



EBA/CP/2014/24

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## Consultation Paper

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Draft Guidelines on the determination when the liquidation of assets or liabilities under normal insolvency proceedings could have an adverse effect on one or more financial markets under Article 42(14) of Directive 2014/59/EU

Draft Guidelines on factual circumstances amounting to a material threat to financial stability and of the elements related to the effectiveness of the sale of business tool under Article 39(4) of Directive 2014/59/EU

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# 1. Responding to this Consultation

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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 December 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

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Article 39(4) of Directive 2014/59/EU mandates the EBA to specify the factual circumstances amounting to a material threat to financial stability arising from or aggravated by the failure or likely failure of an institution under resolution and the elements where compliance with requirements to market the institution as set out in Article 39(1) of Directive 2014/59/EU would be likely to undermine the effectiveness of the sale of business tool in addressing that threat or achieving the resolution objective of avoiding significant adverse effects on financial stability.

To foster convergent practices among resolution authorities, these guidelines give guidance on these circumstances, and elements to be considered in their assessment. When assessing the impact on all market participants, which includes institutions and financial markets including infrastructure providers as well as non-financial customers, resolution authorities should in particular consider circumstances which are relevant for the risk that marketing the institution under resolution results in aggravating uncertainty and a loss of market confidence.

For each of the marketing requirements set out in Article 39(1) the guidelines identify elements where compliance could undermine the effectiveness of the sale of business tool. Potential conflicts between the marketing requirements and the resolution objective can for example arise where there is the risk that full compliance causes additional uncertainty and a loss of market confidence or where certain potential purchasers may be more likely to ensure financial stability than others, and in general with respect to the legal and organisational feasibility, the practicability and the timely implementation of the sale.

Article 42(14) of Directive 2014/59/EU mandates the EBA to issue guidelines to promote the convergence of supervisory and resolution practices regarding the determination when the liquidation of the assets or liabilities under normal insolvency proceeding could have an adverse effect on one or more financial markets.

The guidelines set out three elements that should be considered by resolution authorities when assessing the market situation for the assets concerned and the potential direct and indirect effects on financial markets:

- (a) Whether the market for these assets is impaired.
- (b) The impact of a disposal of these assets on the markets where they are traded.
- (c) The situation of the financial markets and the direct and indirect effects of an impairment of the markets for these assets.

For each of these elements the guidelines identify a list of factors resolution authorities should assess, with a particular view to the risk of causing additional pressure on prices and causing contagion.

## 3. Background and rationale

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### 3.1 Guidelines on factual circumstances amounting to a material threat to financial stability and of the elements related to the effectiveness of the sale of business tool

Directive 2014/59/EU establishes a framework of tools for the orderly resolution of failing institutions. Prior to the existence of resolution frameworks in Member States the sale of an ailing bank has often been a way of avoiding a negative impact on financial markets and financial stability. The creation of a special resolution tool and the potential combination with other resolution tools has facilitated the application and implementation of a sale of the institutions or parts of its business on the initiative of the resolution authority without the consent of shareholders.

Article 39 of the Directive requires resolution authorities when applying the sale of business tool to make arrangements for the marketing of the institution in an open, transparent and non-discriminatory process with a view to fair competition and general principles of the single market, while aiming to maximise, as far as possible, the sale price. However, the Directive recognises that for reasons of urgency a process complying with all requirements may be impossible.

These guidelines aim at giving guidance on these reasons of urgency which justify modifications of the standard sales process by specifying circumstances which amount to a material threat to financial stability arising from or aggravated by the failure or likely failure of the institution under resolution. As every financial crisis has very specific causes and challenges the guidelines set out a non-exhaustive list of circumstances, and elements to be considered in the assessment of such circumstances. In general, resolution authorities should consider the impact on all market participants, which includes institutions and financial markets including infrastructure providers and non-financial customers. Resolution authorities should in particular consider, but not limit themselves, to circumstances which are relevant for the risk that marketing the institution under resolution results in aggravating uncertainty and a loss of market confidence, such as dysfunctional interbank lending and funding markets.

