paper. Given the nature of the study, the IA is high-level and qualitative in nature.

Problem definition

The core problem which the Guidelines on failing or likely to fail aim to address is the lack of the European harmonised approach to the interpretation of circumstances when institutions should be deemed as failing or likely to fail. Directive 2014/59/EU aims to address this issue by specifying certain circumstances when an institution should be considered failing or likely to fail and by mandating the EBA to provide further guidance on this matter. Without the publication of Guidelines on this matter the current problems faced due to inconsistencies in the assessment of when an institution is considered failing or likely to fail will potentially persist due to the fact that the circumstances outlined in Article 32(4) are largely subjective. These circumstances are outlined in the following way:

- a. the institution infringes or there are objective elements to support a determination that the institution will, in the near future, infringe the requirements for continuing authorisation in a way that would justify the withdrawal of the authorisation by the competent authority including but not limited to the situation where an institution has incurred or is likely to incur losses that will deplete all or a significant amount of its own funds;
- b. the assets of the institution are or there are objective elements to support a determination that the assets of the institution will be, in the near future, less than its liabilities;

- c. the institution is or there are objective elements to support a determination that the institution will be, in the near future, unable to pay its debts or other liabilities as they fall due;
- d. extraordinary public financial support is required except when, in order to remedy a serious disturbance in the economy of a Member State and preserve financial stability, the extraordinary public financial support takes any of the following forms [...].

The interpretation and the implementation of the circumstances mentioned above may vary across the Member States (MS). It is reasonable to expect that the divergences in assessing the viability of the institutions could lead to problems, including:

- Distortions in the functioning of the European banking sector due to suboptimal resolution decisions. The literature refers to the trade-off between the Type I error of missing a required intervention and the Type II error of incorrectly initiating an intervention.
- Authorities avoiding the implementation any resolution actions if there is a lack of clarity about the circumstances when these actions can be taken. This leads to the problem of moral hazard.
- Asymmetric information between authorities in different Member States when there is a need for cooperation in cross-border cases.
- Uneven playing field for institutions in the EU, i.e. different treatment of various entities belonging to the same cross-border groups due to different supervisory/resolution practices.
- Regulatory arbitrage, i.e. institutions may cease their operations in Member States where the regulatory framework is stricter and/or less predictable and relocate to Member States with more favourable regulatory frameworks.
- Increased costs of eligible liabilities issued by institutions due to uncertainty surrounding the conditions for determining that the institution is failing or likely to fail and thus possible resolution actions.
- Increased risk of challenging by creditors in court decisions of resolution authorities to resolve institutions.

The following section of this Impact Assessment presents a qualitative assessment of the alternative options and identifies a set of options that can effectively address these problems to varying degrees.

Objectives

The objective of these Guidelines is to promote convergence of supervisory and resolution practices regarding the interpretation of the circumstances when an institution should be considered as failing or likely to fail. A central element to establishing such a harmonised framework is to specify a common set of indicators and conditions which can be used by the authorities across Member States when assessing the viability of an institution. A common framework is also expected to facilitate cooperation among authorities in EU Member States when they assess cross-border cases. The framework ultimately aims to reduce the problem of moral hazard and promote the effective and efficient functioning of the EU banking sector. Table 1 presents a summary of the objectives of these Guidelines.

Table 1: Operational, specific and general objectives of the Guidelines

| Operational objectives | Specific objectives | General objectives |
|---|--|--|
| Equip competent authorities and resolution authorities with more effective, precise and accurate tools (e.g. indicators and circumstances) for triggering effective resolution. | Improve the regulatory system to achieve optimal resolution practices. | Reduce the probability of systemic banking crises and mitigate threats to financial stability. |
| Harmonise the practices in relation to resolution actions across Member States. | Improve cross-jurisdictional cooperation in relation to the resolution of cross-border institutions. | Promote the effective and efficient functioning of the internal market. |

Baseline scenario

There are substantial differences in the ways Member States currently trigger normal insolvency procedures and resolutions for institutions. National authorities can use different sets of definitions, parameters or circumstances for the purpose of determining that an institution is failing or likely to fail. This is problematic, in particular when divergent circumstances are applied to assess the viability of entities belonging to the same cross-border banking group located in different Member States. As a result, the baseline scenario assumed for this Impact Assessment will be the starting position that highly divergent sets of approaches could be adopted by Member States in defining the circumstances when an institution should be considered failing or likely to fail.

