



EBA/GL/2015/07

---

26 May 2015

---

## Final report

---

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

---

# Contents

---

1. Executive Summary	3
2. Background and rationale	5
<b>3. EBA Guidelines on the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail under Article 32(6) of Directive 2014/59/EU</b>	<b>9</b>
<b>Title I - Subject matter, scope and definitions</b>	<b>10</b>
Subject matter	10
Definitions	11
Scope and addressees	11
<b>Title II - Objective elements for determination that an institution is failing or likely to fail</b>	<b>12</b>
1. General considerations	12
2. Capital position	13
3. Liquidity position	15
4. Other requirements for continuing authorisation	16
<b>Title III - Process of determining that an institution is failing or likely to fail</b>	<b>18</b>
1. Determination made by the competent authority	18
2. Determination made by the resolution authority	19
3. Consultation and information exchange between the competent authority and the resolution authority	19
<b>Title IV - Final Provisions and Implementation</b>	<b>20</b>
4. Accompanying documents	21
4.1 Impact Assessment	21
4.2 Views of the Banking Stakeholder Group (BSG)	27
4.3 Feedback on the public consultation	28

# 1. Executive Summary

---

Article 32(6) of the Directive establishing a framework for the recovery and resolution of credit institutions and investment firms<sup>1</sup> (hereafter referred to as Directive 2014/59/EU) mandates the EBA to issue Guidelines to promote the convergence of supervisory and resolution practices regarding the interpretation of the different circumstances when an institution should be considered as failing or likely to fail. A determination that an institution is failing or likely to fail constitutes one of the three cumulative conditions determining whether resolution authorities should take resolution actions. It is also one of two cumulative conditions determining that an institution is no longer viable and that resolution authorities shall exercise the write down or conversion power in accordance with Article 60 of Directive 2014/59/EU.

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

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

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

---

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

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

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

The competent authorities should base their determination primarily on the outcomes of the supervisory review and evaluation process (SREP) as described in Article 97 of Directive 2013/36/EU and as further specified in the EBA Guidelines on common procedures and methodologies for the SREP that considers the objective elements outlined in these Guidelines. In addition, the competent authorities should take into account the results of the application of supervisory and early intervention measures, recovery options applied by institutions, and the results of the valuation of an institution's assets and liabilities.

The resolution authorities, when empowered under national law to determine that an institution is failing or likely to fail should be in a position to carry out their own assessment and base it on the objective elements outlined in these Guidelines. These objective elements reflect the areas and elements evaluated by the competent authorities under the SREP assessment (i.e. the institution's capital position, liquidity position and other requirements for its continuing authorisation).

On the basis of the assessment of these objective elements and the overall SREP assessment (the latter carried out by the competent authority), the competent and resolution authorities should consult each other and appropriately discuss the results of their assessments. Upon identifying the presence of objective elements specified in these Guidelines the resolution authority should ask the competent authority to provide an explanation as to how the circumstances identified by the resolution authority have been reflected in the overall SREP assessment of the institution. The competent authority should provide this information.

The Guidelines have been subject to public consultation and to the opinion of the EBA Banking Stakeholders Group. The competent and resolution authorities are expected to apply these Guidelines from 1 January 2016 following the implementation of the EBA Guidelines on common procedures and methodologies for the SREP.

## 2. Background and rationale

---

Resolution is the final step in a sequence of supervisory actions, generally following, where possible and appropriate, the adoption of early intervention measures. Resolution constitutes an alternative to normal insolvency proceedings. Indeed, resolution actions can be taken by the resolution authorities only when an institution is considered as failing or likely to fail, where private sector solutions and supervisory actions are not likely to prevent the failure of an institution within a reasonable timeframe, and where normal insolvency proceedings would not meet the public interest test.

According to Article 32(1) of Directive 2014/59/EU, three conditions need to be simultaneously met before resolution actions can be taken by a resolution authority, namely:

- 1) the competent authority or (under certain conditions) the resolution authority determines that an institution is failing or likely to fail;
- 2) having regard to timing and other relevant circumstances, there is no reasonable prospect that any alternative private sector or supervisory action (including measures by IPS, or supervisory action, including early intervention measures or the write-down or conversion of capital instruments in accordance with Article 59(2) taken in respect of the institution), would prevent the failure of the institution within reasonable timeframe;
- 3) a resolution action is necessary in the public interest.

Article 32(6) of Directive 2014/59/EU mandates the EBA to issue guidelines 'to promote the convergence of supervisory and resolution practices regarding the interpretation of the different circumstances when an institution should be considered as failing or likely to fail', i.e. the first of the above-mentioned three conditions. Article 32(6) of Directive 2014/59/EU confines these Guidelines only to the first condition and therefore this document does not provide further guidance on conditions two and three presented in paragraph 2 above.

Article 32(4) of Directive 2014/59/EU provides that the determination that an institution is failing or likely to fail should be based on the circumstances related to the following aspects:

- a. a current or likely infringement of the requirements for continuing authorisation in a way that would justify the withdrawal of authorisation (Article 32(4)(a) of Directive 2014/59/EU);
- b. assets currently lower or likely to be lower than liabilities (Article 32(4)(b) of Directive 2014/59/EU);
- c. a current or likely inability to pay debts or other liabilities as they fall due (Article 32(4)(c) of Directive 2014/59/EU);

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

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

The Guidelines focus on the circumstances specified in Article 32(4)(a), (b) and (c) of Directive 2014/59/EU and set out objective elements that can be both of a qualitative and quantitative nature to be considered for a determination by the authorities. These Guidelines do not specify further the extraordinary public financial support referred to Article 32(4)(d) as the other circumstance for the determination that an institution is failing or likely to fail.

The assessment of whether an institution is still meeting the requirements of its continuing authorisation and the objective elements stipulated in these Guidelines is carried out on a continuous basis by the competent authorities through the supervisory review and evaluation process (SREP) as described in Article 97 of Directive 2013/36/EU. The assessment is further specified in the EBA Guidelines on common procedures and methodologies for the SREP. According to the EBA Guidelines on common procedures and methodologies for the SREP, the SREP focuses on the assessment of an institution's viability and requires competent authorities to have an up-to-date view on the risk profile of the institution, governance arrangements, its business model and strategy, and the adequacy of available own funds and liquidity resources to cover the risks to which the institution is or might be exposed and consequently the overall viability of the institution.

The goal of these Guidelines is to foster convergence among competent authorities as well as resolution authorities on the practices regarding the interpretation of circumstances when the institution should be deemed to be failing or likely to fail as outlined in Article 32(4)(a), (b) and (c) of Directive 2014/59/EU. Due to their different roles and interplay with the institutions, the competent authority and resolution authority would follow different practices, which nevertheless should be consistent and coordinated.

The competent authorities should base their determination of whether an institution can be considered as failing or likely to fail primarily on the outcomes of the SREP that consider the objective elements outlined in Title II of these Guidelines as well as consider the results of the application of the supervisory measures or early intervention measures applied by them to a particular institution. In addition, the competent authorities should take into account the outcome of recovery options applied by institutions, and the results of the valuation of an institution's assets and liabilities.

The resolution authorities when determining that an institution is failing or likely to fail should be in a position to carry out their own assessment and base it on the objective elements outlined in Title II of these Guidelines, which reflect the areas and elements evaluated by the competent authorities under the SREP assessment (i.e. the institution's capital position, liquidity position and

other requirements for its continuing authorisation). On the basis of the assessment of these objective elements and the overall SREP assessment, the competent and resolution authorities should consult each other and appropriately discuss the results of their assessments. Upon identifying the presence of objective elements specified in Section 3 of Title II of these Guidelines the resolution authority should ask the competent authority to provide relevant information and an explanation how the circumstances identified by the resolution authority have been reflected in the overall SREP assessment of the institution.