In their second part the guidelines specify for each of the requirements set out in Article 39(1) the elements where compliance could undermine the effectiveness of the sale of business tool in addressing the threat to financial stability mentioned in the previous paragraph or achieving the resolution objective to avoid significant adverse effects on financial stability. Again the list of elements is non-exhaustive to enable resolution authorities to decide on a case-by-case decision while giving sufficient guidance to achieve an appropriate level of convergence. Potential conflicts between the marketing requirements on the one hand, and the effectiveness of the tool and the resolution objective on the other hand, can *inter alia* arise where there is the risk that they cause additional uncertainty and a loss of market confidence or where certain potential purchasers may

be more likely to ensure financial stability than others. More in general such conflicts should be assessed with respect to the legal and organisational feasibility, the practicability and the timely implementation of the sale.

### 3.2 Guidelines on the determination when the liquidation of assets or liabilities under normal insolvency proceedings could have an adverse effect on one or more financial markets

Holdings of impaired assets and depreciation were the cause for most cases of financial distress of institutions during the global financial crisis of 2008 and the following years. Many Member States established asset separation schemes ('bad banks') to relieve banks' balance sheets from these depreciated assets and the risks linked to them. In a comparable way the asset separation tool under Directive 2014/59/EU enables authorities to transfer assets, rights or liabilities of an institution under resolution to a separate vehicle, in order to wind these activities down orderly while maintaining the continuance of critical functions of the institution in resolution. However, the Directive stipulates that the tool may only be used in conjunction with other tools to prevent an undue competitive advantage for the failing institution. For the same reason, Article 42(5) limits the use of this power: It may only be used if the situation of the particular market for those assets is of such a nature that the liquidation of those assets under normal insolvency proceedings could have an adverse effect on one or more financial markets, or where the transfer is necessary to ensure the proper functioning of the institution under resolution or bridge institution or to maximise liquidation proceeds.

The EBA is mandated to issue guidelines to promote the convergence of supervisory and resolution practices regarding the determination when the liquidation of the assets or liabilities under normal insolvency proceeding could have an adverse effect on one or more financial markets. The scope of the guidelines is limited to this condition point (a) of Article 42(5) and does not relate to the points (b) and (c). The guidelines set out three categories of elements that should be considered by resolution authorities when assessing the market situation for the assets concerned and the potential direct and indirect effects on financial markets:

- (a) Whether the market for these assets is impaired.
- (b) The impact of a disposal of these assets on the markets where they are traded.
- (c) The situation of the financial markets and the direct and indirect effects of an impairment of the markets for these assets.

The latter categories are based on the former ones, and the guidelines identify for each of them a non-exhaustive list of factors resolution authorities should assess. As far as the urgency of the matter permits, resolution authorities should analyse the situation of the market for these assets and comparable asset classes, the general condition of financial markets and competitors of the institution in resolution, with a particular view to the risk of causing additional pressure on prices or contagion. However, it should be noted that neither a deterioration in the quality of the assets

concerned nor dysfunctional markets are indispensably required for the conclusion that the liquidation could have an adverse effect on one or more financial markets.

The mandate speaks of a liquidation of assets or liabilities. A liquidation of assets may occur if assets and liabilities are linked together in a portfolio, for example of derivatives. The guidelines establish that resolution authorities should have regard to the specificities of derivative portfolios, as their liquidation or transfer, respectively may have a considerable impact on counterparties.

## 4. EBA Guidelines on factual circumstances amounting to a material threat to financial stability and of the elements related to the effectiveness of the sale of business tool

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### Status of these guidelines

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 (*‘the EBA Regulation’*). In accordance with Article 16(3) of the EBA Regulation, competent authorities and financial institutions must make every effort to comply with the guidelines.

