



EBA/CP/2014/17

9 July 2014

Consultation Paper

Draft Guidelines

On the types of tests, reviews or exercises that may lead to support measures under Article 32(4)(d)(iii) of the Bank Recovery and Resolution Directive

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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 9 August 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. You may request a confidential response 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 may be reviewed 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) No 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 in the Legal notice section of the EBA website.

2. Executive summary

1. Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions, investment firms and related entities (the Bank Recovery and Resolution Directive — BRRD) sets out a Union-wide framework for crisis prevention in relation to these entities and the management and resolution of these entities.
2. The BRRD objective is to avoid the need to use taxpayers' money as far as possible when dealing with unsound or failing credit institutions and investment firms. It therefore sets out a harmonised framework for resolving institutions at Union level. Within that regulatory framework, resolution should be primarily and almost exclusively financed by private resources.
3. In accordance with Article 32 of the BRRD, the need for extraordinary public financial support for an institution should be considered as an indicator that this institution is failing or is likely to fail, and therefore triggers the need for resolution. However, the BRRD also acknowledges the existence of situations where extraordinary public financial support may not be in itself a condition that sufficiently demonstrates that an institution is failing or will fail in the near future.
4. In particular, extraordinary public financial support taking the form of an injection of own funds or purchase of capital instruments to a solvent institution in order to address capital shortfall resulting from tests, reviews or equivalent exercises may not be considered as a trigger for resolution when it is provided to remedy a serious disturbance in the economy of a Member State and to preserve financial stability with respect to all the conditions laid down in Article 32(4)(iii).
5. These EBA Guidelines specify the main features of the types of tests, reviews or exercises that may lead to support measures. These support measures include a timeline, a scope, a time horizon and reference date, a quality review process, a common methodology and, where relevant, a macro-economic scenario and hurdle rates, as well as a timeframe to address the shortfall. These elements are designed to assist the competent authorities when they are conducting such tests, reviews and exercises where institutions may not be able to address the capital shortfall resulting from the test, review or exercise and would, in that situation, be a potential candidate for resolution in accordance with Article 32(4)(iii) of the BRRD.

3. Background and rationale

6. Article 32(4) of the BRRD stipulates that an institution shall be deemed to be failing or likely to fail whenever one or more of the following circumstances occur or will occur in the near future:
 - a. a breach of the requirements for continuing authorisation in a way that would justify the withdrawal of authorisation (Article 32(4)(a) of the BRRD);
 - b. assets less than liabilities (Article 32(4)(b) of the BRRD);
 - c. inability to pay obligations when they become due (Article 32(4)(c) of the BRRD);
 - d. a need for extraordinary public financial support, subject to exceptions specified in Article 32(4)(d) of the BRRD;
7. This can be determined either by supervisory authorities after consulting with resolution authorities, or by the resolution authorities after consulting with the supervisory authorities, depending on the option that the jurisdiction in question decides to take.
8. Whilst the provision of extraordinary public support means that resolution action must be taken, the BRRD provides an exception according to which resolution action should not be taken on the sole basis of extraordinary public support if all the conditions listed in Article 32(4)(d) of the BRRD are met. Neither the circumstances referred to in point (a), (b) or (c) of Article 32(4) nor the circumstances referred to in Article 59(3) can be present at the time the public support is granted. The support will be provided at prices and on terms that do not confer an advantage upon the institution, will be granted only to a solvent institution, will be of a temporary nature and proportionate to remedy the consequences of a serious disturbance in the economy of a Member State and preserve financial stability, cannot be used to offset losses that the institution has incurred or is likely to incur in the near future and is subject to final approval under state aid rules.
9. Moreover, when this public support takes the form of an injection of own funds or purchase of capital instruments, these injections of funds must be ‘necessary to address capital shortfall established in the national/Union/SSM-wide stress tests, asset quality reviews or equivalent exercises conducted by ECB/EBA/national authorities’.
10. In this regard, Article 32(4)(d) stipulates that the EBA shall issue guidelines on the type of tests, reviews or exercises that may lead to capital shortfalls that may be eligible to be covered by public recapitalisation under the exception specified in Article 32(4)(d)(iii), provided that all other conditions are met.

11. In parallel with the public consultation, the EBA will seek the views of the EBA's Banking Stakeholder Group, in accordance with Article 37 of Regulation 1093/2010 ('the EBA Regulation'). Following completion of the consultation, the EBA will review the feedback provided, publish a feedback statement and take any feedback into account when revising the final guidelines, where appropriate.