The Guidelines are addressed both to the competent authorities and resolution authorities and aim to assist the authorities with their assessment. The Guidelines will also help resolution authorities in interpreting outcomes of the supervisory assessment when being consulted following the provisions of Article 32(1)(a) of Directive 2014/59/EU. The Guidelines are without prejudice to the authorities' discretion to decide, on the basis of the facts and circumstances of each specific case, whether the conditions for resolution are fulfilled.

These Guidelines should be read in conjunction with other regulatory products developed by the EBA, and in particular:

- the EBA regulatory technical standards developed pursuant to Article 81(1) of Directive 2014/59/EU, specifying, among other things, the procedures, content and conditions related to the notification that an institution is failing or likely to fail;
- the EBA guidelines on types of tests, reviews and exercises developed pursuant to Article 32(4)(d) of Directive 2014/59/EU;
- the EBA guidelines on triggers to apply early intervention measures developed pursuant to Article 27(5) of Directive 2014/59/EU;
- the EBA regulatory technical standards on valuation developed pursuant to Article 36 of Directive 2014/59/EU;
- the EBA guidelines on the common procedures and methodologies for the SREP developed pursuant to Article 107 of Directive 2013/36/EU.

#### **Box 1 – Explanatory text**

Examples outlined below describe situations in which an institution could be considered as failing or likely to fail by the competent authority and/or the resolution authority, but where the conditions to take resolution action under Article 32(1)(b) and (c) of Directive 2014/59/EU are not met.

The examples are only provided to illustrate potential links between the different conditions for undertaking a resolution action, and are without prejudice to the authorities' discretion when facing similar situations as each individual resolution decision will be based on the facts and circumstances of each particular case. The context, the specific features of the institution that is

failing or likely to fail and the resolution authority's assessment of the potential repercussions of its actions at that moment will determine whether the authority considers that the conditions set forth in Article 32(1)(a), (b) and (c) are simultaneously met or not.

- a) Institution A is a large credit institution which is likely to incur substantial losses. The extent of the losses is still unknown but there are objective elements to support a determination that the losses will deplete all or a substantial amount of the own funds of Institution A. Pursuant to Article 32(4) of Directive 2014/59/EU and to these Guidelines, Institution A should be considered likely to fail. Yet, at this stage, Institution A is not experiencing liquidity difficulties. The recovery plan of Institution A envisages measures that are likely to restore its capital in the current circumstances. If the resolution authority is confident that these actions will succeed in restoring the financial situation of the institution in a sufficiently short timeframe, it may decide that resolution action is neither needed, nor appropriate in the light of the conditions laid down in Article 32(1)(b) of Directive 2014/59/EU. This decision can be revised at any time if the competent or resolution authority's assessment of the situation changes or the situation further deteriorates.
- b) Institution B is a very small, not systemically important credit institution which does not perform any critical functions and it is expected to experience significant losses. Given the extent of the expected losses, the assets of the institution are likely to be less than its liabilities. In consequence, Institution B should be considered likely to fail according to Article 32(4) of Directive 2014/59/EU and to these Guidelines. However, if the resolution authority considers that the institution can be wound down under normal insolvency proceedings, resolution action is not necessary in the public interest as per Article 32(1)(c) of Directive 2014/59/EU.



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

---

## Contents

### Status of these Guidelines

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

### Reporting Requirements

3. Pursuant to Article 16(3) of the EBA Regulation, the competent authorities and resolution authorities must notify the EBA as to whether they comply or intend to comply with these guidelines, or otherwise with reasons for non-compliance, by dd.mm.yyyy. In the absence of any notification by this deadline, such competent authorities and resolution authorities will be considered by the EBA to be non-compliant. Notifications should be sent by submitting the relevant form to [compliance@eba.europa.eu](mailto:compliance@eba.europa.eu) with the reference 'EBA/GL/2015/07'. Notifications should be submitted by persons with appropriate authority to report compliance on behalf of their competent authorities and resolution authorities.
  4. Notifications will be published on the EBA website, in line with Article 16(3).
-

## Title I - Subject matter, scope and definitions

### Subject matter

5. Pursuant to Article 32(6) of Directive 2014/59/EU, these Guidelines intend to promote the convergence of supervisory and resolution practices regarding the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail.
6. For this purpose, these Guidelines provide a set of objective elements that should support the determination that an institution is failing or likely to fail, in accordance with the circumstances laid down in Article 32(4)(a),(b) and (c) of Directive 2014/59/EU. When such a determination is made by the competent authority, it will be based on the outcomes of the SREP performed in accordance with Article 97 of Directive 2013/36/EU and further specified in the SREP Guidelines. In this respect the resolution authority may have to interpret the outcomes of the SREP when consulted by the competent authorities in accordance with Article 32(1)(a) of Directive 2014/59/EU.
7. These Guidelines do not purport to constrain the ultimate discretion of the competent authority and of the resolution authority in making the determination that an institution is failing or likely to fail. The identification that an objective element enlisted in Title II of these Guidelines has materialised in respect of a particular institution should not lead the competent or the resolution authority as the case may be, to the automatic determination that the institution is failing or likely to fail or result in an automatic application of resolution tools. Similarly, the list of objective elements specified in these Guidelines is not exhaustive and should remain open since not all crisis circumstances can be reasonably foreseen.
8. These Guidelines should be read in conjunction with the conditions laid down in Article 32(1)(b) and (c) of Directive 2014/59/EU, which specify the other two requirements, in addition to 'failing or likely to fail', that need to be met for taking resolution actions. As a consequence, the determination that an institution is failing or likely to fail made by the competent authority and/or the resolution authority in compliance with these Guidelines, does not in itself entail that all conditions to take resolution actions are met. For sake of completeness it is worth keeping in mind that pursuant to Article 32(1)(b) and (c) of Directive 2014/59/EU respectively, the taking of resolution action is also subject to the absence of alternative private sector or supervisory action that can be taken to remedy the situation within a reasonable timeframe, and that the resolution action is necessary in the public interest.
9. The provisions in these Guidelines should also apply when a determination that an institution is failing or likely to fail is conducted by the relevant authority in the context of determining that an institution is no longer viable for the purpose of exercising the write-down and/or conversion power in accordance with Article 60 of Directive 2014/59/EU.

## Definitions

10. For the purpose of these Guidelines, the following definitions apply:
- a. 'SREP' means supervisory review and evaluation process as defined in Article 97 of Directive 2013/36/EU and further specified in the SREP Guidelines.
  - b. 'SREP Guidelines' means EBA Guidelines on common procedures and methodologies for SREP developed in accordance to Article 107(3) of Directive 2013/36/EU<sup>2</sup>.
  - c. 'Overall SREP assessment' as defined in the SREP Guidelines, is the up-to-date assessment of the overall viability of an institution based on assessment of SREP elements.
  - d. 'Overall SREP score' as defined in the SREP Guidelines, is the numerical indicator of the overall risk to the viability of an institution based on the overall SREP assessment.

