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Technical advice on the delegated acts on critical functions and core business lines

Mandate and structure of the advice

1. In accordance with Article 2(2) of Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 ('BRRD'), the European Commission has been mandated to issue delegated acts in order to "*specify the criteria for the determination of the activities, services and operations referred to in point (35) of the first subparagraph as regards the definition of 'critical functions' and the criteria for the determination of the business lines and associated services referred to in point (36) of the first subparagraph as regards the definition of 'core business lines'*". The Commission has requested that the European Banking Authority ('EBA') provide technical advice to support the work on these delegated acts.
2. The aim of this advice is to develop a common understanding of which of the functions performed by an institution are critical to the real economy and financial markets and which are core to its own performance. To this end, in this advice the EBA proposes shared definitions and harmonised evaluation criteria to be used, as guidance, by financial institutions, competent authorities and resolution authorities to identify "critical functions" and "core business lines".
3. The EBA has structured its advice in two main sections:
 - (i) Section 1 is entitled 'Critical functions'. It proposes further details to be added to the definition of 'critical functions' envisaged in the BRRD and offers criteria for the identification of 'critical functions';
 - (ii) Section 2 is entitled 'Core business lines'. It proposes a clarification for the definition envisaged in the BRRD and presents potential criteria for the identification of 'core business lines'.

1. Critical functions

1.1 Legal background and framework for the advice

4. Continuity of critical functions of the institution under resolution, to safeguard financial stability and the real economy, is one of the main resolution objectives and therefore plays a key role in the recovery and resolution planning process. For instance, the recovery plan (to be drawn up by the institution) must include the identification of critical functions¹ and the resolution plan (to be drawn up by the resolution authority) must demonstrate how critical functions and core business lines could be legally and economically separated from other functions so as to ensure continuity upon the failure of the institution². The definition of critical functions is also important in other parts of the BRRD: for example, (i) when assessing the resolvability of the institution, resolution authorities should take into account whether the chosen strategy would ensure the continuity of critical functions³, and also the power to address or remove impediments to resolvability relates to critical functions⁴, (ii) when the bail-in tool is applied, liabilities could be exempted from the scope of the bail-in if it is strictly necessary and proportionate to achieve the continuity of critical functions⁵, (iii) when the application of the bridge bank tool and the operation of a bridge bank tool and operation of a bridge bank institution should maintain critical functions⁶, etc.
5. “Critical functions” are defined in Article 2(1) point (35) of the BRRD as follows:
 - **‘critical functions’** means activities, services or operations the discontinuance of which is likely in one or more Member States, to lead to the disruption of services that are essential to the real economy or to disrupt financial stability due to the size, market share, external and internal interconnectedness, complexity or cross-border activities of an institution or group, with particular regard to the substitutability of those activities, services or operations.
6. The definition of ‘critical functions’ in the BRRD incorporates several concepts that are not fully explained within the BRRD itself: for example, ‘function’, ‘activities’, ‘services’, ‘operations’, ‘real economy’, ‘discontinuance’ and ‘substitutability’. To further clarify the definition of ‘critical functions’ and the objectives of the Directive, this advice addresses the meaning of those concepts within the definition and also considers them in the identification criteria.

¹ Section A point (7) of the Annex of the BRRD.

² Section B point (4) of the Annex of the BRRD and Article 10(7)(c) of BRRD.

³ Article 15(1), Article 16(1).

⁴ Article 17(5) points (a) and (g).

⁵ Article 44(3), point (b) of the BRRD.

⁶ Article 40 (1), (2) point (b), Art. 41 (2).