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 and financial institutions to whom guidelines are addressed to comply with guidelines. Competent 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

According to Article 16(3) of the EBA Regulation, competent 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 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](mailto:compliance@eba.europa.eu) with the reference ‘EBA/GL/201x/xx’. Notifications should be submitted by persons with appropriate authority to report compliance on behalf of their competent authorities.

Notifications will be published on the EBA website, in line with Article 16(3).



## Title I - Subject matter, scope and definitions

1. The guidelines specify the factual circumstances amounting to a material threat to financial stability arising from or aggravated by the failure or likely failure of an institution under resolution within the meaning of point (a) of Article 39(4) of Directive 2014/59/EU and the elements where compliance with requirements to market the institution as set out in Article 39(1) of Directive 2014/59/EU would be likely to undermine the effectiveness of the sale of business tool in addressing that threat or achieving the resolution objective specified in point (b) of Article 31(2) of Directive 2014/59/EU.
2. The guidelines apply to resolution authorities.

## Title II- Circumstances amounting to a material threat to financial stability

3. When assessing whether there is a material threat to financial stability arising from or aggravated by the failure or likely failure of the institution under resolution in the context of the requirement to market relating to the application of the sale of business tool, resolution authorities should consider the impact on other institutions and financial markets including infrastructure providers and non-financial institution customers. Resolution authorities should in particular consider, but not limit themselves to, factual circumstances which are relevant for the risk that marketing the institution under resolution results in aggravating uncertainty and a loss of market confidence. These circumstances should include at least any of the following:
  - (a) the risk of a systemic crisis or contagion, as evident from the number, size or significance of institutions which are at risk of meeting the conditions for early intervention, or from public financial support to institutions or extraordinary liquidity facilities by central banks;
  - (b) the risk of a discontinuance of critical functions or a significant increase in prices for the provision of these functions as evident from changes in market conditions for these functions or their availability, or the expectation of counterparties and other market participants in this respect;
  - (c) withdrawal of short term funding or deposits;
  - (d) decreases in share prices of institutions or in prices of assets held by institutions, in particular where they can have an impact on the capital situation of institutions;
  - (e) reduction in short or medium term funding available to institutions;
  - (f) impairment to the functioning of the interbank funding market, as particularly apparent from an increase of margin requirements and decrease of collateral available to institutions;

- (g) increases in prices for credit default insurance or decrease in ratings of institutions or other market participants, which are relevant for the financial situation of institutions.
4. Resolution authorities should assess the likelihood of an imminent impairment to any of these elements which could affect institutions other than the institution under resolution that are relevant for the financial stability of one or more Member States based on their relevance as individuals and collective, as appropriate.

### Question 1

**Should the elements listed above be further specified by any qualitative or quantitative indicators, in particular with respect to the development of prices or market conditions as factors evidencing a material threat to financial stability, to ensure convergent practices?**

**Are there further relevant elements which should be included?**

## Title III- Elements relating to the effectiveness of the sale of business tool and to financial stability

5. When assessing whether compliance with the requirements set out in Article 39(1) of Directive 2014/59/EU would be likely to undermine the effectiveness of the sale of business tool or achieving the resolution objective of avoiding significant adverse effects on financial stability, resolution authorities should consider at least the following elements:
- (a) With regard to the requirement of transparency stipulated by point (a) of Article 39(2) of Directive 2014/59/EU, the risk that marketing to a wider circle of potential purchasers and that disclosure of risks and valuations, or the identification of critical and non-critical functions in respect of the institution under resolution may result in additional uncertainty and in a loss of market confidence. In particular preparations for the marketing should not increase the risk that the institution enters resolution.
- (b) With regard to the principle of non-discrimination established by point (b) of Article 39(2) of Directive 2014/59/EU the fact that certain potential purchasers may be more likely to ensure financial stability, in particular due to factors such as their financial or market position, their structure and business model, which may facilitate the business integration and the legal and organisational feasibility or may have positive effects on the time required for the implementation of the resolution action and the expectation that critical functions can be continued. Resolution authorities should take into account the needs and expectations of counterparties, infrastructure providers, depositors and liquidity providers and of the wider market.
- (c) Resolution authorities should ensure that arrangements to ascertain that parties involved in the marketing process are free from conflicts of interest as stipulated by point (c) of Article 39(2) of Directive 2014/59/EU do not impede the practicability and the timely

implementation of the resolution action. Resolution authorities should take into account that given the limited number of service providers, advisers and potential purchasers in the market a certain risk of conflicts of interests may be inherent to the sales process.

