
EBA/RTS/2015/08

9 July 2015

EBA final draft Regulatory Technical Standards

specifying the conditions for group financial support under Article 23 of Directive 2014/59/EU

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1. Executive summary

Article 23(2) and (3) of 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 mandates the EBA to develop draft regulatory technical standards (RTS) and to issue guidelines on the various conditions for the provision of financial support that must be satisfied to permit one group entity to provide financial support based on a support agreement in accordance with Article 19 to another group entity that meets the conditions for early intervention. Chapter III of the Directive aims to enable cross-border groups to allocate liquidity optimally when the group is in financial distress. The purpose is to set out a clear, harmonised framework, facilitate group support and enhance legal certainty despite existing legal obstacles, while maintaining adequate safeguards for financial stability, including prudential requirements and public interests such as the resolvability of the entity providing the support, as well as for the interests of the group entities concerned and their respective creditors. It should be noted, however, that a support agreement under Chapter III is not a condition for providing liquidity within a group, in particular with regard to regular liquidity management within a group. Furthermore, the provisions do not affect contractual or statutory liability arrangements between institutions which protect the participating institutions through cross-guarantees and equivalent arrangements.

The conditions relate to the expected success of the support, to the interest of the group as a whole, to the terms of the support (taking into account the interest of the providing entity in the stabilisation of the group as a whole) and various prudential requirements applying to the providing entity, and to the impact on financial stability and the resolvability of the providing entity. When specifying the conditions, the draft RTS and the guidelines require institutions to take into account possible reasons for the financial distress of the institution concerned, including the business model, the current market situation and potential further adverse developments. Whether or not the conditions are fulfilled must be assessed based on a description and a projection of the capital and liquidity situation and needs of the receiving entity. They should be assessed by the receiving entity and the competent authority responsible for the providing entity, taking into consideration also the information provided by the competent authority for the receiving entity. The assessment of the terms under which the support is granted has to take into account the default risk of the receiving entity and the loss given default (LGD), including a comparison of the LGDs if support were and were not provided. It takes into account direct and indirect benefits for the entity providing the support, including those resulting from a recovery of the group as a whole, as well as the risks that would result from the destabilisation of the group.

In addition, the risks for financial stability and the impact on the resolvability of the providing entity are to be analysed based on, among other factors, the significance of the providing entity for the financial system of one or more Member States and an analysis of whether the provision of the support makes the implementation of the resolution strategy substantively less feasible or less credible.

Article 23 makes clear that prudential requirements for the providing entity relating to capital, liquidity and large exposures have to be respected; however, it empowers competent authorities to authorise the provision despite non-compliance where necessary. The guidelines set out principles for the assessment of whether such authorisation should be granted.

2. Background and rationale

Article 23(2) of Directive 2014/59/EU mandates the EBA to develop draft RTS on the conditions for providing group financial support set out under points (a), (c), (e) and (i) of Article 23(1). Under Article 23(3) there is an additional mandate to issue guidelines on the conditions under points (b), (d), (f), (g) and (h) relating to, among other things, prudential requirements applying to the providing entity. The following overview groups the conditions into those for which the EBA is mandated to draft RTS and those for which it is mandated to draft guidelines.

| Conditions in Article 23(1) | EBA deliverable | Summary of content |
|--|-----------------|--|
| (a) Reasonable prospect that the support will redress the financial difficulties of the receiving entity. | RTS | Capital and liquidity needs of the receiving entity covered for a sufficient period of time. |
| (b) Objective of preserving or restoring the financial stability of the group as a whole and is in the interest of the providing entity. | GL | Analysis of the benefits for the group as a whole resulting from a preservation or restoration of the financial soundness of the receiving entity compared with the risks for the financial position of the group to be expected if the support is not provided. |
| (c) Terms of the support in accordance with Art. 19(4). | RTS | Terms reflect the default risk of the receiving entity, the LGD and the relation of benefits and costs taken into account when determining the best interest under Art. 19(4). |
| (d) Reasonable prospect that the consideration will be paid and, in case of a loan, the | GL | Analysis of risk factors which may influence the ability of the receiving entity to meet |

| Conditions in Article 23(1) | EBA deliverable | Summary of content |
|---|-----------------|--|
| loan will be reimbursed. | | its obligations, evaluation of collateral. |
| (e) The support would not jeopardise the liquidity or solvency of the providing entity. | RTS | The assets of the providing entity can be reasonably expected to be at all times greater than its liabilities and it can be reasonably expected to be able to pay all of its liabilities as they fall due, taking into account potential adverse developments, and the default risk of the receiving entity and the LGD. |
| (f) The support would not create a threat to financial stability. | GL | Analysis of various factors such as significance of the providing entity for the financial stability of one or more Member States and the financial condition of the providing entity. |
| (g) The support would not cause the providing entity to breach CRD IV/CRR capital and liquidity requirements. | GL | Combined buffer requirement and liquidity requirements have to be complied with, unless authorised by competent authorities. Principle-based approach to non-compliance with combined buffer requirement and liquidity requirements, based on restoration plans. |
| (h) The support would not cause the providing entity to breach CRD IV/CRR large exposure requirements. | GL | Large exposure requirements have to be complied with, unless authorised by competent authorities. |

| Conditions in Article 23(1) | EBA deliverable | Summary of content |
|--|-----------------|---|
| (i) The support would not undermine the resolvability of the providing entity. | RTS | Principle-based approach. The provision of the support does not make the implementation of the resolution strategies substantively less feasible or less credible. |

Chapter III of Directive 2014/59/EU sets out harmonised rules for group financial support. The rationale for the harmonisation of these rules was to overcome obstacles to an optimal allocation of liquidity and available collateral in groups in distress, especially cross-border groups, resulting from Member States' national laws, which did not take into account the specific needs of banking groups, and diverging national regulatory requirements concerning intra-group agreements. In the broader interests of financial stability, which is enhanced by strengthening recovery options for groups in distress, the Directive recognises the objective of restoring the financial stability of the group as a whole, while maintaining adequate safeguards. As, pursuant to Article 19(4), Member States shall remove any legal impediment in national law to group financial support transactions, after the transposition the requirements and conditions under Chapter III will replace most requirements under national laws, provided that nothing prevents Member States from imposing limitations on intra-group transactions in accordance with the options provided for in Regulation (EU) No 575/2013, transposing Directive 2013/36/EU or from requiring the separation of parts of a group or activities carried on within a group for reasons of financial stability. It should be noted, however, that a support agreement falling under Chapter III is not a condition for providing liquidity within a group.