4. Draft EBA Guidelines on the types of tests, reviews or exercises that may lead to support measures under Article 32(4)(d)(iii) of the Bank Recovery and Resolution Directive

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 (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 these 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 which guidelines are addressed to comply with guidelines. Competent authorities and resolution authorities to which 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. In accordance with 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 provide 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 in 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).

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Title I - Subject matter, scope and definitions

Subject matter

5. Pursuant to Article 32(4) of the BRRD, these guidelines specify the types of tests, reviews or exercises that may lead to capital shortfalls that may be eligible to be covered by public recapitalisation not triggering resolution referred to, as an exception, in Article 32(4)(d)(iii) of the BRRD — provided that all other conditions specified in the Article are met.

Definitions

6. For the purpose of these guidelines, the following definitions apply:
 - a) ‘tests’ means tools, coordinated at the national, SSM or Union level, designed to assess the resilience of an institution or of a group of institutions against hypothetical adverse market developments.
 - b) ‘reviews’ means assessments, coordinated at the national, SSM or Union level, of the quality of the accounting or prudential framework applied by an institution or by a group of institutions, including an assessment of the risk management framework, loan classification, collateral valuation and loan origination and arrears management.
 - c) ‘exercises’ means tests or reviews coordinated at Union level and conducted on a population of institutions over multiple jurisdictions. The assessment carried out in these exercises is based on the consistency, transparency and comparability of the outcomes across institutions.
 - d) ‘competent authorities’ are authorities identified as competent authorities in Article 4(1)(a) and 4(1)(d) of the EBA Regulation.

Scope and level of application

7. These guidelines are addressed to competent authorities to establish consistent, efficient and effective supervisory practices within the ESFS, and to ensure the common, uniform and consistent application of the third subparagraph of Article 32(4)(d) of the BRRD.
8. These guidelines do not affect nor prejudice in any way the competent authorities' obligation to verify on a continuous basis whether an institution is deemed failing or likely to fail pursuant to the remaining paragraphs of Article 32(4) of the BRRD.

Title II – Types of tests or reviews

Main features of a test or review

9. The main features of a test or a review should be a **timeline**, a **scope**, a **time horizon and reference date**, a **quality review process**, a **common methodology and, where relevant, a macro-economic scenario and hurdle rates**, as well as a **timeframe to address the shortfall**.
10. A test or review should have a precise **timeline**, including a launch date and a deadline for the institutions subject to the test or review to provide their results to the relevant competent authorities. It should also include a deadline for the communication (publication) of the results of the test or review by the relevant competent authority or the coordinator of the exercise. For exercises, the coordinator should be clearly identified, and the coordination process with all the competent authorities and the institutions involved should be clearly defined and understood ahead of the performance of the test or review.
11. A test or review should have a predefined **scope**. The sample of institutions subject to the test or review should be clearly defined. It should cover a material sample of institutions in terms of risks and assets. An explanation of the macroeconomic and/or prudential reasons for determining the sample should also be provided. This explanation can be based on absolute or relative qualitative figures and support the materiality of the sample defined.
12. A test or review should have a **time horizon and/or reference date**. A test or review should be carried out on the basis of financial statements and supervisory figures with reference to a predefined date. The purpose of the time horizon is to establish the length of time over which the scenarios will be applied, i.e. over a specified number of years. The time horizon and the reference date for the test or review should be clearly identified in the test or review's common methodology and should influence the timeframe required to implement measures. The time horizon and the timeframe required to implement measures may depend on the risk characteristics of the analysed exposures and on whether a test (dynamic and long-term perspective) or review (point in time and short-term approach) is conducted.

13. A test or review should have a deadline for the competent authorities to conduct their **quality review process** and assessment and to provide the results of the institutions concerned to the coordinator in an exercise. Banks' figures, approaches and projections should be subject to thorough plausibility checks in the quality assurance analysis, including a comparison against relevant benchmarks. This may lead to requests for revisions to banks' figures and projections in the context of the quality assurance process.
14. A test or review should be supported by a clear and detailed **common methodology**. Tests should also be supported by one or more **macro-economic scenarios**. The methodology, without necessarily being a pass/fail test approach, should also include a range of hurdle rates or indicators that represent the quantitative references used to help assess the appropriate supervisory reaction function, including additional capital needs. When the test or review is concluded, institutions should be positioned according to the hurdle(s) rate(s) defined in the test or review methodology. This assessment may identify the need for institutions to fill a capital shortfall depending on different hurdle rates. When a capital shortfall is identified, competent authorities should request institutions to address this shortfall by private means. Institutions should address this shortfall through private capital increases or other measures to be taken by the institution within **a specific timeframe**, which should be defined in the exercise or pursuant to the criteria indicated in the exercise.