- (d) When assessing whether advantages to potential purchasers are unfair within the meaning of point (d) of Directive 2014/59/EU, resolution authorities should take into account that the resolution objectives and the need for rapid action may justify incentivising purchasers or limiting their risk, in particular in the context of the use of the financing arrangements for these purposes as mentioned in Article 101(1) of Directive 2014/59/EU.
  - (e) When aiming at maximising the sale price as required by point (f) of Directive 2014/59/EU, resolution authorities should take into account the need for rapid action, which may be in conflict with prolonged price negotiations or bidding processes, and the resolution objectives, in particular the continuance of critical functions, which may be in conflict with maximising the sale price for certain business areas. In addition, resolution authorities should take into account that certain potential purchasers may be more likely to ensure financial stability, in particular due to factors such as their financial or market position, their structure and business model.
6. When the resolution authority assesses the need to effect a rapid resolution action in accordance with point (e) of Directive 2014/59/EU, it should pay particular regard to the continuance of critical functions, the confidence of depositors and the public, the functioning of infrastructures and the trading times in relevant markets.

#### **Question 2**

**Are there further potential conflicts between the marketing requirement and the effectiveness of the sale of business tool?**

#### **Question 3**

**How could the exercise of judgment by resolution authorities be constrained to ensure convergence in practices in assessing these conflicts?**

## **Title IV- Final Provisions and Implementation**

These guidelines shall apply as of xxx 2015.

## 5. EBA Guidelines on the determination when the liquidation of assets or liabilities under normal insolvency proceedings could have an adverse effect on one or more financial markets

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### Status of these guidelines

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 (*‘the EBA Regulation’*). In accordance with Article 16(3) of the EBA Regulation, competent authorities and financial institutions must make every effort to comply with the guidelines.

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 and financial institutions to whom guidelines are addressed to comply with guidelines. Competent 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

According to Article 16(3) of the EBA Regulation, competent 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 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](mailto:compliance@eba.europa.eu) with the reference ‘EBA/GL/201x/xx’. Notifications should be submitted by persons with appropriate authority to report compliance on behalf of their competent authorities.

Notifications will be published on the EBA website, in line with Article 16(3).

## Title I - Subject matter, scope and definitions

1. The guidelines promote the convergence of supervisory and resolution practices in accordance to Article 42(5) of Directive 2014/59/EU regarding the determination, when the liquidation of assets or liabilities under normal insolvency proceedings could have an adverse effect on the financial market.
2. The guidelines apply to resolution authorities.

## Title II- Adverse effect on the financial market of the liquidation of assets or liabilities

3. When assessing whether the market for certain assets or liabilities is of such a nature that the liquidation of these assets under normal insolvency proceedings could have an adverse effect on one or more financial markets, resolution authorities should assess the situation of the market for these assets, and the impact of a disposal of these assets on the markets where they are traded and on financial stability. However, resolution authority should not assume deterioration in the quality of the assets concerned or dysfunctional markets as necessary requirements for the conclusion that the liquidation could have an adverse effect on one or more financial markets.
4. Resolution authorities should assess at least the following elements, taking into account the urgency of the resolution action:
  - (a) Whether the market for these assets is impaired, based on the following indicators:
    - (i) The development of the liquidity of the markets for these assets or comparable asset classes;
    - (ii) whether these assets or comparable asset classes have been classified as impaired for accounting purposes and whether provisions have been set up by institutions in respect of these assets;
    - (iii) incurred losses and unstable cash flows under these assets;
    - (iv) downward value adjustments of the assets or corresponding price developments of associated hedges or comparable asset classes;
    - (v) high volatility in prices compared to the market in general, in particular uncommonly high price differences between different markets which typically show an identical development;
    - (vi) reduction of share prices and deterioration of ratings and refinancing conditions of institutions holding high amounts of these assets, compared to the rest of the market;