## Scope and addressees

11. These Guidelines are addressed to the competent authorities, as defined in Article 4(2)(i) of Regulation (EU) No 1093/2010 establishing the EBA and to the resolution authorities, as defined in Article 4(2)(iv) of Regulation (EU) No 1093/2010 when they assess whether an institution is failing or likely to fail, according to Article 32(1)(a) of Directive 2014/59/EU, or to Article 32(2) respectively.
12. The Guidelines also apply to institutions where they determine themselves to be failing or likely to fail, in accordance with Article 81(1) of Directive 2014/59/EU. In this respect, the parts of these Guidelines that make reference to the conditions for resolution set forth in Article 32(1)(b) and (c) of Directive 2014/59/EU do not apply to the institutions.
13. The scope of these Guidelines is expanded beyond the scope set forth by Article 32(4) of Directive 2014/59/EU, since Section 3 of Title III also covers the consultation and information exchange between the competent authority and the resolution authority for the purpose of making a determination that an institution is failing or likely to fail. Pursuant to Article 16 of Regulation (EU) No 1093/2010, the EBA may issue guidelines in order to establish consistent, efficient and effective supervisory practices within the European System of Financial Supervision. The additional guidance provided in Section 3 of Title III is limited to the information exchange between authorities established in the same jurisdiction and its provisions are without prejudice to any rules for exchanging information between authorities across jurisdictions. In Member States where the resolution authority is not empowered with determining that an institution is failing or likely to fail the provisions laid down in paragraphs 40-41 do not apply.

---

<sup>2</sup> EBA/GL/2014/13 of 19 December 2014

## **Title II – Objective elements for determination that an institution is failing or likely to fail**

### **1. General considerations**

14. For the purposes of making a determination that an institution is failing or likely to fail, in accordance with the circumstances laid down in Article 32(4)(a)-(c) of Directive 2014/59/EU, the competent authority and the resolution authority as the case may be should assess the objective elements relating to the following areas as further specified in these Guidelines:
  - the capital position of an institution;
  - the liquidity position of an institution; and
  - any other requirements for continuing authorisation (including governance arrangements and operational capacity).
15. The objective elements listed in these Guidelines should be carefully analysed on a comprehensive basis. The determination that an institution is failing or likely to fail should remain an expert judgement and should not be automatically derived from any of the objective elements alone. This is especially true as regards the interpretation of the elements which may be affected by factors not directly related to the financial position of the institution.
16. In most cases it is expected that several factors, rather than merely one, set out in these Guidelines would inform the determination that an institution is failing or likely to fail. Nevertheless, there might be situations where meeting just one condition, depending on its severity and prudential impact, would be sufficient to trigger resolution.
17. Without prejudice to paragraph 16, some of the objective elements included in these Guidelines, such as macro-economic developments and market indicators should always be assessed in conjunction with other factors for determining that an institution is failing or likely to fail, and framed within a comprehensive assessment of the institution. When the relevant authorities use the external indicators referred to in paragraphs 21(c)-(e) and 25(a)-(b) of these Guidelines, any determination relating to the institution failing or being likely to fail must be supported by an objective assessment of the institution's actual financial position, to cater for the risk of market speculation and acknowledge the risk of market failures in case of a systemic crisis.
18. When determining whether an institution is failing or likely to fail, the competent or the resolution authority should base their determination on the assessment of the objective elements set out in Sections 2, 3 and 4 of Title II and taking into account the following, where relevant:

- a. the fact that an institution has activated its recovery plan and that the implementation of the recovery options chosen from its recovery plan have failed, in particular when the activation of the recovery plan was imposed on an institution by the competent authority as an early intervention measure under Article 27(1)(a) of Directive 2014/59/EU;
- b. a notification received by the competent authority in accordance with Article 81(1) of Directive 2014/59/EU from the management body of an institution which considers the institution to be failing or likely to fail.

## 2. Capital position

19. In accordance with Article 32(4)(a) and (b) of Directive 2014/59/EU, an institution should be considered as failing or likely to fail if it does or if there are objective elements to support a determination that in the near future it will:
  - a. infringe own funds requirements, including requirements imposed according to Article 104(1)(a) of Directive 2013/36/EU, relating to the continuing of the authorisation, in a way that would justify the withdrawal of its authorisation by the competent authority, including but not limited to, on grounds that it has incurred or is likely to incur losses that will deplete all or a significant amount of its own funds; or
  - b. have assets which are less than its liabilities.
20. When assessing the assets and liabilities of the institution in the near future and when assessing whether the institution will comply in the near future with the own funds requirements, the determination should be based on objective elements including among other things:
  - a. the level and composition of own funds held by an institution and whether it meets the minimum and additional own funds requirements imposed on the institution in accordance with Article 92 of Regulation (EU) No 575/2013 and Article 104(1)(a) of Directive 2013/36/EU;
  - b. the results of an asset quality review, including a national/Union/Single Supervisory Mechanism ('SSM') review, indicating a significant decrease in asset value leading to infringement of own funds requirements, where available;
  - c. results of any valuation conducted in order to inform whether the conditions for resolution are met in accordance with Article 36(4)(a) of Directive 2014/59/EU, where available; or
  - d. the results of any other institution specific assessment of the value of its assets and liabilities which has been prepared, whether conducted by an independent valuer or resolution authority or any other person, to the extent that the valuation methodology applied is consistent with Article 36 of Directive 2014/59/EU, supporting a determination

that the assets of the institution are less than its liabilities or that this is likely to occur in the near future. Elements of the valuation results may be used in the determination whether the institution infringes or is likely to infringe in the near future the own funds requirements set out in Directive 2013/36/EU and Regulation (EU) No 575/2013 in a way that justifies a withdrawal of its authorisation, where available.

21. Additional elements that should be considered, when carrying out the determination specified in paragraph 19, where they are relevant to the characteristics of the institution, include:
- a. threats to institution's capital position and viability stemming from a significant non-temporary increase in the cost of funding of the institution to a level which is unsustainable for the institution;
  - b. the likely materialisation of the institution's significant off-balance sheet items (i.e. contingent liabilities) in the near future, causing substantial loss threatening the institution's capital position and viability;
  - c. significant adverse developments in the macro-economic environment that could threaten the institution's capital position and viability, including relevant developments in interest rates, real estate values or economic growth. Such developments should significantly adversely affect the business model of the institution, the outlook for its profitability, capital position and viability;
  - d. significant deterioration of market perception of an institution reflected by indicators suggesting that the solvency of the institution is severely impaired and its capital position and viability threatened, as reflected in, among other things, a collapsing price-to-book level or a rapidly increasing level of the economic leverage (i.e. the economic leverage measured as the ratio of total assets to market value of equity). The development of both ratios could be compared with the institution's peer group duly considering distortions that may arise from differences in accounting standards; or
  - e. a significant non-temporary deterioration in the absolute and relative evolution of market indicators including, where available, equity-based indicators (for instance share price and book-to-market equity ratio) or debt-based indicators (for instance credit default swaps or subordinated debt spreads) indicating that an institution is likely to incur losses that could threaten its capital position and viability.
22. With reference to paragraph 19(b) the extreme case of inadequate capital position would be considered to materialise when the institution has insufficient assets to cover its liabilities. The likelihood of such a situation can be assessed on the basis of the circumstances and events listed in paragraphs 20 and 21.