7. The EBA considered the findings of a benchmarking exercise based on recovery plans that have been collected and examined by the EBA and the extensive evidence from these plans. These findings are described in detail in the ‘Comparison report on the approach to determining critical functions and core business lines in recovery plans’, which was published in conjunction with this advice.
8. In addition, the advice takes into account the Financial Stability Board (FSB) “Guidance on Identification of Critical Functions and Critical Shared Services”. The FSB guidance seems to be a good basis for identifying critical functions given that in some Member States financial institutions already use this guidance to define their critical functions in their recovery plans, in particular for the recovery plans to be submitted by G-SIFIs.
9. The EBA is of the opinion that the main difference between “critical function” and “core business line” lies in the impact of the activities concerned. While “critical functions” should be assessed from a perspective of their importance for the functioning of the real economy and financial markets and therefore for financial stability as a whole, “core business lines” should be assessed from the perspective of the importance for the institution itself (for example how much they contribute to revenues and profits of the institution).
10. In the international discussion, critical functions are always discussed together with critical external or internal services necessary to maintain these functions. Therefore it seems advisable that the delegated acts also mentions critical services.⁷
11. In order to afford to resolution authorities targeted information allowing an adequate identification of critical functions and core business lines for the purposes of the elaboration of resolution plans, it is of the utmost importance to make available to all stakeholders in advance clear guidance on the definitions presented in the BRRD, taking into account the precise goals envisaged by those concepts.

1.2 Definitions and concepts

12. Within the scope of the definition of ‘critical function’ set out in Article 2(1), point (35) of the BRRD, and considering the approach envisaged therein (i.e. the importance of the function to the economy), the following concepts included in that definition could be clarified as follows:
 - **‘Function’**: a structured set of activities, services or operations that are delivered by the institution or group to third parties (including its clients, counterparties, etc.). Examples of critical functions can include credit granting to SMEs, deposit taking, financial advisory, clearing, payments, etc.

⁷ An indicative list of necessary supporting services will be included in the EBA guidelines on the minimum list of services or facilities that are necessary to enable a recipient to operate a business transferred to it under Article 65(5) of the BRRD.

It is worth noting that the concept of “critical function” is intrinsically linked to the concept of the underlying services that are essential to the setting up of the deliverable services, relationships or operations to third parties. The latter concept, as detailed below as “critical services”, although not explicitly mentioned in the BRRD, it is addressed by the FSB and, given its high importance in resolution planning and in the assessment of impediments to resolvability, it seems advisable to highlight this concept in the Advice.

- **Activities, services and operations:** it does not seem possible to distinguish clearly between these three terms. This advice interprets these terms from the BRRD to specify that they include services and relationships with third parties and operations and activities undertaken for third parties.
- **‘Critical services’** are the underlying operations/activities/services performed for one (dedicated services) or more business units or legal entities (shared services) within the group which are needed to provide one or more critical functions. The disruption or failure of these ‘critical services’ can present a serious impediment or completely prevent the performance of functions essential to the real economy and financial markets. This reflects the concept of ‘critical shared services’ addressed by the FSB in its ‘Guidance on Identification of Critical Functions and Critical Shared Services’.

Critical services can be either performed by one or more entities (separate legal entity, internal unit, etc.) within the group (Internal service) or be outsourced to an external provider (External service).

Critical services are inherently attached to the critical function and their identification follows the identification of a critical function. This advice presents elements of a test to determine whether a critical service is essential to the performance of a critical function. If an underlying operation/activity/service can be substituted easily by another provider, to a comparable extent, with a comparable quality, with an acceptable cost and within a reasonable timeframe, then it should not be considered a critical service. This substitutability evaluation is also applied to the analysis of the criticality of a function, as presented in section 1.3 below.

- **‘Critical operations’:** in Annexes B and C of the BRRD, there are some references to ‘critical operations’, in relation to the concept of ‘core business line’. As an example, pursuant to Annex B, resolution authorities may request that institutions provide (4) ‘a mapping of the institution’s critical operations and core business lines including material asset holdings...’, (8) ‘a description of the off-balance sheet exposures of the institution and its legal entities, including a mapping to its critical operations and core business lines’ and (11) ‘each system on which the institution conducts a material number or value amount of trades, including a mapping to the institution’s legal persons, critical operations and core business lines’. Also, pursuant to Annex C, the matters to be considered by the resolution authority when assessing the resolvability

of an institution/group include (1) ‘the extent to which the institution is able to map core business lines and critical operations to legal persons’; (2) ‘the extent to which legal and corporate structures are aligned with core business lines and critical operations’; etc.

However, the concept of “critical operation” is not defined in the BRRD. The advice assumes that the term “critical operations” has the same meaning as critical functions. This assumption is supported by evidence from the legislative process.