Article 23 stipulates a number of conditions which must be satisfied to permit one group entity (a parent, subsidiary or sister company) to provide financial support to another group entity that meets the conditions for early intervention. Competent authorities have to assess the extent to which these conditions are met when deciding whether to authorise the provision of support (Article 25), and the decision of the institution's management on the provision is required to indicate that the provision complies with them (Article 24). The conditions contain safeguards relevant for the protection of the entity providing the support and its creditors, as well as for the financial stability of the entities and the financial system as a whole, including public interests such as the resolvability of the entity providing the support. In addition, Article 23 empowers competent authorities to authorise non-compliance with prudential requirements for capital, liquidity and large exposures. The guidance on how to use this power should be used should allow appropriate flexibility for competent authorities to analyse the situation of each group on a case-by-case basis, while providing sufficient clarity for firms and investors.

When analysing the prospects that the financial support will redress the financial difficulties of the receiving entity, several aspects concerning the past and current situation of the institution have to be assessed, in particular the capital and liquidity needs of the receiving entity, the internal and external causes for the financial difficulties – especially the business model and the risk management of the receiving entity, and past, present and expected market conditions – and a plan for accompanying action.

Recital 38 of the Directive makes clear that the assessment of the financial support should take into account the interest of the group as a whole and the interdependency of the entities of the same group. Therefore, the terms of the support should adequately reflect the best interest of the providing entity in accordance with Article 19(7) and the relation of benefits and costs taken into account when determining the best interest. This means, on the one hand, the default risk of the receiving entity and the expected loss to the providing entity given default of the receiving entity and, on the other hand, the direct and indirect benefits for the providing entity and the group from the provision. This should be based on, among other things, a comparison of the default risk of the receiving entity if the support were and were not provided. The analysis should also take into account potential damage to franchise, refinancing and reputation as well as benefits from efficient use and fungibility of the group's capital resources and its refinancing conditions.

A further condition for the provision of the financial support is that it does not undermine the resolvability of the providing entity. This is to be assessed on the basis of the most likely resolution strategy for the institution as set out in the resolution plan, in accordance with the assessment under Articles 15 and 16 of Directive 2014/59/EU, taking into account in particular the potential absorption of losses within the group, the increased interconnectedness of the providing entity with the receiving entity, the increasing risk of contagion within the group, its higher complexity and the capital and liquidity situation of the providing entity, and having regard to the specific situation.

3. Final draft regulatory technical standards specifying the conditions for group financial support

COMMISSION DELEGATED REGULATION (EU) No .../..

of XXX

supplementing Directive 2014/59/EU of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms with regard to regulatory technical standards for the specification of conditions for group financial support

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to 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 Council¹, and in particular Article 23(2) thereof,

Whereas:

- (1) Article 23(1) of Directive 2014/59/EU sets out various conditions which must be fulfilled to permit a parent institution, a Union parent institution and certain other entities in a group and their subsidiaries in other Member States or third countries that are institutions or financial institutions, on the basis of a group financial support agreement falling under Chapter III of that Directive, to provide financial support in the form of a loan, of provision of guarantees or of assets for use as collateral to another group entity that meets the conditions for early intervention. Pursuant to Article 25(2) of Directive 2014/59/EU, the competent authority of the group entity providing the support may prohibit or restrict the provision of the financial support.
- (2) Having regard to the financial difficulties of the receiving entity and the condition that there must be a reasonable prospect that the financial support redresses these financial difficulties, a thorough analysis of capital and liquidity needs of the receiving entity and an analysis of the internal and external causes for the financial difficulties and of past, present and expected market conditions should be undertaken. This analysis should include measures planned for addressing the causes of the distress of the receiving entity which can efficiently support the restoration of its financial situation.

¹

OJ L 173, 12.6.2014, p. 190.

- (3) The assessment of the various conditions falls in the responsibility of the entity providing the support (providing entity) and of the competent authority responsible for the providing institution. The assessment should take into account the risk of potential adverse developments. For a comprehensive assessment of the conditions that relate to the providing entity, the competent authority responsible for the providing entity should also take into account information and assessments provided by the competent authority responsible for the group entity receiving the financial support (receiving entity).
- (4) The condition that the terms of the provision are in accordance with Article 19(7) of Directive 2014/59/EU should take into account the default risk of the receiving entity and the loss for the providing entity given a default of the receiving entity, based on a comparison of the situations following the support or, respectively, without granting it, and on full disclosure of the relevant information. They should reflect the best interest of the providing entity as described in point (b) of Article 19(7), which stipulates that any direct or indirect benefits may be taken into account that may accrue to a party as a result of the provision of the financial support. This should be verified by a thorough analysis of costs and benefits for the providing entity and the group as a whole in these two scenarios.
- (5) Financial support agreements and the provision of the group financial support may improve the resolvability of a group, for example if they are in line with the loss absorption mechanism provided by the resolution strategy. However, they may also impair the feasibility of the implementation of the chosen resolution strategy, for example if that strategy envisages a separation of different parts of the group. Therefore the assessment of the impact on resolvability should be based on the resolvability assessment and on the group and individual resolution plan, where applicable on the group resolution plan as determined by the joint decision of resolution colleges.
- (6) This Regulation is based on the draft regulatory technical standards submitted by the European Banking Authority to the Commission.
- (7) The European Banking Authority has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010 of the European Parliament and of the Council²,

HAS ADOPTED THIS REGULATION:

Article 1

Subject matter

This Regulation specifies the conditions set out in points (a), (c), (e) and (i) of Article 23(1) of Directive 2014/59/EU with regard to financial support by a group entity in accordance with Article 19 of that Directive.

² 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 (OJ L 331, 15.12.2010, p. 12).