### 3. Liquidity position

23. In accordance with Article 32(4)(a) and (c) of Directive 2014/59/EU an institution should be considered as failing or likely to fail if it does or if there are objective elements to support a determination that in the near future it will:
- infringe regulatory liquidity requirements, including requirements imposed according to Article 105 of Directive 2013/36/EU, for continuing authorisation in a way that would justify the withdrawal of its authorisation by the competent authority; or
  - be unable to pay debts and liabilities as they fall due.
24. The determination whether the institution is likely to be unable to meet regulatory requirements for liquidity or to pay its debts and liabilities as they fall due should be based on objective elements including among other things:
- a. significant adverse developments affecting the evolution of the institution's liquidity position and sustainability of its funding profile, and its compliance with the minimum requirements for liquidity as stipulated in Regulation (EU) No 575/2013 and the additional requirements imposed under Article 105 of that Regulation or under any national minimum requirements for liquidity;
  - b. significant non-temporary adverse evolution of the institution's liquidity buffer and its counterbalancing capacity. The assessment of the counterbalancing capacity dynamics should consider, where relevant:
    - highly probable liquidity inflows, including received committed credit and liquidity lines;
    - any forecasted contractual inflows;
    - the capacity to renew funding (including tenors and type of instruments of the new financing);
    - the access to long term funding;
    - extraordinary and large reduction or termination of liquidity lines from counterparties;
  - c. a non-temporary increase in the costs of funding of the institution to an unsustainable level, especially reflected by an increase of the costs (for instance reflected in spreads) of secured and unsecured financing in relation to comparable institutions;
  - d. a significant adverse evolution of the institution's current and future obligations. The assessment of the evolution of the institution's obligations should consider, where relevant:
-

- expected and exceptional outflows of liquidity, including requests from counterparties of the institution for margin calls and/or early redemption of liabilities and emerging signs of potential bank runs;
  - expected and exceptional collateral requirements, as well as the evolution of haircuts on collateral by central counterparties and other counterparties;
  - any contingent obligation, including those arising from granted credit and liquidity lines;
- e. the position of the institution in the payment, clearing and settlement systems and any indication that the institution is experiencing difficulties to fulfil its obligations including executing payments in payment, clearing and settlement systems; or
- f. developments that would be likely to severely impair the institution's reputation, in particular significant rating downgrades by one or several rating agencies if they lead to substantial outflows or the inability to renew funding or to the activation of contractual triggers based on the external ratings.
25. Additional elements that should be considered, where relevant to the characteristics of the institution, include:
- a. significant adverse developments in the macro-economic environment that could threaten the institution's financial position and viability, including developments in interest rates, real estate values or economic growth. Such developments should affect, directly or indirectly, the liquidity position of the institution in a significantly adverse way; or
  - b. significant deterioration in the market perception of an institution reflected by signs of non-temporary deterioration in the absolute and relative evolution of market indicators, including, where available, equity-based indicators (for instance share price and book-to-market equity ratio), or debt-based indicators (for instance credit default swaps and subordinated debt spreads) indicating that an institution is likely to incur losses or face liquidity problems that could threaten its viability.

#### **4. Other requirements for continuing authorisation**

26. According to Article 32(4)(a) of Directive 2014/59/EU, an institution shall be considered as failing or likely to fail when it infringes, or in the near future is likely to infringe, the requirements for the continuing authorisation in a way that would justify the withdrawal of its authorisation by the competent authority pursuant to Article 18 of Directive 2013/36/EU.
27. For the purpose of the above, the competent and/or the resolution authority should consider among other things whether there are serious weaknesses in the institution's governance arrangements, as well as in its operational capacity, and whether these weaknesses have



material impact on the institution's reliability and capacity to provide banking/investment services.

#### **4.1. Governance arrangements**

28. Certain objective elements should indicate that an institution has serious weaknesses in its governance arrangements which may, in most cases in conjunction with other objective elements related to capital and liquidity, justify withdrawal of the authorisation. These elements include among other things:
- a. significant misstatements in regulatory reporting or financial statements, especially resulting in a refusal of opinion or providing a qualified opinion by the external auditor;
  - b. a prolonged deadlock in the institution's management body which leads to its inability to make critical decisions;
  - c. an accumulation of material deficiencies in key areas of the governance arrangements, which together have material negative prudential impact on the institution.
29. For the purposes of paragraph 28(c) examples of such material deficiencies, which in combination can have a material negative prudential impact on the institution, can include:
- inadequate strategic planning and formalisation of risk tolerance/appetite and its risk management framework, leading to the inability to identify, manage and report the risks the institution is or might be exposed to;
  - material weaknesses, deficiencies or issues that were not properly and/or in a timely manner reported to the management body;
  - inadequate internal control mechanisms;
  - major reputational depreciation resulting from the non-compliance with 'fit and proper' criteria of individuals with key functions in the institution;
  - major reputational depreciation arising from a lack of transparency in the conduct of business and operations or incomplete/inaccurate disclosure of information;
  - major litigation or disputes in the nomination and succession of individuals performing key functions in the institution;
  - major non-compliance with remuneration requirements.

#### **4.2. Operational capacity to provide regulated activities**

30. Certain objective elements may negatively impact the institution's operational capacity to provide banking and investment activities, even without infringing own funds and liquidity regulatory requirements. Such circumstances and events, when they are not contingent and

cannot be removed in a timely and efficient way, should be considered in the assessment of whether the institution is failing or likely to fail. The indicators of the negative circumstances and events include among other things:

- a. the institution's inability, due to persistent operational constraints, to any longer fulfil its obligations towards its creditors, in particular, the failure to any longer provide security for the assets entrusted to it by its depositors;
- b. the institution's inability to make or receive payments and thereby to conduct its banking activities due to persistent operational constraints;
- c. the institution's loss of market and depositors confidence due to operational risks, leading to a situation where the institution is no longer able to carry out its business activities (as evidenced by the unwillingness of its counterparties and other stakeholders to transact with or provide capital to the institution and, where relevant, by the intention of existing counterparties to terminate their contracts, including a bank run).

### **Title III – Process of determining that an institution is failing or likely to fail**

#### **1. Determination made by the competent authority**

31. The assessment of the objective elements laid down in Title II of these Guidelines will usually be carried out by the competent authority in the course of the SREP performed in accordance with SREP Guidelines. The outcomes of the SREP assessment will be reflected in the overall SREP assessment supported by the overall SREP score assigned to an institution. Pursuant to the outcomes of the SREP assessment the competent authority should base its determination that an institution is failing or likely to fail on the following:
  - a. An overall SREP score of 'F' assigned to an institution based on the considerations stipulated in the SREP Guidelines; or
  - b. An overall SREP score of '4' assigned to an institution based on the considerations stipulated in SREP Guidelines and failure to comply with the supervisory measures applied in accordance with Articles 104 and 105 of Directive 2013/36/EU, or early intervention measures, applied in accordance to Article 27(1) of Directive 2014/59/EU.
32. It should be noted that contrary to the standard SREP procedure applied to cross-border banking groups and their entities (which pursuant to the SREP Guidelines requires discussion and coordination of the outcomes of the SREP assessment within the framework of colleges of supervisors prior to their finalisation), the competent authority upon considering assigning a score of 'F' to an institution, in line with Article 81 of Directive 2014/59/EU, should engage with the resolution authority following the procedure laid down in Article 32 of Directive 2014/59/EU without prior discussion or coordination within the supervisory college.

## **2. Determination made by the resolution authority**

33. When the resolution authority is entrusted to make the determination whether an institution is failing or likely to fail, it should consider the objective elements provided in Title II of these Guidelines in relation to the institution's capital position, liquidity position and other aspects with respect to the requirements for continuing authorisation based on the information that the resolution authority has at its disposal.
34. The objective elements listed in Title II of these Guidelines should be also taken into account when reviewing the relevant outcomes of SREP performed by the competent authority that are provided to the resolution authority under paragraph 40.
35. While making a determination that an institution is failing or likely to fail the resolution authority should also consider as an objective element the notification received from the competent authority stating that an overall SREP score of '4' was assigned to an institution based on the considerations stipulated in the SREP Guidelines; and that the institution has failed to comply with supervisory measures applied in accordance with Articles 104 and 105 of Directive 2013/36/EU or early intervention measures, applied in accordance with Article 27(1) of Directive 2014/59/EU.