- **“Real economy”**: this refers to the set of inter-related economic production and consumption activities of goods and services developed in an economy.

In addition to the impact on the ‘real economy’, the definition of critical functions complements this with a reference to the impact on financial markets.

- **“Discontinuance”** of a function: means that a function is no longer provided to a comparable extent, under comparable conditions and with a comparable quality, unless this change in providing the function concerned takes place in an orderly manner.

Therefore, as part of the identification criteria for critical functions, institutions, competent authorities and resolution authorities should assess the impact of the failure of the institution on the continuance of a critical function to the economy and the financial markets.

- **‘Substitutability’**: this refers to the ability to replace the provision of a certain function in comparable terms (i.e. to a comparable extent and quality and with an acceptable cost from existing or new market participants) and within a reasonable timeframe, thereby avoiding a disruption in the provision of functions that are essential to the real economy and financial markets.

As the disruption in financial stability due to the failure in the provision of a certain (critical) function can result from the importance of the institution that provides that function to the market, e.g. its size, market share, interconnectedness, complexity and cross border activities, these elements should be analysed when assessing the impact and substitutability.

13. As the extent of disruption to financial stability resulting from the failure of an institution to provide a certain (critical) function may depend on the importance of the institution and its function within the market, e.g. its size, market share, interconnectedness, complexity and cross border activities, these elements should be analysed when assessing the impact and substitutability.

Conclusions:

It should be unmistakably clear that in the definition of “critical function” the term ‘functions’ means activities, services and operations provided to third parties and should not be determined from a merely internal perspective oriented at the business and organisation of the institution.

Critical services are intrinsically linked to the critical functions that an entity performs to third parties, and therefore those underlying activities/operations/services should only be classified as being part of critical functions if their discontinuance would lead to the collapse of, or present a serious impediment to the performance of critical functions to third parties. These underlying activities should not be analysed separately but always together with these services provided to third parties. In contrast, the services to third parties may constitute critical functions which may be analysed separately and distinguished from the underlying activities.

In accordance with the definition in the BRRD, criticality should not be assessed only on its direct impact on the real economy but also on its impact on financial markets. This, in particular, means that the confidence of participants in financial markets should be an element of the test.

1.3 Elements of a test for determining critical functions and critical services

14. This advice presents a set of criteria for the identification of ‘critical functions’ addressed to institutions, competent authorities and resolution authorities in the scope of their obligations under the BRRD. This methodology relates to:

- (i) The self-assessment performed by institutions, in a bottom-up approach, which must be critically reviewed by authorities (e.g. to ensure coherence and consistency in the approaches used by banks) when they identify critical functions;
- (ii) A mapping exercise for competent authorities and resolution authorities only, in a top-down approach, which benefits from the overarching view of authorities as to which functions are essential to maintain financial stability as a whole.

1.3.1 Institution specific assessment of criticality (“bottom-up” approach)

15. According to the BRRD, critical functions have to be identified by institutions in the context of recovery planning and by resolution authorities in the process of resolution planning and resolvability assessment. The main source of information for the resolution authority will in most cases be the strategic analysis carried out by the institution/group in the scope of its recovery planning, and in the information to be submitted for resolution planning, that identifies the institution’s/group’s essential and systemically important (or critical) functions.

16. The first layer in a test designed to adequately determine the critical functions is expected to draw on the self-assessment performed by institutions themselves in the strategic analysis required as part of recovery planning, identifying which functions are critical to the economy, based on the extent to which the real economy and financial markets, and ultimately financial stability as a whole, would be affected by the failure of or material disruption to services provided to the institution's clients (or other third parties). Therefore, it is especially important for the resolution authorities and competent authorities to ensure, when they perform a critical review of the self-assessment of the institution and assess the quality of the information obtained from institutions, that this self-assessment reflects the purpose of the definition, in particular the external perspective on negative externalities to the real economy and financial markets.
17. Nevertheless, institutions must be aware that the designation of a particular function as critical should not lead market participants to the assumption that the function will be maintained under all circumstances and that they will be immune from losses if the institution providing the function fails. Identifying the criticality of a function is meant to assist resolution authorities in developing resolution strategies that minimise systemic disruption and the loss of value. Therefore, the criteria for identifying critical functions should be designed to support resolution planning and, consequently, resolution strategies. For example, this means that when identifying critical functions, resolution authorities should already be assessing the separability of critical functions from each other or from other (non-critical) functions, which may need to be wound down in accordance with the resolution strategy. Identifying critical functions should also inform the need for measures to address impediments to resolvability. As a consequence, the identification should be sufficiently granular to inform the assessment of resolvability.
18. Taking into consideration the definition envisaged in the BRRD and corresponding to the FSB 'Guidance on Identification of Critical Functions and Critical Shared Services', the elements of the test for the determination of 'critical functions' should include the following:

For a function to be considered critical, it has to fulfil the following two elements:

- (i) The function is provided by an institution to third parties not affiliated to the institution/group; and
- (ii) The sudden failure to provide that function would likely have a material impact on the third parties, give rise to contagion or undermine the general confidence of market participants due to:
 - the systemic relevance of the function for the third parties; and
 - the systemic relevance of the institution/group in providing the function.

This requires that the function cannot be substituted on acceptable terms within a reasonable timeframe, which would exclude such an impact of the failure.

19. As required by the definition of critical functions in the BRRD, when assessing these elements, the resolution authority should consider the (i) size, (ii) market share, (iii) external and internal interconnectedness, (iv) complexity, and (v) cross-border activities of an institution or group. These aspects are reflected in the test below.
20. The evaluation of the criticality of a function, necessarily implies an analysis of the materiality of the potential impact that the failure to provide that function would have on the real economy and financial markets. In order to give more substance to the identification criteria, this impact analysis could address the following dimensions: on the one hand (i) the impact on third parties and in the market as a whole and, on the other hand (ii) an assessment of whether the “structure” of that market would by itself (by its dynamics) be likely to replace the provision of that function.

(i) analysis of the impact of the sudden discontinuance of the function on third parties (“impact assessment”);

- Impact on third parties that rely on that function: if the failure to provide the function only has a direct negative impact on a small number of counterparties which are not systemic themselves due to their size or interconnectedness (given the circumstances at the time of the assessment) then the function should generally not be considered critical.
- Systemic impacts and interconnection: if the failure to provide the function has wide and material adverse effects on the real economy and financial markets, namely in terms of contagion effects and impact on market confidence. Nevertheless, the impact on markets will differ depending on the specific circumstances in place in financial markets at the time of the disruption in providing the function:
 - Contagion effects: whether the failure of the function is likely to disrupt the respective market and therefore to affect unrelated participants that are exposed to that market and thereby interconnected with the institution. For instance, if the institution’s function of market making for certain financial instruments fails, it can have a serious impact in drying up the liquidity of that asset market. The sudden decline in liquidity may have a material impact on the prices of those financial assets which consequently can jeopardise the liquidity or solvency of other counterparties in a “domino effect”.
 - Market confidence: whether the disruption in providing the function would have a knock-on effect on a wide range and number of market participants (third parties) such as customers, service providers and public services; whether the market of that function is crucial to the

functioning of any other market(s) and which interdependencies are at stake.

Even if a function can be substituted, there is a risk that markets may be affected by a general loss of confidence amongst market participants, including retail functions. It is also important to take into account the probability of a 'domino effect'.

Loss of market confidence is highly probable in the case of functions that are more 'visible' or publicly known to counterparties, customers and the public (e.g. retail payment services), and is amplified when institutions are interconnected. It can therefore be assumed that this would affect not only retail customers but also wholesale customers or counterparties.