Article 2

Prospect to redress financial difficulties

1. The condition of a reasonable prospect that the support provided significantly redresses the financial difficulties of the group entity receiving the financial support (receiving entity) shall be considered as being met, if such prospect of redress is supported by the following elements:
 - (a) capital and liquidity needs of the receiving entity identified by a description of the capital and liquidity situation of the receiving entity and a projection of its capital and liquidity needs are covered for a sufficient period of time, taking into account all other relevant financial sources from which these needs could be met, the timescale required to redress the financial difficulties and the term of the support;
 - (b) the analysis of the financial situation and of the internal and external causes for the financial difficulties, in particular of the business model and the risk management of the receiving entity, and of past, present and expected market conditions does not contradict the prospect of redress;
 - (c) an action plan describing measures for the redress of the financial situation of the receiving entity, including where necessary a revision of its business model and risk management;
 - (d) the underlying assumptions in the descriptions and projections mentioned in points (a), (b) and (c) are coherent and plausible and take into account the stressed condition of the receiving entity, the current market conditions and potential adverse developments.
2. When assessing the condition referred to in paragraph 1, the competent authority responsible pursuant to Article 25(2) of Directive 2014/59/EU shall take into account information and assessments provided by the competent authority responsible for the receiving entity.

Article 3

Terms of the support

1. The terms, including consideration, for providing the financial support shall be deemed to be in accordance with Article 19(7) of Directive 2014/59/EU, if the following conditions are met:
 - (a) the terms adequately reflect
 - (i) the default risk of the receiving entity;
 - (ii) the seniority of the claim;
 - (iii) the expected loss for the group entity providing the support (providing entity) in the event of a default of the receiving entity;
 - (iv) in case of a loan or committed facility, the maturity profile, based on a full disclosure of all relevant and up-to-date information by the receiving entity and further information available to the providing entity.

- (b) the terms reflect the best interest of the providing entity in accordance with Article 19(7) of Directive 2014/59/EU and the relation of benefits, risks and costs taken into account when determining the best interest, including direct or indirect benefits that may accrue to the providing entity as a result of the provision of financial support and of the benefits for the group from this provision.

For the purposes of point (a)(iv), an anticipated temporary impact on market prices arising from events external to the group does not need to be taken into account, if a plausible projection of the market situation supports the assumption that the extent of this impact and its duration do not jeopardise the ability of the receiving entity to meet all of its liabilities as they fall due.

2. The assessment referred to in points (a) and (b) shall be based on a comparative analysis of the default risk of the receiving entity for each of the cases if the support is or is not provided. The analysis of the default risk shall be based on the elements set out in Article 2. This is without prejudice to considering, for the purpose of the assessment of the relation of benefits, risks and costs on a case-by-case basis and at the discretion of the competent authority responsible for the providing entity, further elements that the providing entity would consider in a credit assessment when deciding on granting a loan on the basis of all information available to the providing entity.
3. The assessment shall further include potential damage to franchise, refinancing and reputation and benefits from an efficient use and fungibility of the group's capital resources and its refinancing conditions. To the extent possible, the benefits and costs taken into account in determining the best interest shall be quantified in monetary terms. In addition, the discount granted to the receiving entity compared to market terms shall be quantified, including in relation to haircuts on collateral or interest rates.
4. When assessing the best interest, any binding commitments in the financial support agreement sustaining the assumptions on the future business model and risk management of the receiving entity shall be taken into account.
5. The competent authority shall take into account information and assessments provided by the competent authority responsible for the receiving entity.

Article 4

Liquidity and solvency of the providing entity

Subject to the condition specified in point (g) of Article 23(1) of Directive 2014/59/EU, the provision of the financial support shall be considered not to jeopardise the liquidity or solvency of the providing entity if, following the provision of the financial support,

- (a) the assets of the providing entity can be reasonably expected to be at all times higher than its liabilities;
- (b) the providing entity can be reasonably expected
 - (i) to be able to pay all of its liabilities as they fall due;

- (ii) not to infringe requirements on solvency and liquidity under Regulation (EU) No 575/2013 of the European Parliament and of the Council³ in a way that would justify the withdrawal of the authorisation by the competent authority.

The assessment shall take into account the default risk of the receiving entity and the loss for the providing entity resulting from the default of the receiving entity also having regard to a potential adverse development. The assessment shall comply with the appropriate prudential requirements of proper risk management for the providing entity.

Article 5

Resolvability of the providing entity

1. The provision of the financial support shall be considered not to undermine the resolvability of the providing entity, if the provision of the financial support does not make the implementation of the resolution strategy for the providing entity as set out in the resolution plan substantively less feasible or less credible, in accordance with the assessment under Articles 15 and 16 of Directive 2014/59/EU.
2. That assessment shall take into account in particular the impact of the provision of the financial support on
 - (a) the potential absorption of losses within the group after the resolution conditions have been met;
 - (b) the interconnectedness of the providing entity with the receiving entity;
 - (c) the risk of contagion within the group;
 - (d) the group's complexity increased by the provision of the financial support;
 - (e) the capital and liquidity situation of the providing entity.
3. If providing entities are not fully informed about a preferred resolution strategy, they shall perform the assessment referred to in paragraph 1 on the basis of the information available to them about the resolution plan.
4. The competent authorities and resolution authorities responsible for the providing entity shall cooperate closely in determining the impact of the group financial support on the resolvability of the providing entity.

Article 6

Entry into force

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

³ Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, (OJ L 176, 27.6.2013, p. 1).



Done at Brussels,

*For the Commission
The President*

*For the Commission
On behalf of the President
[Position]*

4. Accompanying documents

4.1 Cost–benefit analysis/impact assessment

Introduction

Article 23(2) of Directive 2014/59/EU mandates the EBA to develop draft RTS and to issue guidelines on the conditions for the provision of group financial support to a group entity that meets the conditions for early intervention.

In accordance with Article 10(1) and Article 16(2) of the EBA Regulation (Regulation (EU) No 1093/2010 of the European Parliament and of the Council), any draft guidelines and RTS developed by the EBA must be accompanied by a cost and benefit analysis. 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 therefore presents an impact assessment of the policy options considered in these RTS and the guidelines. The lack of systematic publicly available data on intra-group funding represents a difficulty in analysing the role this funding plays in stabilising/destabilising the banking sector in crisis times. As a result the present impact assessment is mainly qualitative and relies on academic papers.