## **3. Consultation and information exchange between the competent authority and the resolution authority**

36. Without prejudice to Article 90 and Article 32(2) of Directive 2014/59/EU, in order to facilitate the timely flow of information for the purpose of assessing whether an institution is failing or likely to fail, the competent authority and the resolution authority should exchange information in accordance with the requirements set out below.
37. Before concluding the determination that the institution is failing or likely to fail, the competent authority and resolution authority should appropriately discuss the results of their assessments.
38. Upon identifying the presence of the objective elements specified in Title II of these Guidelines the resolution authority should request the competent authority to explain whether and how these circumstances have been reflected in the overall SREP assessment of the institution.

### **3.1. Information provided by the competent authority**

39. According to Article 27(2) of Directive 2014/59/EU the competent authority is required to inform the resolution authority about the determination that the conditions for application of early intervention measures have been met. In addition, pursuant to Article 81(2) of Directive 2014/59/EU, the competent authority should inform the resolution authority of any crisis prevention measures (defined in point (101) of Article 2(1) of Directive

2014/59/EU), or any actions referred to in Article 104 of Directive 2013/36/EU it requires an institution to take.

40. To facilitate such exchanges of information, the competent authority should also provide the resolution authority with the outcomes of the SREP, at least every time the competent authority based on the outcomes of SREP assigns an overall SREP score of '4' or 'F'. In particular, the competent authority should notify the resolution authority and provide it with the following information in respect to the specific institution:
- a. a summary of the overall SREP assessment together with all SREP scores;
  - b. the complete set of indicators used in the regular monitoring of key indicators supporting SREP as stipulated in the SREP Guidelines;
  - c. all details on the applied supervisory measures (according to Articles 104 and 105 of Directive 2013/36/EU) and early intervention measures (according to Article 27(1) of Directive 2014/59/EU), as well as a description of the institution's compliance with them; and
  - d. details on the recovery options applied by the institution, where relevant.

### **3.2. Information provided by the resolution authority**

41. Upon the identification of objective elements specified in Title II of these Guidelines the resolution authority should, in writing, provide the competent authority with its findings and reasoning.
42. The competent authority should be informed in each case when the resolution authority:
- decides to exercise the power to require an institution to contact potential purchasers in order to prepare for the resolution of the institution, pursuant to Article 27(2) of Directive 2014/59/EU;
  - requests the valuation of institutions' assets and liabilities to be carried out by an independent valuer, or decides that the provisional valuation will be conducted by the resolution authority, pursuant to Article 36 of Directive 2014/59/EU;
  - receives results of the valuation of an institution's assets and liabilities, pursuant to Article 36 of Directive 2014/59/EU, from the independent valuer or determines the result of the provisional valuation that it has conducted.

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

43. These Guidelines will apply from 1 January 2016.

## 4. Accompanying documents

---

### 4.1 Impact Assessment

#### Introduction

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

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

This annex presents the Impact Assessment with a cost-benefit analysis of the provisions included in these Guidelines. Given the nature of the study, the Impact Assessment is high-level and qualitative in nature.

#### Problem definition

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

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

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

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

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

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

## Objectives

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

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

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

## Baseline scenario

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

## Assessment of the technical options

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

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

analysis has been carried out in the literature to identify which factors can successfully predict distress in the banking sector<sup>3</sup>. One of the recent publications<sup>4</sup> examines a set of factors that cover bank-specific indicators, country-specific banking sector indicators and country-specific macro-financial indicators. Taking such factors into account it is possible to develop a qualitative based framework to promote the convergence of practices regarding the determination that an institution is failing or likely to fail. It is equally possible to develop a quantitative based framework using these factors.

Both options have therefore been considered under this impact assessment:

#### A1. Qualitative Based Framework

#### A2. Quantitative Based Framework

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

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

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

---

<sup>3</sup> Betz et al. (2013). ‘Predicting Distress in European Banks.’ ECB Working Paper Series, No. 1597, Drehmann M. and Juselius M. (2013). ‘Evaluating early warning indicators of banking crisis: Satisfying policy requirements’. BIS Working Papers, No. 421; Oet, M. V. et al. (2013). ‘SAFE: An early warning system for systemic banking risk’. Journal of Banking & Finance; Jahn N. and Kick T. (2012). ‘Early warning indicators for the German banking system: a macro prudential analysis’. Deutsche Bundesbank Discussion Paper, No. 27/2012.

<sup>4</sup> Betz et al. (2013). ‘Predicting Distress in European Banks.’ ECB Working Paper Series, No. 1597.



Table 2: Potential advantages and disadvantages associated with the options

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

## Preferred Option

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

### B. Options related to time horizon: providing vs. not providing any definition of 'near future'

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

The assessment considers the following two options:

#### B1. Providing a definition of 'near future'

#### B2. Not providing any definition of 'near future'

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

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

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

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

#### Preferred Option

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

## 4.2 Views of the Banking Stakeholder Group (BSG)

The BSG is of the option that resolution framework needs to be straightforward, predictable and credible. For this reason, triggers should be as objective, transparent and predictable as possible; however they should not be automatic, but subject to supervisory judgment. The BSG supported the clarification that the Guidelines only establish guidance on a non-exhaustive number of elements to be considered by the authorities when assessing the question of whether an institution is failing or likely to fail, and that there is no automatic decision on the basis of any of the elements addressed in the Guidelines.

In addition, the BSG claimed that the conditions for initiating resolution must be clear in order to provide the market with reasonable certainty and assist investors to price risk. In addition, we consider that the implementation of the trigger should be consistent across the competent authorities and/or the resolution authority. In that vein, the BSG expressed some concerns about the possibility of considering different elements, depending upon whether the competent authority or the resolution authority was making the determination. It also suggested merging the sections of the draft Guidelines addressed to competent authorities and to resolution authorities. Furthermore, the BSG considered coordination and cooperation between the competent authority and the resolution authority essential and should be focused, not only on consultation and information exchange, but also on the way that both authorities interact with banks.

The BSG considered the level of the Guidelines to be sufficiently detailed, nevertheless it is important to clarify the interaction of the SREP assessment with other indicators used in the recovery and resolution framework (quantitative and qualitative recovery actions and internal management indicators), in order to have coherence in the measures applicable in the process. The BSG also considered the examples provided in Box 1 as useful and helpful.

In the view of the BSG, a failure of the implementation of a recovery option, when the recovery plan has been activated, does not necessarily mean that the institution is failing or likely to fail. Moreover, it was not clear to the BSG members when a valuation in line with Article 36 should be undertaken prior to determining that an institution is likely to fail. With regard to macroeconomic and market-based indicators the BSG stressed that they should be evaluated in both absolute and relative terms, in order to identify and differentiate whether weakened indicators are related to systemic or idiosyncratic events. The impacts on banks and potential solutions are completely different, depending on whether the 'likely to fail' situation is due to a systemic or idiosyncratic event.

The BSG claimed that the circumstances specified under the governance arrangements section do not necessarily indicate that an institution is either failing or likely to fail. In their view, the Guidelines should clarify that these elements are linked to others (capital or liquidity requirement) to justify that the institution is either failing or likely to fail. Finally, the BSG believed that the elements enlisted in the section operational capacity to provide regulated activities are sufficiently laid down and covered by other concepts and areas of the Guidelines, therefore there is no need to include such a section in this regulatory product.