Specific assessment criteria for the impact on third parties should include the following elements:

a. the nature and reach of the activity:

- type of function;
- global, national or regional reach;
- volume and number of transactions;
- number of customers and counterparties;
- number of customers for which the institution is the only or principal banking partner.

b. the relevance of the institution (local/regional and national or EU wide, as appropriate for the market concerned):

- Market share; the market share can be analysed from a number of perspectives, including but not limited to, the value or number of transactions or the number of customers as a proportion of the market, as appropriate.
- Interconnectedness with other entities; to assess interconnectedness, quantifiable indicators such as those used for the identification of globally and other systemically important institutions may be applied.
- Complexity; to assess complexity, quantifiable indicators such as those used for the identification of globally and other systemically important institutions may be applied.
- Cross border activities.

c. the nature of the customers and stakeholders affected by the function:

- Retail, corporate, interbank, central clearing houses, public entities, etc.
- d. the impact of the disruption of the function on markets, infrastructures, customers and public services. In particular, the analysis could include the:
- effect on the liquidity of markets concerned;
 - impact and extent of disruption to customer business, and short-term liquidity needs;
 - perceptibility to counterparties, customers and the public;
 - capacity/speed of customer reaction;
 - the relevance of this market to the functioning of other markets;
 - effect on the liquidity, operations, structure of another market;
 - effect on other counterparties related to the main customers;
 - interrelation of the function with other services.

21. There is the option to include in the delegated acts more or less binding quantitative benchmarks for the assessment criteria above. In the benchmarking exercise the EBA conducted on existing recovery plans, the market share played an important role in the self-assessment of institutions. However, there was no consistency in the specific quantitative benchmarks, and most recovery plans did not indicate standard pre-defined market share thresholds to determine criticality. Therefore, threshold levels for market share varied significantly between institutions for the same function, mainly reflecting the features of the market, in particular its degree of concentration. In general, for economic functions, such as retail deposits, a market share between 3% and 5% was considered to be an appropriate level for determining criticality. The fact that the market for this type of service is often fragmented should also be taken into account. In the case of less visible functions, such as payment or asset management transactions, the minimum market share level was often set at a higher level (more than 10%), reflecting the standardised nature of these functions and their substitutability. In many recovery plans assessed by the EBA, there was little evidence to support the setting of these thresholds, in particular the choice of benchmarks was not supported by an in-depth analysis of these functions. These examples show that it would be very difficult to specify quantitative benchmarks, even if the specification distinguished different types of functions and the appropriate benchmarks for each function. As a consequence, the EBA recommends that specific quantitative benchmarks should not be included in the assessment of the criteria above.

(ii) evaluation of the market for the provision of that function, in particular in terms of concentration and substitutability (“supply side analysis”);

- Substitutability: if the function and its role can be easily substituted by other market participants (including such that may newly enter the market), to a comparable extent, with a comparable quality, with acceptable cost and within a reasonable timeframe, than it should not be considered critical,

unless there is the risk mentioned above that markets are affected by a general loss of confidence among market participants.

In addition, one of the challenges of assessing substitutability is defining the granularity of the assessment, because an activity might be substitutable at national level but not at a local level (e.g. region, town). Therefore, the level of the assessment should be chosen by the resolution authority accordingly by analysing the relevant existing or potential market based on an analysis of providers and demand.

Additional specific assessment criteria for assessing “substitutability” by institutions on a best effort basis:

- a. The structure of the market for that function and the availability of clear substitute providers:
 - The concentration structure of the market for the function, i.e. how many participants are in the market (including market shares, number of competitors or peer group participants that might be able to take over critical functions);
 - Assessment of whether there are other functions and markets that provide a function broadly equivalent to the activities of the failing institution or critical function;

Although some of the recovery plans assessed by the EBA in its benchmarking exercise used specific quantitative thresholds to measure concentration (for example, if the institution was amongst the top five market participants/competitors), the EBA recommends that specific quantitative benchmarks are not used for this criterion.

- b. Assessment of whether the capacity of providers would be sufficient to take on all activities or clients
- c. Assessment of the willingness of other providers to take on these activities and reasons why some existing or new market participants would find this business attractive while others would not (e.g. economies of scale, margins, cross selling)
The ability to substitute a function with acceptable cost may depend, among other things, on the profitability of the corresponding critical function. Nevertheless, the function does not necessarily need to be profitable to raise the interest of third parties in developing it. That can be the case when the bidder has a business structure where the incorporation of this function would complement its overall business.
- d. Necessary requirements for performing this function and barriers to entry into the market:

- organisational arrangements or infrastructure needed to provide this function, including the assessment of risk and counterparties (due diligence, market and risk analysis), in particular if the function is highly specialised;
 - the expertise and training needed for employees of the substitute function provider to develop that function;
 - significance and form of barriers to entry;
 - importance of brand, positioning or reputation;
 - the costs of substitution, including:
 - identification of the share of the critical function within the institution in relation to manpower, fixed and variable costs;
 - internal interconnectedness: upstream and downstream services required by the critical function;
 - external interconnectedness: dependencies on other entities to perform the function;
 - complexity: whether specialist knowledge, specialised equipment and/or techniques are required, operational and organisational structure;
 - whether the activity is standardised or customised;
 - whether the performance of the function has cross-border links;
 - the regulatory framework for providing the function, in particular regulatory approvals/requirements needed, for example with regard to large exposures;
 - other legal impediments to market entry, in particular, the assessment of the resulting market concentration with a view to potential obstacles from the Competitions Authorities (DG Comp and national Competition Authority).
- e. The expected time needed for other competitors (i) to take over the institutions' activities compared to (ii) the time acceptable for the substitution to take place to prevent significant disruption. Again, some of the recovery plans assessed by the EBA

in its benchmarking exercise used certain maximum timelines when the substitution should be completed (e.g. 30 days). However, the EBA does not see any added value in specifying a timeline and recommends that specific quantified benchmarks should not be used for this criterion, as this assessment most likely depends of the type of service. In fact, timeframe and cost considerations may vary depending on the type of service and the impact of the time of discontinuance on the affected third parties: There may be services that should be available continually (e.g. payment services) while a reasonable timeframe for investment management, for example, could be longer. Nevertheless it would be advisable for institutions to indicate the expected timeframe in their recovery plans and in the elements to be submitted for the creation of resolution plans, and also for resolution authorities to assess the expected timeframe.

- f. The time required by users of the service to move to the new service provider and steps and costs of that move, in particular, the cost that market participants would incur if forced to switch service provider.
- g. The timeframe within which a disruption in the provision of the product or service would materially affect market participants or market functioning.

The competition for these activities may be an indicator within the assessment of the elements a. to f. above.

- 22. When incorporating these tests of criticality, the delegated acts should be sufficiently detailed, but not require specific quantitative benchmarks for certain indicators. The recovery plans which have been collected and examined by the EBA in its benchmarking exercise have shown that institutions are in the position to deliver high quality analysis of the market situation and the impact on third parties resulting from the discontinuance of the provision of a critical function. Institutions usually have some insight in the market as a whole and in the situation of the third parties for which the functions are performed as well as of existing and potential market participants. Where this insight is limited, the institutions obligation to undertake the analysis of the impact would, as a result of the principle of proportionality, apply on a best efforts basis.
- 23. In addition to the identification of essential functions to the economy and its degree of criticality, the tests also improve authorities' understanding of critical functions and their ability to plan for the continuity of these functions, including assessing impediments to resolvability. Therefore, the EBA recommends incorporating the tests in the delegated act with the level of detail as outlined above, i.e. including all of the elements and indicators mentioned above, but without specifying quantified benchmarking levels. Nevertheless,

simplified obligations in accordance with Article 4 of the BRRD may mean that not all elements have to be documented explicitly at all times.

24. At a later stage, once authorities have gained more experience in recovery and resolution planning, there may be room to incorporate a minimum set of precisely defined specific indicators (e.g. market share) into the tests. This would allow resolution authorities to have a comparable set of indicators amongst institutions and to harmonise some information in the resolution plans.

1.3.2 Determination of critical services

25. The designation of critical services should follow the identification of the critical functions to the real economy and financial markets. The following elements should be assessed when analysing the criticality of a service:
 - a. The impact of the failure of a particular service on one or more critical functions; a service should be designated as critical only if the failure or malfunction would lead to the collapse of, or present a serious impediment to, the performance of one or more specific critical functions by the recipient of the service.
 - b. The substitutability of the service. This requires an assessment of how the critical functions would be adversely affected, and how quickly the critical service could be replaced, including the willingness and ability of internal or external service providers to provide these services at comparable extent, with a comparable quality and at an acceptable cost.
26. Critical services can be performed for one business unit only (dedicated services) or shared with more than one business unit (shared services). In addition to the evident need for the clear identification and understanding of the underlying critical services that are deemed to be essential for the performance of each critical function to third parties, the distinction between dedicated and shared services may be of relevance to inform resolution authorities during the resolvability assessment and in particular in the clear identification of interconnectedness between critical functions and associated services with the ultimate aim of maintaining the provision of critical functions to the economy.
27. Moreover, these critical services should be determined with a view to enabling institutions to organise them in a way that ensures their continued availability, e.g. by performing them through entities or units that are robust in a failure (e.g. separated or can be carved out in a crisis), or, if they are supplied by an external provider, by arrangements ensuring their continuation.