Policy background

In the broader interests of financial stability, Directive 2014/59/EU recognises the objective of restoring the financial stability of a banking group as a whole, while maintaining adequate safeguards to avoid destabilising effects on affiliated providing entities. Under Article 19(4), Member States must remove any legal impediment in national law to intra-group financial support transactions.

Therefore, Article 23 stipulates a number of conditions which must be satisfied to permit one group entity (a parent, subsidiary or sister company) to provide financial support to another group entity that meets the conditions for early intervention. Competent authorities have to assess the extent to which these conditions are met when deciding whether to authorise the provision of support (Article 25). The conditions contain safeguards relevant for the protection of the entity providing the support and its creditors, as well as for the financial stability of the entities and the financial system as a whole, including public interests.

Baseline

Cross-border activities are high in the European Union banking sector

Cross-border activities are very high in the European Union (EU) due to the legislative efforts that have been made to create a single market and due to the common currency within the euro area. Around 28% of the credit institutions that operate in the EU are foreign-controlled subsidiaries and branches, and they account for 22% of total EU banking assets (Table 1).

Table 1: Number and total assets of credit institutions operating in the EU (billion EUR)

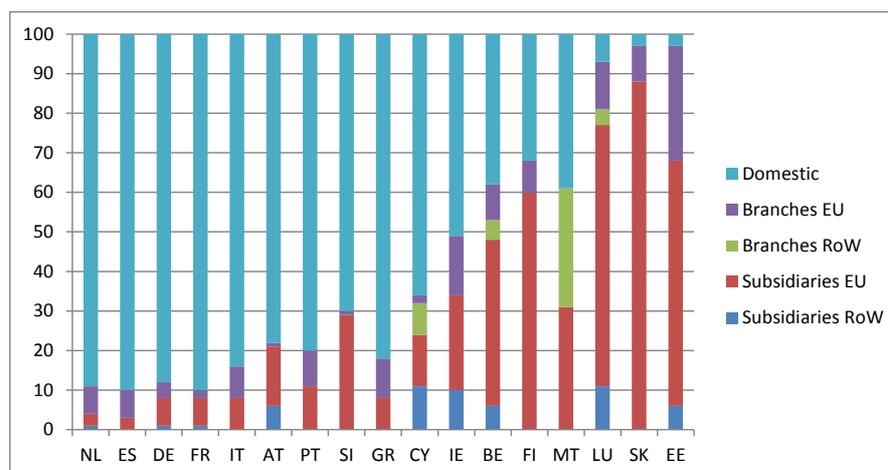
| | Number of credit institutions | | | Total assets | | |
|----------------|-------------------------------|--|---|--------------|--|---|
| | Domestic | Foreign-controlled subsidiaries and branches | share of foreign controlled subsidiaries and branches | Domestic | Foreign-controlled subsidiaries and branches | share of foreign controlled subsidiaries and branches |
| 2010 | 3,727 | 1,051 | 28% | 34,638 | 8,289 | 24% |
| 2011 | 3,694 | 1,046 | 28% | 35,926 | 8,978 | 25% |
| 2012 | 3,609 | 1,032 | 29% | 35,471 | 8,136 | 23% |
| 2013 (30 june) | 3,593 | 1,018 | 28% | 34,426 | 7,499 | 22% |

Source: ECB/ Consolidated Banking Data

In some EU Member States the banking sector is dominated by non-domestic banks, which in some cases have a share of more than 80% or 90% of total domestic banking assets (Luxembourg, Slovakia, Estonia) (Chart 1).

In addition, a foreign presence in the form of bank subsidiaries supervised by the host authorities, as opposed to foreign branches supervised by home authorities, largely prevails in terms of euro area banking assets (Table 1).

Chart 1: Composition of the banking sector's assets in euro area countries by type of credit institution in 2012



Source: ECB/ Consolidated Banking Data

Recent events shed light on the importance of intra-group asset transferability in crisis management

Intra-group financial support may take different forms (transfers of capital, transfers of collateral, interbank lending, guarantees, and liquidity backup facilities) and it needs to be promptly implemented in case of financial crisis. Intra-group transfers of are very common in the normal course of business, but in times of distress access to internal intra-group liquidity flows may become even more important, as it can be used for recovery purposes in order to provide the parent company (upstream support) or the branches or subsidiaries (downstream support) with vital funding.

As shown by De Haas and Van Lelyveld (2009), an efficient intra-group financial framework has positive effects on financial stability. Several case studies came to the conclusion that the existence of an efficient European intra-group banking network in Central Eastern and South-eastern Europe was a crisis-mitigating factor, as parent companies were able to carry on providing funding (Berglof et al., 2009; EBRD, 2009). The role of parent funding in helping Swedish subsidiaries by maintaining credit supply in Baltic States during 2007–09 was also highlighted by the BIS (2010).

The current legal framework for intra-group support is underdeveloped

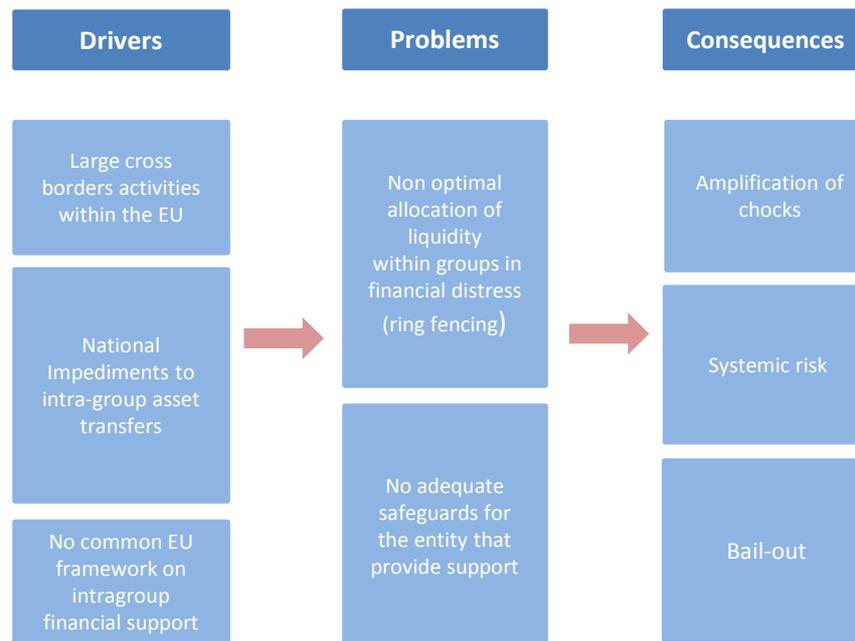
There is no specific EU legal framework for intra-group financial support. The only substantial restriction is the large exposure regime, which limits intra-group transactions to 25% of the respective institution’s own funds.