Assessment of the technical options

A. Options related to indicators to be considered by the authorities: qualitative vs. quantitative indicators

Both competent authorities and resolution authorities may have roles to play in the determination that an institution is failing or likely to fail. In general, similar factors will be taken into consideration by both authorities in a Member State when reaching these decisions. Much

analysis has been carried out in the literature to identify which factors can successfully predict distress in the banking sector⁴. One of the recent publications⁵ examines a set of factors that cover bank-specific indicators, country-specific banking sector indicators and country-specific macro-financial indicators. Taking such factors into account it is possible to develop a qualitative based framework to promote the convergence of practices regarding the determination that an institution is failing or likely to fail. It is equally possible to develop a quantitative based framework using these factors.

Both options have therefore been considered under this impact assessment:

A1. Qualitative Based Framework

A2. Quantitative Based Framework

Under Option A1 a qualitative based framework could be developed which outlines the types of factors, such as those identified in the literature referenced above, that should be assessed by competent authorities and resolution authorities in order to assess whether or not an institution is failing or likely to fail. Using a qualitative approach would imply that general terms such as ‘a significant increase in the cost of funding’ or ‘significant adverse macro-economic developments’ be included in the Guidelines as circumstances when an institution shall be considered failing or likely to fail. Whilst this approach provides some common metrics and factors to be considered by authorities in making their decision some of the issues identified in section Problem definition will persist due to the level of discretion available to the authorities in Member States.

Under Option A2 a quantitative based framework could be developed by specifying predefined thresholds for certain measurable factors which, if breached, can lead to a determination that the institution is failing or likely to fail. Similarly, a model could be developed based on a combination of measurable factors which are seen to be successful predictors of distress in banks. This model could then be used to define a certain threshold which, if breached, can be used to arrive at the failing or likely to fail determination.

The following table highlights some of the key potential advantages and disadvantages associated with each of the options considered.

⁴ Betz et al. (2013). ‘Predicting Distress in European Banks.’ ECB Working Paper Series, No. 1597, Drehmann M. and Juselius M. (2013). ‘Evaluating early warning indicators of banking crisis: Satisfying policy requirements’. BIS Working Papers, No. 421; Oet, M. V. et al. (2013). ‘SAFE: An early warning system for systemic banking risk’. Journal of Banking & Finance; Jahn N. and Kick T. (2012). ‘Early warning indicators for the German banking system: a macro prudential analysis’. Deutsche Bundesbank Discussion Paper, No. 27/2012.

⁵ Betz et al. (2013). ‘Predicting Distress in European Banks.’ ECB Working Paper Series, No. 1597.

Table 2: Potential advantages and disadvantages associated with the options

| | Potential Advantages | Potential Disadvantages |
|---|--|---|
| A1. Qualitative Based Framework | A level of supervisory discretion can be retained | A lack of consistency across jurisdictions may develop |
| | Harmonisation is achieved to a certain extent through the specification of common factors | This approach places higher requirements on the expertise and judgement of the competent and resolution authorities |
| | The need to develop and test new models is avoided | The extensive discretion given to the authorities does not eliminate the risk of supervisory forbearance |
| | | Market participants may lack confidence in the timeliness of resolution decisions made by authorities |
| | | Uncertainty amongst investors and a lack of confidence in the consistency of decisions may lead to difficulty in pricing eligible liabilities |
| A2. Quantitative Based Framework | Full convergence is achieved for supervisory and resolution activities across jurisdictions | If econometric models are used supervisory judgment could be fully removed from the decision making process and authorities may be forced to initiate resolution or insolvency proceedings even in cases where they do not agree that it would produce the optimal result |
| | Clarity and transparency are provided to market participants as well as institutions regarding the trigger for resolution and timing | Thresholds for individual factors could be considered as new regulatory requirements for institutions. Market participants may easily overreact to situations where an institution approaches any of the quantitative thresholds; this may lead to bank runs |
| | The problem of excessive regulatory forbearance can be reduced | Institutions could attempt to adjust their financial data to avoid breaching quantitative indicators |
| | The pricing of debt becomes more feasible given the greater degree of certainty amongst market participants regarding the timing and basis of resolution decisions | Using thresholds for individual factors may lead to excessive Type I and Type II errors due to the significant diversity across institutions/jurisdictions |
| | | Models based on combinations of factors which can more effectively reduce Type I and Type II errors could be difficult, costly as well as time consuming to develop, test and update |

Preferred Option

These Guidelines use the approach based on the combination of Qualitative and Quantitative Based Framework which can achieve a combination of the benefits associated with options A1 and A2 as well as reducing the costs associated with both options. The approach adopted is based on a set of qualitative indicators (Option A1) which includes also the Overall SREP score of the institution. In result, the assessment of whether the institution is failing or likely to fail, indirectly takes into account also the quantitative risk assessment of the institution (Option A2) reflected in its Overall SREP score. According to the Guidelines on common procedures and methodologies for SREP each competent authority should establish monitoring systems of key financial indicators and set thresholds for the purpose of identifying material deteriorations and anomalies in the behaviour of these indicators. When the pre-defined thresholds are breached the competent authorities should investigate the reason and, where relevant, update the Overall SREP score and/or make a decision of the application of early intervention measures. The Guidelines on failing or likely to fail, among other qualitative factors, refer to the Overall SREP score instead of providing a separate set of quantitative indicators and thresholds to be applied in the whole European Union. This approach aims at ensuring the continuum between the normal supervision, early intervention and resolution, while taking into account specific characteristic of the EU national banking sectors.