- (b) the impact of a disposal of these assets on the markets where they are traded, taking into account:
- (i) The size of the concerned markets and the range of potential purchasers;
  - (ii) the impact the liquidation of the assets is expected to have on the prices for comparable asset prices;
  - (iii) the expected timeframe for the liquidation of the assets under normal insolvency proceedings, including a potential accelerated distress sale;

#### **Question 4**

**Should the elements listed above further be specified by any qualitative or quantitative factors to ensure convergent practices?**

**Are there further relevant elements which should be included?**

- (c) the situation of the financial markets and the direct or indirect effects of a disposal of these assets, taking into account:
- (i) the risk of a systemic crisis, as evident from the number, size or significance of institutions which are at risk of meeting the conditions for early intervention or the resolution conditions;
  - (ii) whether the sale of the assets or an impairment of markets can result in contagion, in particular with regard to the amount of assets or comparable asset classes held by institutions, or where such holdings are valued at market prices;
  - (iii) a reduction in or an increase in prices of short or medium term funding available to institutions;
  - (iv) an impairment to the functioning of the interbank funding market, as particularly apparent from an increase of margin requirements and decrease of collateral available to institutions.
5. The elements listed in paragraph above are without prejudice to further elements, the assessment of which resolution authorities deem relevant in the specific case having regard to the particular circumstances.
6. Where the resolution authorities considers the transfer of assets and liabilities, in particular a portfolio of derivatives or other assets and liabilities that are legally or economically interlinked, the resolution authority should assess the elements under paragraph 3 also with respect to the portfolio as a whole and comparable portfolios. In addition, the resolution authority should assess the impact the unwinding of the portfolio could have on the financial markets, taking into account the effect on counterparties to these assets and liabilities such

as the discontinuance of hedging relations and the need to find a replacement for them or the impact on or special requirements of central counterparties.

**Question 5**

**Which specific considerations should apply regarding the liquidation of derivative portfolios? Is the assessment of the impact of the unwinding of derivative portfolio practicable? How could it be made more practicable?**

**Question 6**

**Are there further relevant examples of assets and liabilities linked to each other?**

**Question 7**

**How could the exercise of judgment by resolution authorities be constrained to ensure convergence in practices in assessing the situation of the financial markets and the impact of the disposal of assets?**

## Title IV- Final Provisions and Implementation

These guidelines shall apply as of xxx 2015.

## 6. Accompanying documents

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### 6.1 Cost- Benefit Analysis / Impact Assessment

#### Introduction

Article 39(4) of Directive 2014/59/EU requires the EBA to develop guidelines that specify the factual circumstances amounting to a material threat and the elements relating to the effectiveness of the sale of business that the resolution authorities should account for when:

- There is a material threat to financial stability arising from or aggravated by the failure of likely failure of the institution under resolution, and
- The compliance with the requirements<sup>1</sup> would be likely to undermine the effectiveness of the sale of business tool in addressing the threat or achieving the resolution objective.

Article 42(14) of Directive 2014/59/EU requires the EBA to issue guidelines to promote the convergence of supervisory and resolution practices regarding the determination when the liquidation of the assets or liabilities under normal insolvency proceeding could have an adverse effect on the financial market. The determination is in accordance to paragraph 5 of same Article and is applicable when:

- the situation of the particular market for those assets is of such a nature that the liquidation of those assets under normal insolvency proceedings could have an adverse effect on one or more financial markets,
- such a transfer is necessary to ensure the proper functioning of the institution under resolution or bridge institution; or
- such a transfer is necessary to maximise liquidation proceeds.