The terms and conditions for intra-group asset transfers are currently governed by national laws or case law. In some countries, for instance, asset transfers can be subject to authorisation. As an example, in a crisis situation, Portuguese supervisory authorities may decide that transfers must be previously authorised. Some Member States also require direct or indirect fair compensation for the entity which provides the support. In Spain, for instance, there is a legal regime (and disclosure rules) intended to prevent potential abuses, and in Poland sufficient creditworthiness is required of borrowers⁴.

Problem identification

Chart 2: Problem identification

⁴ European Commission (2008). *Report on asset transferability*.



This fragmented framework does not provide for a clear and efficient *modus operandi* in crisis situations. The current legal framework gives rise to two main contradictory problems. On the one hand, it does not allow for an optimal allocation of resources within groups in financial distress. On the other hand, domestic supervisors should prevent intra-group transactions that may jeopardise the solvency of foreign subsidiaries.

Obstacles to optimal allocation of liquidity within groups in financial distress

The financial crisis clearly demonstrated that cross-border intra-group support may be difficult in stress situations. For instance, in some countries where cross-border groups were placed under resolution, ring-fencing of the assets of a bankrupt group (Lehman Brothers, Kaupthing Bank, Landsbanki) has been observed.

Appropriate safeguards for entities that provide financial support

On the other hand, when financial support is actually provided to a distressed entity within the banking group, there may be no clear safeguards to protect the providing entity. The use of intra-group financial support may increase instability by channelling resources away from affiliates and may jeopardise the financial situation of foreign subsidiaries. Some studies show that, as foreign bank subsidiaries may have dominant positions in host countries' banking sectors, especially in the new Member States, intra-group financial support has created serious risks to the soundness of the financial systems in those regions (Allen et al., 2009). In addition, the difficulties faced by a single subsidiary might affect not only one country but also multiple countries at the same time due to the network of its own subsidiaries (Allen et al., 2009).

Objectives of the RTS and of the guidelines

General objective

The draft RTS and guidelines aim to provide a harmonised EU framework to specify the conditions national competent authorities have to assess when permitting an affiliated entity to provide intra-group financial support to another entity of the group.

Specific objectives

The specific objectives of the draft RTS and guidelines are to:

- avoid counterproductive ring-fencing of capital and liquidity and overcome any other obstacles to an optimal allocation of liquidity in groups in financial distress, especially in cross-border groups;
- protect providing affiliated entities, and their creditors and customers, against disproportionate detrimental impact on their financial robustness;
- strengthen financial stability and avoid the amplifications of shocks;
- limit recourse to public support (bail-out) in case of failure; and
- harmonise practices across jurisdictions.

Policy options

When drafting these guidelines and RTS, the EBA considered several options in three main areas:

Assessment of potential adverse developments and their effect on the group

Option 1: formal stress tests. Under Option 1, institutions would be required to run a formal stress test to assess potential adverse developments and their effect on the group entities concerned.

Option 2: flexible approach on how to assess potential adverse developments. Under Option 2 competent authorities would be given broader discretion when deciding how potential adverse developments should be assessed by banking groups when requesting an authorisation for the provision of support.

Assessment of the credit profile of the receiving entity

Option 1: credit assessment. Option 1 would require credit institutions to provide competent authorities with an assessment of the credit profile of the receiving entity that would be comparable to that which a bank would perform when deciding to grant a loan to a third party (which might include additional elements to those listed in the RTS and the guidelines or follow different criteria).

Option 2: no credit assessment. Option 2 would not explicitly require credit institutions to perform a formal assessment of the credit profile of the receiving entity in addition to those listed in the RTS and guidelines.

Option 3: credit assessment on a case-by-case basis within the cost–benefit analysis: Option 3 would allow competent authorities the flexibility to require further elements of a credit assessment where they are necessary to fully assess the risk of the provision of the support and to balance this risk against the benefits of the provision.

Conditions to be taken into account to allow a providing entity to depart from the minimum liquidity and capital requirements

Option 1: principle-based approach with identical conditions applicable to both upstream and downstream support. When deciding whether an institution can depart from the liquidity and capital (conservation and systemic) minimum requirements, national competent authorities would be requested to look at the following conditions for both upstream and downstream support:

- the expected timeframe for the restoration of the CET1/liquidity requirements;
- the size and the significance of the capital/liquidity shortfall;
- the best interest of the providing entity; and
- the impact on financial stability.

Option 2: additional conditions for upstream support. In addition to all the conditions listed in Option 1, Option 2 would allow the use of capital and liquidity buffers for upstream support only under very exceptional circumstances.

Option 3: support implying non-compliance with capital and liquidity buffers only under exceptional circumstances. Option 3 would allow the use of capital and liquidity buffers for both upstream and downstream support only under very exceptional circumstances.

Comparison of the policy options

| Area | Policy options | Advantages | Disadvantages |
|---|--------------------------------------|---|--|
| Assessment of the impact of the group financial support | Option 1: formal stress test. | Would enable a comprehensive and detailed assessment of the potential impact. | Costly to design. Need to agree on the hypothesis and methodology in a very short period of time. |