B. Options related to time horizon: Providing vs. non-providing any definition of 'near future'

Article 32(4) of Directive 2014/59/EU requires the competent authorities and resolution authorities to assess whether there are objective elements to support a determination that in the near future the institution would infringe requirements for continuing authorisation; have assets lower than liabilities; be unable to pay its debts and liabilities. The time horizon when considering the 'near future' is not specified by Directive 2014/59/EU. The following options aim to find an optimal benchmark to guide the authorities on how to interpret this expression.

The assessment considers the following two options:

B1. Providing a definition of 'near future'

B2. Not providing any definition of 'near future'

Option B1 aims at defining a common term of 'near future' either in general terms leaving room for the national interpretation and considerations for the time horizon to be considered, or alternatively setting a more precise definition for the time horizon to be considered by the authorities. Providing consistent definition of the 'near future' will help with the harmonisation of the regulatory framework. However, it may bring unintended consequences by eliminating the possibility of adopting the time horizons for the purposes of the assessment of particular elements (e.g. when assessing an institution's compliance with the requirements for continuing authorisation, authorities would use the time horizon used for the purposes of SREP and Directive 2013/36/EU, whereas in conducting valuation exercises in order to check that assets are not less than liabilities the time horizon should be consistent with the valuation criteria according to

Article 36 of Directive 2014/59/EU, taking into account maturity of assets and liabilities and the length of their economic cycle).

Under Option B2 the Guidelines would not define the 'near future'. This approach would allow competent and resolution authorities to select the most appropriate time horizon given the objectives of each of the particular assessments – for example the SREP assessment of meeting the requirements for continuing authorization under Directive 2013/36/EU, valuation of assets and liabilities, etc.

Neither of the two options introduce significant costs, whereas benefits from not introducing definition allow for additional benefit of keeping the time horizon fit for the purposes of the assessment, and also minimise potential conflicts between competent and resolution authorities using different time horizons for the assessment, especially as regards assessment of meeting the requirements for continuing authorisation through the SREP, where competent authorities are bound by Directive 2013/36/EU and EBA Guidelines for common procedures and methodologies for SREP, whereas the resolution authorities are not.

Preferred Option

The benefits for option B2 outweigh the benefits of Option B1 and provided that both options have negligible costs, Option B2 is considered as the preferred one.

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| Q10 | Do you agree with our analysis of the impact of the proposals in this Consultation Paper? If not, can you provide any evidence or data that would explain why you disagree or might further inform our analysis of the likely impacts of the proposals? |
|-----|---|

5.2 Overview of questions for Consultation

Questions related to the draft Guidelines

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| Q1 | Do you have any general comments on the draft Guidelines for determining that an institution is failing or likely to fail? |
| Q2 | Do you consider the level of detail of these draft Guidelines to be appropriate? |
| Q3 | Do you consider the examples provided in Box 2 to be sufficiently clear and providing useful guidance? |
| Q4 | Do you have any comments on the proposed specification of circumstances which should be taken into account by the competent authority in determining that an institution is failing or likely to fail? |
| Q5 | Do you reckon that a significant decrease in asset value can be predefined in a quantitative manner? If yes, which threshold would you suggest for that purpose? |
| Q6 | Do you have any comments on the proposed specification of objective elements related to the capital position which should be taken into account by the resolution authority in determining that an institution is failing or likely to fail? |
| Q7 | Do you have any comments on the proposed specification of objective elements related to the liquidity position which should be taken into account by the resolution authority in determining that an institution as failing or likely to fail? |
| Q8 | Do you have any comments on the proposed specification of the circumstances, related to governance arrangements, which should be taken into account by the resolution authority in determining that an institution is failing or likely to fail? |
| Q9 | Do you have any comments on the proposed specification of the circumstances, related to the institution's operational capacity to provide regulated activities, which should be taken into account by the resolution authority in determining that an institution is failing or likely to fail? |

Questions related to the Impact Assessment

| | |
|-----|---|
| Q10 | Do you agree with our analysis of the impact of the proposals in this Consultation Paper? If not, can you provide any evidence or data that would explain why you disagree or might further inform our analysis of the likely impacts of the proposals? |
|-----|---|