### **4.3 Feedback on the public consultation**

The EBA conducted a public consultation on the draft proposal contained in this paper.

The consultation period lasted for three months and ended on 22 December 2014. In total eleven responses were received, of which nine non-confidential ones were published on the EBA website.

The summary of the key points and other comments arising from the consultation, the analysis and discussion triggered by these comments and the actions taken to address them, if deemed necessary, are presented below.

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

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

## Summary of key issues and the EBA's response

### Structure of the Guidelines

Many respondents felt that the same elements should be taken into account when competent and resolution authorities make a determination that an institution is failing or likely to fail. Therefore, the Guidelines should set out consistent criteria for making the determination, regardless of whether the decision is taken by the competent or the resolution authority. Some of these respondents were concerned that the draft suggests that some elements are only relevant for determinations performed by the resolution authority, i.e. the outcome of an Asset Quality Review (AQR) exercise.

In addition, some respondents noted that considering an overall SREP score of 'F' as an indicator for failing or likely to fail seems circular because the SREP Guidelines define 'F' as being 'an institution is meeting the conditions for failing or likely to fail pursuant to Article 32 of Directive 2014/59/EU'.

The EBA notes that the intention of the Guidelines is to ensure that competent and resolution authorities make their determination on the basis of the same objective elements, albeit following different processes reflecting the roles and responsibilities of the authorities. In particular, the objective elements set out in the Guidelines in the provisions addressed to the resolution authorities reflect also the areas and elements evaluated by the competent authorities under the SREP assessment. However, for clarification purposes, all objective elements for determination that an institution is failing or likely to fail, specified in the draft Guidelines, were moved to Title II of the final Guidelines which now sets general criteria that apply to both competent and resolution authorities. The fact that competent and resolution authorities have different means to make a determination, e.g. by conducting a SREP assessment, is taken into account under Title III of the final Guidelines which includes separate procedural rules for the competent and resolution authorities which should be followed to make this determination.

The structure of the Guidelines has been rearranged to differentiate between objective elements and the process of how a determination of failing or likely to fail is made. These changes acknowledge the fact that a score of 'F' is not an objective element in its own right, but reflects the conclusion of a SREP assessment of objective elements carried out by the competent authorities. Therefore, this approach is not circular as score of 'F' is assigned on the basis of elements reviewed within the SREP process which are relevant for the determination of failing or likely to fail (i.e. capital position, liquidity position and other requirements for continuing authorisation).

### Failure of recovery options, supervisory and early intervention measures

Most respondents remarked that the failure of certain recovery options does not necessarily mean that an institution is failing or likely to fail. Instead it should be assessed 'whether the institution has exhausted all feasible recovery options that could be achieved in the relevant

timeframe'. One respondent thought that the question of availability of recovery options is more relevant for the determination of failing or likely to fail than for the determination under Article 32(1)(b) of Directive 2014/59/EU. This respondent thought that a forward-looking view should also be applied to the results of supervisory or early intervention measures. This respondent thought that the backwards-looking results of such actions are not necessarily relevant to the determination whether an institution is failing or likely to fail.

In this regard the EBA notes that the conditions for resolution would not be met if feasible recovery options are available to the institution that could be implemented in the relevant timeframe. However, Directive 2014/59/EU implies that this issue should be examined under Article 32(1)(b) as a second step. The same applies to the results of supervisory and early intervention measures. It should be examined as a second step whether other early intervention measures are available that would prevent failure of the institution within a reasonable timeframe (forward-looking view).

### **Valuation**

Two respondents found it unclear when a valuation in line with Article 36 of Directive 2014/59/EU should have been undertaken prior to determining that an institution is failing or likely to fail. One respondent thought that a valuation pursuant to Article 36 of Directive 2014/59/EU should be the element that has the greatest weight when making the determination of failing or likely to fail.

In this regard it should be clarified that the valuation which is referred to in the Guidelines could be (1) an *a priori* valuation of assets and liabilities (for example requested by the competent authority) performed using the methodology that is consistent with the requirements set out in Article 36 of Directive 2014/59/EU but following a simplified procedure (in particular it does not need to be performed by the independent valuer or resolution authority), or (2) the valuation fulfilling all requirements of Article 36(4)(a) of Directive 2014/59/EU to determine whether the conditions for resolution or write-down or conversion of capital instruments are met. The results of the valuation of an institution's assets and liabilities pursuant to Article 36 of Directive 2014/59/EU are particularly important in the determination of failing or likely to fail because they are a necessary precondition for determining 'failing or likely to fail' (Article 36(4)(a) of Directive 2014/59/EU).

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

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
<b>Responses to questions in Consultation Paper EBA/CP/2014/22</b>			
<p>Question 1.</p> <p>Do you have any general comments on the draft Guidelines for determining that an institution is failing or likely to fail?</p>	<p>1. Many comments were received on the relationship between the SREP and the determination of failing or likely to fail.</p> <p>A number of respondents were concerned whether the SREP can be effective for making the determination of whether an institution is failing or likely to fail.</p> <p>The main concerns were the following:</p> <p>a. Two respondents thought that the SREP was not useful because it has been designed to assess institutions in the going concern. Therefore the outcomes of early intervention measures, the unsuccessful implementation of recovery options and a valuation pursuant to Article 36 of Directive 2014/59/EU seem to be more relevant factors.</p>	<p>1.</p> <p>a. Despite the SREP being a going-concern supervision, it is important to note that the ultimate objective is to ensure that an institution remains viable and therefore the ultimate focus of the SREP assessment is on the assessment of the viability of an institution, which is also reflected in the definitions of the overall SREP scores introduced in the SREP Guidelines published in December 2014. In particular, a score of 'F' has been introduced which is applicable when an institution is 'failing or likely to fail' based on the supervisory assessment of objective elements to support a determination that the institution will breach regulatory requirements in the near future as required by Article 32(4)(a) of Directive 2014/59/EU done as part of the SREP.</p> <p>The EBA agrees that the outcomes of early</p>	<p>1.</p> <p>a. No change</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>b. One respondent asked for clarification of whether the timing of the SREP assessment is appropriate for making the determination of 'failing or likely to fail'. Another respondent was concerned that such a determination could be based on outdated information.</p>	<p>intervention measures, the unsuccessful implementation of recovery options and a valuation in accordance with the methodology of Article 36 of Directive 2014/59/EU are equally important indicators for making the determination of 'failing or likely to fail' as is already reflected in the text of the Guidelines. However the latter elements alone would not allow a complete assessment of the circumstances set out in Article 32(4)(a)-(c) of Directive 2014/59/EU, e.g. a valuation is not helpful with respect to liquidity issues. Also, a crisis might develop so quickly that no recovery options or early intervention measures can be implemented before the determination of failing or likely to fail is made.</p> <p>b. According to the SREP Guidelines, the competent authorities shall review scores regularly, not only with the frequency defined for the regular review but also <u>without undue delay on the basis of material new findings or developments</u>. The latter will enable the competent authorities to make a determination of 'failing or likely to fail' on the basis of available, up-to-date information. There is no obligation to arrive at a joint decision on the SREP scores pursuant to Article 113 of Directive 2013/36/EU and therefore no joint assessment/decision of the competent authorities is necessary for a determination that an institution is failing or likely to fail, i.e. a score of 'F'. Therefore engagement with the resolution authorities will start as soon as any competent authority makes a determination of failing or likely to fail.</p>	<p>b. Clarification that no joint decision of competent authorities is necessary for determining SREP score 'F'</p>



Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>c. Some respondents remarked that a SREP score of 'F' being an indicator for failing or likely to fail seems circular because the SREP Guidelines define 'F' as meaning 'the institution is meeting the conditions for failing or likely to fail pursuant to Article 32 of Directive 2014/59/EU'.</p> <p>d. One respondent pointed out that not all factors considered in the SREP, such as strategy or deviation from a budget are likely to be relevant when determining whether an institution is failing or likely to fail.</p> <p>e. One respondent was concerned that there is a risk that the detailed links to specific SREP scores could create automatic triggers in practice.</p>	<p>c. The structure of the Guidelines has been rearranged to differentiate between objective elements that are applicable to all authorities and the process of how the determination of failing or likely to fail is made by different authorities. These changes acknowledge the fact that score of 'F' is not an objective element in its own right, but reflects conclusion of the SREP assessment of objective elements done by the competent authorities. Therefore this approach does not have circularity because score of 'F' is assigned based on the elements reviewed within the SREP process which are relevant for the determination of failing or likely to fail (i.e. capital position, liquidity position and other requirements for continuing authorisation).</p> <p>d. As set out in the Guidelines, objective elements that cover the following areas and elements should be taken into account: capital position, liquidity position and other requirements for continuing authorisation. All these elements are taken into account in a SREP assessment carried out in accordance with the SREP Guidelines.</p> <p>e. Para. 16 of the Guidelines clarifies that the determination that an institution is failing or likely to fail should remain an expert judgement and should not automatically be derived from the list of objective elements. A score of 'F' assigned to an institution means that the competent authority has assessed all objective elements as part of SREP and has determined that an institution is failing or likely to fail.</p>	<p>c. The structure of the Guidelines has been rearranged to differentiate between objective elements and the process of how the determination of failing or likely to fail is made.</p> <p>d. No change</p> <p>e. No change</p> <p>f. Change of</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>f. Two respondents noted that the SREP Guidelines must be implemented by 1 January 2016 which is after Directive 2014/59/EU and the Guidelines on failing or likely to fail must be applied by Member States.</p> <p>2. Some respondents thought that the breach of any particular indicator (e.g. SREP scoring or failure to implement a concrete recovery option) should trigger a discussion among authorities – supervisors and resolution authorities – and a bank’s management rather than trigger the resolution process. The indicators set out in the Guidelines should not be viewed on a stand-alone basis, but rather as part of a combination of bank-specific indicators, banking benchmark indicators, country level indicators and banking sector indicators.</p> <p>3. Many respondents felt that the same elements should be taken into account when each authority makes a determination that an institution is failing or likely to fail. Therefore, the Guidelines should set out consistent criteria for making the determination, regardless of whether it is being made by the competent authority or the resolution authority. Sections two (determination by the competent authority) and three (determination made by the</p>	<p>f. The date for implementation of Guidelines on failing or likely to fail will be aligned with the date for implementation of the SREP Guidelines.</p> <p>2. Notification of assessment and consultation between competent and resolution authorities is already foreseen in Articles 32 and 81 of Directive 2014/59/EU. The Guidelines provide that the identification of single objective elements should not lead to an automatic application of resolution tools. Therefore, the breach of any particular indicator does not trigger the resolution process. Prescribing discussion with the institution is outside the scope of the Guidelines. The EBA expects that competent and resolution authorities will discuss the situation with the institution, in particular to determine whether alternative private sector measures might be available (Article 32(1)(b) of Directive 2014/59/EU). The Guidelines set out that the list of objective elements set out in the Guidelines is not exhaustive. Therefore it is also possible to take into account banking benchmark indicators, country level indicators and banking sector indicators.</p> <p>3. The intention of the Guidelines is to ensure that the competent and resolution authorities make their determinations on the basis of the same objective elements. In particular, the objective elements set out in the draft Guidelines in provisions aimed at the resolution authorities (i.e. Section 3 of Title II of the draft Guidelines) were also reflected the areas and elements evaluated also by the competent authorities under the SREP assessment. However,</p>	<p>implementation date to 1 January 2016</p> <p>2. No change</p> <p>3. The text of the Guidelines has been amended to clarify that the competent and resolution authorities shall base their decisions on the same objective elements.</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>resolution authority) of Title II of the Guidelines should be merged. The current draft suggests that some elements are only relevant for determination by the resolution authority, i.e. the outcome of an AQR exercise.</p>	<p>for clarification purposes, all objective elements for determination that an institution is failing or likely to fail, specified in the draft Guidelines, were moved to Title II of the final Guidelines which applies to both competent authorities and resolution authorities. The fact that competent authorities and resolution authorities have different means to make the determination, e.g. by conducting a SREP assessment, is taken into account under Title III of the final Guidelines which includes separate procedural rules for the competent authorities and resolution authorities which should be followed to make this determination.</p>	
<p>Question 2. Do you consider the level of detail of these draft Guidelines to be sufficient?</p>	<p>Generally, respondents considered the level of detail of the Guidelines to be sufficient.</p> <ol style="list-style-type: none"> <li>Two respondents thought that cooperation and coordination between the competent and the resolution authority should also focus on the way that authorities interact with banks. Another respondent said that the Guidelines should provide more detail on communication and cooperation between the competent and resolution authorities.</li> <li>Only one respondent thought that the EBA should consider further specifying certain quantitative indicators with thresholds.</li> <li>Some respondents thought that the interaction of a SREP assessment for failing or likely to fail with other indicators (recovery and early intervention under</li> </ol>	<ol style="list-style-type: none"> <li>Interaction of competent and resolution authorities with banks is outside the mandate of the Guidelines; therefore it should be left to Member States. It should be also noted that when the determination is made by the competent authority within the SREP framework, the dialogue with institutions is organised pursuant to the SREP process as provided in the SREP Guidelines.</li> <li>It appears that the outcome of the public consultation supports the policy option selected by the EBA in the Impact Assessment with regard to setting thresholds for qualitative indicators.</li> <li>The interaction seems clear enough.</li> </ol>	<ol style="list-style-type: none"> <li>No change</li> <li>No change</li> <li>No change</li> </ol>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	Directive 2014/59/EU) should be clarified.		
<p>Question 3.</p> <p>Do you consider the examples provided in Box 1 to be sufficiently clear and providing useful guidance?</p>	<p>The majority of respondents agreed that examples are useful. However, some respondents thought that example (b) should be further clarified. Some respondents criticised that the example created the impression that a temporary inability to pay obligations due to technical reasons could justify the determination that an institution is failing or likely to fail. Another respondent remarked that the size of obligations is independent of the ability to meet them and should therefore not be a valid criterion. It was also remarked that a resolution process could not be of help in the case of an IT outage. In such situation appropriate communication would be sufficient to prevent failure if the IT outage occurred in a situation in which overall systemic confidence was not affected.</p>	<p>The EBA agrees with the comments and example (b) will be deleted.</p>	<p>Deletion of example (b) from Box 1.</p>