| | | | |
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| | | | <p>Assessment of the outcome might be difficult to interpret and time consuming.</p> <p>Given the diversity of banks' business models, this 'one size fits all' approach might be too burdensome for some banking groups.</p> |
| | <p>Option 2: flexible approach to assessment of potential adverse developments.</p> | <p>More flexible, as it allows assessment on a case-by-case basis.</p> <p>Easy to implement.</p> | <p>Less clear data basis.</p> <p>Possibility of underestimating the risks.</p> <p>Would create differences in treatment between banking groups across jurisdictions.</p> <p>Less harmonisation.</p> |
| <p>Assessment of the credit profile of the receiving institutions</p> | <p>Option 1: Credit assessment similar to that which would be done by a bank when deciding whether to grant a loan to a third party.</p> | <p>Maximum protection for the providing entity.</p> <p>More guidance provided to competent authorities when deciding whether or not financial support may be granted.</p> | <p>Costly to design and time consuming for banking groups.</p> <p>Might not take into account the specific intra-group situation.</p> <p>Might add burden and delay to the financing process.</p> |
| | <p>Option 2: no formal credit assessment.</p> | <p>No additional operational and administrative costs for institutions and national competent authorities (NCAs).</p> | <p>Might exclude from the assessment substantial elements which are relevant for the risk management of the providing entity.</p> |
| | <p>Option 3: optional credit assessment as part of the analysis of benefits and risks.</p> | <p>Specific group situation and benefits resulting from the stabilisation of the group as a whole are taken into account.</p> | <p>Might add burden and delay to the financing process; however, costs are limited by making further elements optional.</p> |
| <p>Conditions to be taken into account to allow institutions not to comply with</p> | <p>Option 1: principle-based approach with identical conditions applicable to both upstream and downstream support.</p> | <p>Would enhance symmetrical information when NCAs handle cross-border cases.</p> <p>Would ensure the flexibility to make case-by-case decisions while maintaining</p> | <p>Significant room for interpretation, as some conditions are generic and NCAs might handle cases on an ad hoc basis.</p> |

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| <p>the minimum liquidity and capital requirements</p> | <p>Option 2: additional conditions for upstream support.</p> <p>Option 3: support implying non-compliance with capital and liquidity buffers only under exceptional circumstances.</p> | <p>a level playing field for institutions.</p> <p>Better capture of specific risks stemming from upstream support (risks to financial systems of host countries).</p> <p>Would ensure greater protection of sub-group entities.</p> <p>Maximum harmonisation.</p> <p>Maximum safeguards for all providing institutions.</p> | <p>Distinction between upstream and downstream support adds complexity to the framework.</p> <p>Additional cost of implementation for NCAs (cost of designing the additional condition – definition of the ‘exceptional circumstances’ – and of monitoring its implementation).</p> <p>Would create an uneven playing field between parent companies and sub-group entities.</p> <p>Would restrict the ability of all entities to provide financial support, which could increase the risk of capital and liquidity ring-fencing and minimise positive effects of an optimal allocation of resources in a stress situation.</p> |
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Preferred options

Assessment of the potential adverse developments caused by intra-group financial support: **Option 2** (no formal stress test) is more suitable. Formal stress tests would be too burdensome for some specific business models and might make it very difficult for the competent authority to make a prompt assessment if financial support had to be provided urgently.

Assessment of the credit profile of the receiving entity: Option 1 (credit assessment) would ensure the highest extent of risk awareness for institutions and authorities. However, the purpose of Chapter III is to reflect the special situation of a group and to give certainty to institutions and stakeholders. In addition, there are no elements apparent that would permit a better assessment of the efficiency and necessity of the financial support, so it is doubtful if the added value of a mandatory credit assessment is not outweighed by the costs for institutions and the lower degree of harmonisation and legal certainty. Therefore, Options 2 and 3 are more in line with the objective of Chapter III. On the one hand Option 2 might be favourable in terms of harmonisation and legal certainty. On the other hand, Option 3 would give authorities the flexibility to require an additional risk assessment, while the absence of a mandatory requirement avoids the risk of

delaying the financing. In addition, the decision would still be made strictly as part of the comparison of both risks and advantages for the group as a whole, in line with the policy objective of the Directive. **Option 3** is therefore most appropriate.

Conditions under which the providing entity is allowed not to comply with liquidity and minimum capital requirements: **Option 2** (differentiated conditions applicable to upstream and downstream support) is most suitable, as it will ensure an appropriate degree of harmonisation across jurisdictions and help to realise the advantages of the option of providing group financial support intended by the Directive. Option 3 would add complexity to the framework and limit the ability of entities to provide financial support, thus increasing the risk of capital and liquidity ring-fencing. Option 1 might not provide adequate safeguards for subsidiaries and their investors and customers, and for the financial stability of the jurisdiction where they are active.

4.2 Feedback on the public consultation

The EBA publicly consulted on the draft proposal contained in this paper together with the draft guidelines on the same topic in one single Consultation Paper.

The consultation period lasted for three months and ended on 4 January 2014. Four responses were received, of which three were published on the EBA website.

This paper presents a summary of the key points and other comments arising from the consultation on both the draft RTS and the guidelines, the analysis and discussion triggered by these comments and the actions taken to address them if deemed necessary.

In many cases several industry bodies made similar comments or the same body repeated its comments in response to different questions. In such cases, the comments, and the EBA's analysis, are included in the section of this paper where the EBA considers them most appropriate.

Changes to the draft RTS have been incorporated as a result of the responses received during the public consultation.

Summary of key issues and the EBA's response

Credit assessment

Some respondents asked for the inclusion of a credit risk assessment of the receiving entity in the same way that such an assessment would be carried out to decide whether credit should be granted to an entity outside the group ('fully fledged credit assessment') in the analysis of whether intra-group financial support should be granted, as they felt that only in this way could it be ensured that the providing entity had a full overview of the risks resulting from the support.

However, it should be noted that most of the relevant elements of this assessment are already implemented under Article 3(1) of the RTS. Furthermore, the results of a regular credit assessment would not adequately reflect the specific situation in a group or the objectives of Article 19 ff. of Directive 2014/59/EU. To balance these positions, the text has been changed such that the providing entity should, first, properly evaluate the risks of providing the support and, second, compare the identified risks with the potential benefits. This means that the option to consider further elements of a credit assessment on a case-by-case basis could be one step within this analysis of risks, costs and benefits, including those resulting from the stabilisation of the group, which should not be separated from the second step of balancing costs and benefits against each other.

Capital and liquidity requirements

General views are split as to whether allowing the flexibility to authorise breaches of capital or liquidity requirements is appropriate. One respondent expressed concerns that a breach of capital

requirements might generate a problem with the solvability of the providing entity and demanded that group financial support should be provided only to the extent that the providing entity still complies with principal banking regulations. Other respondents argued that too much discretion for national competent authorities to intervene against intra-group financial support to protect national entities should be prevented.