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 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.

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<sup>1</sup> These are the requirements under Article 31(2) of Directive 2014/59/EU referring to the resolution objectives.



This annex presents the impact assessment with cost-benefit analysis of the provisions included in the guidelines described in this consultation paper. Given the nature of the guidelines, the impact assessment is high-level and qualitative in nature.

### Problem definition and the baseline scenario

Current EU regulatory framework is in the process of building a resolution mechanism where Member States aim to achieve an orderly winding-out of the institutions in resolution by preventing potential adverse effect of the resolution process. Directive 2014/59/EU acknowledges the possibility of adverse effects during the process and leaves Member States leeway when they should otherwise carry out the process in line with the standard procedures.

Directive 2014/59/EU states that resolution authorities in Member States should account for potential extraordinary circumstances and waive certain standard procedures applicable to the sale of business tool when i) the circumstances can amount to material threat to financial stability and jeopardise the effective sale of business tool, and ii) the procedures are in conflict with the effectiveness of the tool. The provisions in Directive 2014/59/EU are formulated in generic terms and they do not specify: i) the circumstances that can amount to material threat to financial stability, and ii) the nature and consequences of conflicts between the requirements to ensure a transparent sales process and the effectiveness of the sale of business tool.

With regard to the assessment whether the liquidation of assets and liabilities under normal insolvency proceedings can have an adverse effect on financial market(s), the criteria against which the resolution authorities assess a specific situation that are not specified in Directive 2014/59/EU.

The core problem that the guidelines aim to address is the lack of a harmonised approach when the resolution authorities interpret these elements for assessment. Lack of consistency and potential variations in the interpretation of these elements may lead to:

- Asymmetric information between resolution authorities. This is important in particular when the institution in question has a large cross-border dimension. In order to handle cross-border cases resolution authorities may need to work in cooperation. Lack of information and asymmetric information between resolution authorities can obstacle effective and smooth cooperation and delay orderly resolution process.
- Spillover effect of adverse consequences. Financial stability in several jurisdictions can be affected by lack of timely implementation of resolution action of a third jurisdiction which practice diverse approach.
- 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.

- (Ex-ante) different signals to the market players, i.e. the expectations of the agents such as counterparties, infrastructure providers, depositors, liquidity providers and the wider market players may have different expectation from the regulatory process. Different expectations may also turn into uncertainty when there is a cross-border dimension since the same agent may receive different signals from different resolution authorities.

Currently, none of the Member States has developed a framework to tackle these potential adverse effects of non-coordinated resolution and insolvency frameworks applicable to institutions. The baseline scenario therefore assumes that the starting point for all Member States to comply with the framework suggested in the draft guidelines is the same.

## Objectives

The objective of the guidelines is to promote convergence of supervisory and resolution practices regarding interpretation of the circumstances amounting to a material threat to financial stability, the elements relating to the effectiveness of the sale of business tool and to financial stability, and the criteria to assess the potential adverse effects of the standard liquidation of assets and liabilities on the financial markets. [Table 1](#) presents the objectives of the draft guidelines.

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

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

## Technical options

The section presents the major technical options discussed among the WS members during the preparation of the draft guidelines and presents qualitatively the potential costs and benefits associated with the preferred options.

### Technical options for factual circumstances amounting to a material threat to financial stability and of the elements related to the effectiveness of the sale of business tool

#### a. Technical options related to the scope of 'material threat'

**Option 1a:** The concept of 'material threat' is defined in a way corresponding to the public interest test provided in Article 32(1)(c) and 32(5) of Directive 2014/59/EU (while making additional and more detailed specifications with a view to the focus on financial stability and the objective to ensure convergent practices).

**Option 1b:** The concept of 'material threat' is defined to set a higher threshold of risk for financial stability compared to the public interest test provided in Article 32(1c) and 32(5) of Directive 2014/59/EU.