1.3.3 Resolution authority mapping of critical functions to the real economy and financial markets from an overall perspective ('top-down approach')

28. Institutions/groups may have a different view (from the resolution authority) in terms of which of the activities performed are 'critical' to the economy and financial markets. One reason for this could be linked to the fact that the institutions' analysis of criticality is often limited in scope compared to that of the resolution authorities. The recovery plan comparison exercise highlighted that while banks are generally able to assess their systemic importance in terms of providing a function and to some extent their substitutability (mainly in terms of concentration of the market, number of participants), they find difficult to assess external factors such as the willingness/ability of competitors to substitute for them, contagion effects, or the potential impact on other markets. In summary, institutions have a limited view of their own activity in relation to the whole economy, an aspect which needs to be critically reviewed and supplemented by the resolution authorities' analysis of the peer group information initially, and then through testing the critical functions against a comprehensive overall analysis of all functions that are considered to be essential for the economy and financial stability. In addition, institutions tend to focus on functions that are important for the institution itself, for example, an institution might consider a particular profitable function to be 'critical', while for the resolution authority, that function may not be critical because it would not generate a material impact on financial stability in the event of its failure. Therefore, it is important that the process of identifying critical functions is the subject of a discussion between institutions, supervisory authorities and resolution authorities with the objective of achieving a consistent approach.
29. The input of the resolution authority would likely include an evaluation of what the institution/group has identified as critical against the specific characteristics of the institution, the market for that function (e.g. concentration and substitutability), and the characteristics of the economy and of the financial market.
30. To that end, the resolution authorities should take into account the institutions' business model and structure (i.e. the way an institution's business is organised, including the interconnections between businesses).
31. Moreover, to enable a resolution authority to properly evaluate whether a "critical function" identified by each institution is effectively critical "to the real economy" and financial markets, it is important that the resolution authority would have a mapping of all the functions it considers to be critical to the economy and financial markets (from the most elemental functions – which need to be preserved in all circumstances – to less elemental). This would be in line with the idea of the FSB Guidance that criticality is not a strictly binary concept and there is a spectrum of criticality. It would also help in making decisions on different resolution alternatives, when limited resources are available for maintaining continuity of several critical functions. More than a list of critical functions, this mapping could also include the potential interconnections between functions.

32. Resolution authorities could test the functions identified at the level of individual institutions and groups against this mapping, covering all critical functions performed by the whole banking sector in the Member State.
33. As part of the resolution planning exercise, the home resolution authorities should communicate the relevant results of this mapping exercise to the resolution authorities in the host Member State where the group operates, as effects in one Member State economy or financial market can have a spill over/contagion effects in other Member States.

2. Core business lines

2.1 Definitions and concepts

34. Article 2(1), point (36) of the BRRD defines ‘core business lines’ as *‘business lines and associated services which represent material sources of revenue, profit or franchise value for an institution or for a group of which an institution forms part’*.
35. Core business lines play a role in recovery and resolution planning. Among other things, the recovery plan has to contain a detailed description of the processes for determining the value and marketability of the core business lines, operations and assets of the institution⁸. The resolution plan has to contain a mapping of the institution’s critical operations and core business lines⁹ and a demonstration of how critical functions and core business lines could be legally and economically separated from other functions so as to ensure continuity upon the failure of the institution¹⁰. Core business lines are also important for the assessment of the resolvability of an institution or a group¹¹. In resolution, the continuity of critical functions and core business lines may justify an exemption of certain liabilities from the application of the bail-in tool and may also justify its transference to a bridge bank. This is in line with the FSB Key Attributes, which describes principal or essential business lines in this context.
36. It is to be expected that core business lines could be identified by looking at the institution’s internal organisation, corporate strategy and also at the figures indicating how much they contribute to the financial results of the institution. However, this approach may not completely capture all core business lines because, for example, an institution might provide a service which is not directly profitable (or may even generate losses) but creates significant franchise value and is therefore important to its business as a whole.