The risks mentioned by the respondents are adequately addressed in Article 23 of Directive 2014/59/EU and in the guidelines and RTS, as non-compliance with capital requirements would be only restrictively permitted under exceptional circumstances. Article 23(1)(g) and (h) speaks of authorisation of the 'infringement' of various requirements. Article 23(1)(e) of Directive 2014/59/EU explicitly sets out the condition that group financial support can be provided only if the solvency and liquidity of the providing entity is not jeopardised. Furthermore, the discretion of the competent authority is precisely framed by guidelines and RTS, which explicitly state in Article 4(b) of the RTS that the terms reflect the best interest of the providing entity.

Summary of responses to the consultation and the EBA's analysis

| Comments | Summary of responses received | EBA analysis | Amendments to the proposals |
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| General comments | | | |
| Importance of RTS/guidelines | Some of the respondents who provided general comments noted that the RTS/guidelines are of significant importance for jurisdictions, especially for those that have already implemented restrictions regarding the support. | | No amendment. |
| Discretion for competent authorities | One respondent stated that too much discretion for competent authorities to intervene against intra-group financial support to protect national entities should be prevented. | Directive 2014/59/EU empowers national authorities to authorise or prohibit intra-group financial support. The specifications made by the RTS and the guidelines result in appropriate constraints on discretion. | No amendment. |
| No obligation to adopt support agreements. | One respondent suggested making it explicit in the guidelines/RTS that authorities should not be able to require banks to adopt support agreements. In addition it should be clarified that existing contractual or statutory liability arrangements between institutions are not affected by the guidelines/RTS. | Pursuant to Art.19(3) a group financial support agreement does not constitute a prerequisite to provide group financial support to another entity that experiences financial difficulties if the institution decides to do so, on a case-by-case basis. Art. 19(2) establishes that Chapter III does not apply to intra-group financial arrangements including funding arrangements and the operation of centralised funding arrangements provided that none of the parties to such arrangements meets the conditions for early intervention. | No amendment. |
| Responses to questions in Consultation Paper EBA/CP/2014/30 | | | |
| Question 1 (the question is relevant with regard to the RTS) | One respondent argued that the final range of elements for the analysis of whether or not group | The use of the assessment for granting loans to | Additions have been |

| Comments | Summary of responses received | EBA analysis | Amendments to the proposals |
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| <p>and the guidelines): Are there further elements of a credit assessment which would be useful in this context when assessing whether the financial support is expected to redress the financial difficulties of the receiving entity and the further conditions (e.g. the terms of the provision of the support and the prospect of the payment of consideration and repayment)? Please specify.</p> | <p>financial support should be provided is too narrow and recommended a more prudent approach whereby the providing entity would analyse the situation on a case-by-case basis, including the assessment for granting loans to an entity outside the group ('fully fledged credit assessment').</p> | <p>entities outside the group has been thoroughly discussed while drafting the RTS.</p> <p>On the one hand this could be useful to ensure that the providing entity and the competent authority have a full overview of the risks resulting from the support.</p> <p>On the other hand it should be noted that most of the relevant elements of this assessment are already implemented under Art. 3(1) of the RTS. Furthermore, the results of a regular credit assessment would not adequately reflect the specific situation in a group or the objectives of Art. 19 ff. of Directive 2014/59/EU. To balance these positions, the text has been changed such that the providing entity should, first, properly evaluate the risks of providing the support and, second, compare the identified risks with the potential benefits. This means that the option to consider further elements of a credit assessment on a case-by-case basis could be one step within this analysis of risks, costs and benefits, including those resulting from a stabilisation of the group, which should not be separated from the second step of balancing costs and benefits against each other</p> | <p>inserted in Art. 4(2) of the RTS and paragraph 4 of the guidelines.</p> |
| <p>Question 2 (the question is relevant with regard to the RTS and the guidelines): How could the interest of the providing entity and the group as a whole be measured and reflected in</p> | <p>One respondent remarked that the text of paragraph 5 of the guidelines is ambiguous, as it is unclear if the analysis under paragraphs 3 and 4 should take into consideration the requirements of sound capital and liquidity management only at</p> | <p>The requirements of sound capital and liquidity management should be taken into consideration also atn the level of the providing entity, as set out under Art. 23(1)(g) of Directive 2014/59/EU. The wording of paragraph 5 of the guidelines can be</p> | <p>Paragraph 5 of the guidelines has been amended as follows: 'The analysis under paragraphs 3 and 4</p> |

| Comments | Summary of responses received | EBA analysis | Amendments to the proposals |
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| <p>the terms of the provision of the support? What information could be used to inform the assessment of the terms, also with respect of non-quantifiable costs and benefits?</p> | <p>group level or also at entity level.</p> <p>Suggestions from respondents for additional elements which could be used for further assessment (comments made by one respondent each, if not otherwise marked):</p> <ul style="list-style-type: none"> • the past performance of the receiving entity, as the support should enable the receiving entity to conduct business at the pre-early intervention level (suggested by two respondents); • provisions of group support should be based on prevailing market conditions and facts at the time of providing support; • the reputational impact of allowing a subsidiary to fail; • the chosen resolution strategy for a group <p>One respondent, furthermore, argued that some impacts cannot be assessed within a short time horizon and that some of the elements of the assessment are not easily quantifiable in monetary terms.</p> | <p>clarified.</p> <ul style="list-style-type: none"> • The past performance of the receiving entity is part of the assessment pursuant to Art. 3(b) of the RTS, which refers to ‘internal and external causes’ and ‘past, present and expected market conditions’. • Prevailing market conditions are already included in the analysis under paragraph 6(c) of the guidelines, which refers to ‘past, present and expected market conditions’. • The reputational impact is already taken into account under paragraph 5 of the guidelines and Art. 4(2) of the RTS. • The chosen resolution strategy is part of the assessment as set out under paragraph 5 of the guidelines and Art. 6(1) the RTS. <p>The assessment is demanding within a short time horizon, but the efforts required would always be proportionate to the time available. The fact that some elements are not easily quantifiable in monetary terms is adequately addressed. The quantification in monetary terms is qualified, in Art. 4(2) of the RTS to ‘the extent possible’ and in paragraph 5 of the guidelines to ‘where possible’.</p> | <p>should take into account the requirements of sound capital and liquidity management at individual entity and at group level ...’</p> |
| <p>Question 3: What rules do you deem appropriate for capital requirements? Do the criteria</p> | <p>One respondent criticised the ambiguity of the wording, as the providing entity is obliged to provide the reasoned statement under</p> | <p>The clarification can be made; however, it should be clear that the statement will be provided in any case, as the guidelines are addressed to institutions and</p> | <p>Clarification in paragraph 9(a) of the guidelines and</p> |