The assessment of the options considers whether the term 'material threat' should be defined corresponding to the public interest test or should set criteria higher than the public interest test, i.e. circumstances that may cause more severe threat to the resolution objectives than required in Article 32(1)(c) and 32(5) of Directive 2014/59/EU. Precisely, Article 32(1)(c) and 32(5) of Directive 2014/59/EU states that a resolution action is necessary in the public interest (32(1)(c)) and a resolution action shall be treated as in the public interest if it is necessary for the achievement of and is proportionate to one or more of the resolution objectives referred to in Article 31 of Directive 2014/59/EU and winding up of the institution under normal insolvency proceedings would not meet those resolution objectives to the same extent (32(5)). Option 1a does not identify the risk level beyond the limits of the Article 32(1)(c) and 32(5).

Option 1b suggests that the definition and the criteria that the resolution authorities should assess in order to apply exemption in the standard resolution proceedings should apply under narrower conditions than Article 32(1)(c) and 32(5). The option assumes for the material threat a risk level higher than for the significant adverse effects under the public interest test (Article 32(1)(c) and 32(5)). In other words, the option assures that only a material threat that generates a risk level higher than the risk required for the standard conditions for entering into resolution can justify the exceptions in standard rules.

Option 1a is the preferred option because the context of the two conditions of Article 39(4)(a) and (b) implies that they should focus on the resolution objective of financial stability, whereas there is no evidence that they require a higher risk level. It is reasonable to argue that defining a risk level beyond the objectives of the Directive 2014/59/EU would be in conflict with the objective of Article 39 of ensuring the effectiveness of the sale of business tool. Therefore, at this

stage there is no visible added value of a definition for material threat beyond Article 32(1)(c) and 32(5) of Directive 2014/59/EU.

However, within Option 1a the definition of material threat is reflected in the draft guidelines with a focus on financial stability, and therefore is consistent with and complements the rest of the EBA mandate specified in Article 39(3b).

Since the draft guidelines address resolution authorities only, the costs, if any, that the draft guidelines might generate, will fall on the resolution authorities only. The costs related to the incorporation of the criteria into national practice are expected to be negligible because the guidelines do not imply additional operational and administrative cost beyond the transposition of the Level 1 text.

During the implementation of the process the resolution authorities have a short period of time (e.g. 1-7 days) to carry out the procedures. It is not possible to quantify the costs associated with such intervention since it largely depends on the magnitude and the conditions around that particular case. In any event, again there are no apparent additional costs beyond those required by the Level 1 text.

A wider group of agents is expected to benefit from the policy intervention. In terms of the benefits, a more precise and harmonised regulatory framework is expected to tackle the identified problems and ensure the effectiveness of the resolution. Resolution authorities are expected to benefit from symmetric information, and more effective and efficient cooperation across jurisdictions. This then decreases the probability of systemic risk and bank failure related risk to the public.

#### **b. Technical options related to the circumstances and elements**

**Option 2a:** Exhaustive list of circumstances indicating for the assessment of the material threat to financial stability, and of the elements related to the effectiveness of the sale business tool.

**Option 2b:** Non-exhaustive/indicative list of circumstances indicating for the assessment of the material threat to financial stability, and of the elements related to the effectiveness of the sale business tool.

The assessment discusses whether the draft guidelines should include an exhaustive (Option 2a) or an indicative list (Option 2b) of circumstances and elements for the assessment of the material threat to financial stability and to the effectiveness of the sale business tool.

The preferred option in this assessment is Option 2b for two reasons:

- There are great variations across cases that the resolution authorities will potentially handle. These variations result from the nature, scale and intensity of the crisis and the affected markets, and the characteristics peculiar to the institution, e.g. size, interconnectedness, business model.

- An exhaustive list is very static and may incur higher both opportunity and administrative cost: i) in a case of urgency there may be other relevant criteria that the resolution authorities need to look at yet these criteria are not included in the exhaustive list, and ii) as the further experience reveals other circumstances the regulatory framework needs to be updated on a regular basis.