Title III – Final provisions and implementation

These guidelines should be implemented in national supervisory practices by competent authorities by [date].

5. Accompanying documents

5.1 Draft cost-benefit analysis /impact assessment

Problem definition and objective

The previous version of the BRRD did not address the possibility of allowing public support without launching resolution. Following the relevant provisions of the current version of the BRRD, these guidelines specify the types of tests, reviews or exercises that would identify capital shortfalls that, in turn, may be eligible for public support/recapitalisation without triggering resolution referred to, as an exception, in Article 32(4)(d)(iii) of the BRRD.

To this end, the guidelines provide definitions and other clarifications in relation to ‘tests’, ‘reviews’ and ‘exercises’. In turn, the current impact assessment (IA) aims to provide evidence as to whether the implementation of definitions and other clarifications will have any impact. The IA assesses only the additional impact that may result from implementing the guidelines. It does not consider the impact that has already been experienced by the national authorities, the EBA and credit institutions with respect to other supervisory requirements.

Options

The current IA has not considered any policy options as it is intended only to provide clarification regarding the existing Level 1 framework which, in turn, would help supervisors to identify the credit institutions that may be eligible to public support.

Cost–benefit analysis

General costs

The guidelines use the term ‘tests’ to refer to ‘forward-looking’ tools (e.g. stress tests) that use hypothetical adverse market developments to predict the resilience of credit institutions in the future; the term ‘reviews’ is used to refer to ‘point-in-time’ assessments (e.g. asset quality reviews) that assess the resilience of the banking sector either accounting for the current market conditions or incorporating future conditions that are likely to happen (e.g. full implementation of a regulation that has already been published). Finally, the term ‘exercises’ is used to describe the cases when tests and reviews are being conducted at EU level.

The national supervisory authorities and the EBA have already structured the framework for conducting regular tests, reviews and exercises along these lines, i.e. these actions have not been triggered by the specific guidelines. It is therefore expected that there will be no additional costs arising from the conduct of these actions for the BRRD.

Specific costs

The guidelines specify that the main features of the test or review should be a **timeline**, a **scope**, a **time horizon and reference date**, a **quality review process** and a **common methodology**.

The costs of the implementing the definitions/clarifications regarding the elements specified above is estimated as follows:

Timeline: No additional costs are expected as the timeline is not specified in concrete terms and therefore cannot be compared with the current practices followed by the national supervisory authorities;

Scope: When conducting tests and reviews, the majority of national supervisory authorities follow the principles described in the relevant part of the guidelines. However, there may be negligible costs (man hours spent) in relation to the drafting of the rationale behind the decision to choose the institutions included in the sample and the macro-economic reasons that led to this decision;

Time horizon and reference date: No additional costs are expected, as the time horizon and/or reference date (or even the frequency) for tests and reviews are not specified in concrete terms and therefore cannot be compared with the current practices followed by the national supervisory authorities;

Quality review process: The quality review process has already been conducted by national supervisory authorities and the EBA for other supervisory purposes. Therefore, there will be no additional costs in relation to the implementation of the specific provision.

Common methodology: Since neither the operational requirements nor the hurdle rates/indicators are specified, it is not possible to assess whether this provision deviates from the existing practices and whether it may result in additional costs.

Benefits

The main benefits of implementing the existing guidelines relate to maintaining the financial stability of the EU banking system. However, these benefits have already been addressed by other supervisory requirements described either in the CRR-CRD IV or in the Level 1 text of the BRRD. Therefore, the additional benefit is expected to be close to zero.

Net impact

Having taken into account this cost-benefit analysis, the net impact from implementing the existing guidelines is estimated close to zero.

5.2 Overview of questions for Consultation

- Do you agree with the definitions provided by the Guidelines for tests, reviews and exercises?
- Do you think that the draft Guidelines list all the correct elements to identify tests and reviews, or do you think that any elements are missing and/or other areas and features should be covered?