⁸ Section A, paragraph 1, point (8) of the Annex of the BRRD.

⁹ Section B, paragraph 1, point (4) of the Annex of the BRRD.

¹⁰ Article 10(7), point (c) of the BRRD.

¹¹ Article 44(3), point (b) of the BRRD.

37. Within the scope of the definition of ‘core business line’ presented in Article 2(1), point (36) of the BRRD and considering the approach envisaged therein (i.e. the internal point of view of the importance of the function to the institution), the following concepts included in that definition could be clarified as:

- **‘Business line’**: a structured set of activities, processes or operations that are developed by the institution or group for third parties to achieve the organisation's goals.
- **‘Associated services’**: an activity or group of activities which do not by themselves generate direct profit for the institution (i.e. are cost centres) but support other businesses of the institution thereby contributing indirectly to the institution’s profits.

Examples of ‘associated services’ include common or shared personnel, facilities or systems. Going into more detail, it is possible to distinguish between:

- internal services: those developed by an internal unit or a separate legal entity within the group (e.g. accounting);
- external services: those performed by an external provider, outside the institution/group (e.g. appraisals to real estate assets);

In addition, both ‘internal’ and ‘external services’ may encompass ‘dedicated services’ (those performed for only one business unit of the institution/group, for example, a platform for credit limits) and ‘shared services’ (those performed for more than one business units or legal entities of the group, for example, IT systems).

2.2 Elements of a test for determining ‘core business lines’

38. In terms of specifying the criteria for determining ‘core business lines’, the EBA considers that defining and relying solely on quantitative indicators should be avoided, as this may not accurately and completely reflect the complexity of the generation of profit in an institution with a high level of organisation and complex division of business. Instead, the identification of core businesses lines should follow the internal organisation of institutions as well some quantitative indicators.

39. For instance, a business line might generate losses in revenue but may still be classified by the institution as a ‘core business line’. This could be the case for a new business line that the institution has entered into and which is considered to have strong growth potential, although it is still in the investment phase. Naturally, this type of situation would require an extensive explanation by the institution about its business plan regarding what it considers to be its medium-term perspective for these ‘core business lines’ (i.e. what business lines will be

relevant in the future and the scope of its strategy). The explanation could be supported by documents used for the internal reporting within the institution.

40. Future expected revenues, growth outlooks and franchise value should be supported by plausible, evidenced projections setting out the assumptions on which they are based.

41. Examples of identification indicators of core business lines could include:

- revenues generated by the business line as percentage of overall profit;
- profit generated by the business line as percentage of overall profit;
- return on capital/assets;
- total assets, revenue and earnings;
- the customer base, geographic footprint, brand and operational synergies of the business with other group businesses;
- impact of ceasing the business line on costs and earnings, if it is a source of funding or liquidity;
- growth outlook;
- the attractiveness of the business to competitors as a potential acquisition;
- market potential and franchise value.

42. Where they are clearly linked to the continuity of existing profits or the realisation of growth potential and franchise value the following indicator can be taken into consideration:

- Market share of the business line and industry position.

2.3 Core business lines and critical functions in existing recovery plans

43. In accordance with the importance of core business lines in the recovery planning process, the regulatory technical standards on the content of recovery plans requires institutions to identify core business lines and critical functions in the strategic analysis section of the recovery plan and to outline the key steps to maintaining those core business lines and critical functions in a stress situation. Institutions are also required to provide a description of the process and metrics for identifying the core business lines and critical functions.

44. Therefore, the existing recovery plans can be used as a source of both (i) examples of business lines that institutions have identified as core business lines, (ii) indicators that may be useful

to inform the specification of the definition of core business lines, (iii) information for resolution authorities to support their determination of critical functions, and (iv) understanding the way the institutions perceives its critical businesses and systemic importance.