Option 2a provides a static and inflexible framework for the resolution authorities to rely on in the case of a resolution.

The draft guidelines suggest an indicative set of circumstances which are relevant for the risk that marketing the institution under resolution results in aggravating uncertainty and a loss in market confidence. These circumstances reflect the specific market situation and permit authorities to take into account the importance of the institution in terms of its size, market share, impact on the rest of the banking sector, i.e. on lending and market price.

Similarly, the draft guidelines introduce a set of minimum elements for the resolution authorities to assess whether the implementation of the sale of business tool under the full set of standard rules of the market economy as stated under Article 39 (e.g. fairness, competitiveness and transparency) jeopardises the resolution objectives and whether exemptions should be applied. The list of elements accounts for potential scenarios where the required procedures may aggravate the crisis situation and threat financial stability.

Option 2a is expected to be costlier for both the resolution authorities (higher administrative cost) and the public/tax payers (the opportunity cost and higher risk). Costs associated with the implementation of Option 2b are not expected to go beyond the work that the resolution authorities need to carry out under the Level 1 text.

In terms of benefits, a more precise and harmonised regulatory framework is expected to tackle the identified problems. Resolution authorities are expected to benefit from symmetric information, and more effective and efficient cooperation across jurisdictions. This then decreases the probability of systemic risk and bank failure related risk to the public.

Technical options for the determination when the liquidation of assets and liabilities under normal insolvency proceedings can have an adverse effect on financial markets

### c. Technical options related to the elements

**Option 3a:** Exhaustive list of elements for the assessment of the impairment of market situation.

**Option 3b:** Non-exhaustive/indicative list for the assessment of the impairment of market situation.

The assessment includes whether the draft guidelines should include an exhaustive list or a non-exhaustive of elements for the assessment of the impairment of the market situation for the

assets. The argumentation is similar to the one presented in the previous sub-section and the same theoretical reasoning applies.

Option 3b is the preferred option due to its capacity to handle the resolution process in a crisis situation in a flexible, more effective and efficient way. The option is deemed to be more dynamic and accommodate features peculiar to jurisdictions, institutions and the crisis environment, including circumstances that cannot be anticipated at present.

The minimum list suggested in the draft guidelines covers elements related to the price and liquidity conditions of the assets, market share and relative importance of the assets in the market, and hence potential impact of the disposal of the assets on the banking sector.

Option 3a is expected to be costlier for both the resolution authorities (higher administrative cost) and the public (the opportunity cost and higher risk). Costs associated with the implementation of Option 2a are not expected to go beyond those associated with the work that the resolution authorities need to carry out within the framework of the Level 1 text.

In terms of benefits, a more precise and harmonised regulatory framework is expected to tackle the identified problems. Resolution authorities are expected to benefit from symmetric information, and more effective and efficient cooperation across jurisdictions. This then decreases the probability of systemic risk and bank failure related risk to the public.

## 6.2 Overview of questions for Consultation

### Question 1

**Should the elements listed above be further specified by any qualitative or quantitative indicators, in particular with respect to the development of prices or market conditions as factors evidencing a material threat to financial stability, to ensure convergent practices?**

**Are there further relevant elements which should be included?**

### Question 2

**Are there further potential conflicts between the marketing requirement and the effectiveness of the sale of business tool?**

### Question 3

**How could the exercise of judgment by resolution authorities be constrained to ensure convergence in practices in assessing these conflicts?**

**Question 4**

**Should the elements listed above further be specified by any qualitative or quantitative factors to ensure convergent practices? Are there further relevant elements which should be included?**

**Question 5**

**Which specific considerations should apply regarding the liquidation of derivative portfolios? Is the assessment of the impact of the unwinding of derivative portfolio practicable? How could it be made more practicable?**

**Question 6**

**Are there further relevant examples of assets and liabilities linked to each other?**

**Question 7**

**How could the exercise of judgment by resolution authorities be constrained to ensure convergence in practices in assessing the situation of the financial markets and the impact of the disposal of assets?**