| Comments | Summary of responses received | EBA analysis | Amendments to the proposals |
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| <p>reflect an adequate balance between the interest of the group as a whole and safeguards required for the individual entities? Are there additional criteria that should be considered?</p> | <p>paragraph 9(a) of the guidelines, and the competent authority should require it.</p> <p>Another respondent commented that the text of the guidelines and RTS goes further than the text and conditions of Art. 23 of Directive 2014/59/EU: under paragraph 9(a) and (c) of the guidelines the providing entity seems to be enabled to provide support even if it does not meet capital requirements or combined buffer requirements. The respondent was worried that a breach of the capital requirements might generate a problem with the solvability of the providing entity. Intra-group financial support should be provided only to the extent that the providing entity still complies with principal banking regulations. The rule under paragraph 9(c) should therefore be adjusted accordingly, as it might generate problems for both entities.</p> <p>In contrast, another respondent suggested softening the ‘business as usual’ capital and liquidity limits (for example large exposure limits) where group financial support is required or granted. Another respondent pointed out that these limits might limit the effectiveness of the support.</p> <p>One respondent considered the proposals as appropriate, as they are being aligned with the United Kingdom Prudential Regulation Authority’s existing implementation of capital buffers.</p> | <p>authorities.</p> <p>The guidelines are more specific but do not go beyond the mandate and the wording of Directive 2014/59/EU. Non-compliance with capital requirements may be authorised only under very strict circumstances, which are determined under Art. 23 of Directive 2014/59/EU and specified in the guidelines. Art. 23(1)(g) of Directive 2014/59/EU permits temporary non-compliance with capital and liquidity requirements of Directive 2013/36/EU of the providing entity if authorised by the competent authority in individual cases. Art. 23(1)(e) of Directive 2014/59/EU clarifies the condition that group financial support can be provided only if the solvency and liquidity of the providing entity is not jeopardised. In any case, the suggestion of ongoing compliance with capital requirements does not lie within the mandate of the EBA, as non-compliance is explicitly granted under strict conditions in Art. 23(1)(g) of Directive 2014/59/EU.</p> <p>The fact that some respondents criticised the prerequisites for the authorisation while others found them too narrow supports the conclusion that the EBA struck an appropriate balance between flexibility to provide support where necessary and safeguards required to preserve stability.</p> | <p>consequential changes.</p> |

| Comments | Summary of responses received | EBA analysis | Amendments to the proposals |
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| <p>Question 4: How will the rules for capital requirements, in particular regarding upstream support, impact management decisions on the structure of the group? If you see a negative impact, how could this be mitigated?</p> | <p>One respondent requested that permission for a temporary breach of ratios be considered, to enable provision of group financial support to the extent necessary for the receiving entity.</p> | <p>Temporary non-compliance may be authorised under Art. 23(1)(g) of Directive 2014/59/EU, which provides an appropriate balance between the interest of the providing entity, that of the receiving entity and financial stability.</p> | <p>No amendment.</p> |
| <p>Question 5: What rules do you deem appropriate for liquidity requirements? Do the criteria reflect an adequate balance between the interest of the group as a whole and safeguards required for the individual entities? Are there additional criteria that should be considered?</p> | <p>One respondent suggested further specifying the elements under Art. 10(c) of the RTS such that liquidity coverage ratio, net stable funding ratio, directly applicable liquidity buffers and market conditions must be part of the analysis as well.</p> <p>Another respondent suggested that the limitations of Directive 2013/36/EU and Regulation (EU) No 75/2013 and the strong conditions for group financial support should be applied to liquidity requirements as well.</p> <p>In contrast to the previous response one respondent welcomed the discretion for the competent authority to allow support from a providing entity which is not in compliance with its liquidity requirements and suggested that a similar principle should be applied to capital requirements. It was furthermore proposed that penalties etc. resulting from a breach of the capital or liquidity requirements of the providing entity be waived.</p> | <p>Art. 23(1)(g) of Directive 2014/59/EU refers only to Directive 2013/36/EU, not to Regulation (EU) No 575/2013. Therefore, there is no legal basis for the guidelines to specify criteria for an authorisation of non-compliance with requirements from that regulation, including liquidity coverage and net stable funding ratio. This may be unintentional or due to the staggered introduction of these liquidity requirements; however, there would be no mandate for the EBA to go beyond Directive 2014/59/EU.</p> <p>Non-compliance with capital requirements may be authorised under Art. 23(1)(g) of Directive 2014/59/EU. There are no penalties if the temporary non-compliance is authorised.</p> | <p>No amendment.</p> |

| Comments | Summary of responses received | EBA analysis | Amendments to the proposals |
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| <p>Question 6: How will the rules for liquidity requirements, in particular regarding upstream support, impact management decisions on the structure the group? If you see a negative impact, how could this be mitigated?</p> | <p>One respondent suggested expanding permission for non-compliance with liquidity requirements under extraordinary circumstances as set out under Art. 10(d) of the RTS if the providing entity is the parent company and the receiving entity is its subsidiary.</p> <p>Two respondents noted that the rules might privilege regional funding models over centralised funding models, which needs to be considered in the context of the appropriate resolution strategy (single point of entry or multiple point of entry). This might entail risks if there were a regional-based market-wide event which could then affect all countries in a region.</p> | <p>Differentiation of upstream and downstream support is justified with a view to the different implications the support has for the interests of shareholders and creditors.</p> <p>The EBA considers that the impact of these regulations on the funding model should be kept in mind by competent authorities; the resolution strategy is already part of the assessment by the authority as set out under recital 5 and Art. 6(1) of the RTS. Safeguards are limited to what is necessary to ensure stability.</p> | <p>No amendment.</p> |