<p>Question 4.</p> <p>Do you have any comments on the proposed specification of circumstances which should be taken into account by the competent authority in determining that an institution is failing or likely to fail?</p>	<p>1. Most respondents remarked that the failure of certain recovery options does not necessarily mean that an institution is failing or likely to fail. Instead it should be assessed 'whether the institution has exhausted all feasible recovery options that could be achieved in the relevant timeframe'. One respondent thought that the question of availability of recovery options is more relevant for the determination of failing or likely to fail than for the determination under Article 32(1)(b) of Directive 2014/59/EU.</p> <p>One respondent thought that a forward-looking view should also be applied to the results of supervisory or early intervention measures. This respondent thought that the backwards-looking results of such actions are</p>	<p>1. The EBA agrees that the conditions for resolution shall not apply if feasible recovery options are available to an institution that could be implemented in the relevant timeframe. However Directive 2014/59/EU implies that this issue should be examined under Article 32(1)(b) of Directive 2014/59/EU as a second step. The same applies to the results of supervisory and early intervention measures. It should be examined as a second step whether other early intervention measures are available that would prevent failure of the institution within a reasonable timeframe (forward-looking view).</p>	<p>1. No change</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>not necessarily relevant to determining whether an institution is failing or likely to fail.</p> <p>2. Two respondents found it unclear when a valuation in line with Article 36 of Directive 2014/59/EU should have been undertaken prior to determining that the institution is failing or likely to fail. One respondent thought that the valuation pursuant to Article 36 of Directive 2014/59/EU should be the element that has the greatest weight when making the determination of failing or likely to fail.</p>	<p>2. The valuation which is referred to in the Guidelines could be (1) an <i>a priori</i> valuation of assets and liabilities (for example requested by the competent authority) performed using the methodology that is consistent with the requirements set out in Article 36 of Directive 2014/59/EU but following the simplified procedure, or (2) the valuation pursuant to Article 36(4)(a) of Directive 2014/59/EU to determine whether the conditions for resolution or write down or conversion of capital instruments are met.</p> <p>The results of the valuation of an institution's assets and liabilities pursuant to Article 36 of Directive 2014/59/EU are particularly important in the determination of failing or likely to fail because it is a necessary precondition for determining 'failing or likely to fail' (Article 36(4)(a) of Directive 2014/59/EU).</p>	<p>2. The wording of the Guidelines has been clarified to differentiate between the valuation pursuant to Article 36 Directive 2014/59/EU or an <i>a priori</i> valuation of assets and liabilities (for example requested by the competent authority) performed using the methodology that is consistent with the requirements set out in Article 36 of Directive 2014/59/EU but following the simplified procedure.</p>
<p>Question 5. Do you think that a</p>	<p>None of the respondents considered it appropriate to include a quantitative threshold for defining a significant</p>	<p>The EBA agrees that quantitative thresholds are not appropriate.</p>	<p>No change</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
<p>significant decrease in asset value can be predefined in a quantitative manner? If yes, which threshold would you suggest for this purpose?</p>	<p>decrease in asset value. A significant decrease in asset value in itself does not mean that an institution is failing or likely to fail because an institution might have sufficient capital to support the reduced value of assets. For this reason one of the respondents disagreed that point (e) relating to the results of asset quality reviews should be included as an indicator in the Guidelines. Supervisory processes are the appropriate approach to reflecting outcomes of asset quality reviews in capital position.</p> <p>One respondent suggested establishing a rough predefinition by creating certain scenarios implying a range of assumptions in combination with a range of asset categories.</p>	<p>The suggestion to establish rough predefinitions seems too complicated.</p> <p>The EBA agrees agree that supervisory processes constitute the appropriate approach to reflecting outcomes of asset quality reviews in the institution's capital position. However, such supervisory processes are not available to resolution authorities. Therefore this element has been explicitly set out in the Guidelines as an indicator. The indicator does not necessarily mean that an institution is failing or likely to fail. If the institution has sufficient capital to support the reduced value in assets, the conditions of Article 32(4) of Directive 2014/59/EU will not be met.</p>	
<p>Question 6.</p> <p>Do you have any comments on the proposed specification of objective elements related to capital position which should be taken into account by the resolution authority in determining that an institution is failing or likely to fail?</p>	<ol style="list-style-type: none"> <li>1. One respondent thought that the paragraph introducing sub-sections (f) to (j) should be changed to be made more forward-looking. This should be done by referring to objective elements that result in a depletion of the capital position infringing the institution's own funds requirements if the institution is unable to address this in the relevant timeframe.</li> <li>2. One respondent thought that the Guidelines should refer to significant <b>non-temporary</b> adverse developments in the macro-economic environment.</li> <li>3. Another respondent queried how the non-temporary nature of the deterioration of market indicators could be assessed.</li> <li>4. Other respondents suggested that macroeconomic</li> </ol>	<ol style="list-style-type: none"> <li>1. The heading should not be changed because it reflects the text of Directive 2014/59/EU. Whether an institution is able to address the problems in the relevant timeframe is a question to be dealt with in a second step under Article 32(4)(b) of Directive 2014/59/EU.</li> <li>2. The EBA is of opinion that it cannot be determined in advance whether adverse developments in the macro-economic environment are only temporary.</li> <li>3. This will be assessed by expert judgement. In some cases it may be possible to determine that the deterioration of market indicators is only temporary.</li> <li>4. This issue is already addressed the text of the</li> </ol>	<ol style="list-style-type: none"> <li>1. No change</li> <li>2. No change</li> <li>3. No change</li> <li>4. Clarification was</li> </ol>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>and market-based indicators should be evaluated in both absolute and relative terms, in order to identify and differentiate whether weakened indicators are related to systemic or idiosyncratic events. The impacts on banks and potential solutions are completely different, depending on whether the ‘likely to fail’ situation is due to a systemic or idiosyncratic event. One respondent suggested that market-based indicators should always be used in supervisory processes after acknowledging the possibility of serious market failures.</p>	<p>Guidelines according to which macro-economic developments and market indicators should always be used in conjunction with other input factors. However, it can be added for additional clarification that the possibility of serious market failures should be taken into account.</p>	<p>added to the Guidelines that the possibility of serious market failures should always be taken into account.</p>
<p>Question 7. Do you have any comments on the proposed specification of objective elements related to the liquidity position which should be taken into account by the resolution authority in determining that an institution is failing or likely to fail?</p>	<p>1. One respondent requested that it should be clarified in the Guidelines that a breach of the Liquidity Coverage Ratio (LCR) requirement as such should not be deemed to be a proof in itself of an institution failing.</p> <p>2. The same respondent requested a clarification that the use of central bank facilities should not be regarded as a sign that an institution is likely to fail.</p> <p>3. One respondent requested that the language in para. 26 needs to be amended to become more forward-looking by rephrasing as follows: ‘Indefinitely incapable of meeting regulatory liquidity requirements, including requirements imposed according to Article 105...’ and ‘indefinitely unable to pay debts and liabilities as they fall due’.</p> <p>This reflects that a breach of liquidity requirements may</p>	<p>1. It is not necessary to clarify that a breach of LCR should not be deemed to be proof in itself that an institution is failing or likely because this circumstance alone would not justify withdrawal of authorisation and therefore the conditions of Article 32(4)(a) of Directive 2014/59/EU would not be met.</p> <p>2. The EBA is of view that this issue is sufficiently dealt with by not including ‘the use of central bank facilities’ in the list of objective elements provided in the Guidelines for making failing or likely to fail determination.</p> <p>3. The wording should not be changed because it reflects the text of Directive 2014/59/EU. Whether the institution is able to address the problems in the relevant timeframe is a question to be dealt with in a second step under Article 32(4)(b) of Directive 2014/59/EU.</p>	<p>1. No change</p> <p>2. No change</p> <p>3. No change</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	lead to a firm being unable to pay debts and liabilities, but this does not mean that they are failing or likely to fail, as management action or use of liquidity reserves could restore them.		
<p>Question 8.</p> <p>Do you have any comments on the proposed specification of the circumstances, related to governance arrangements, which should be taken into account by the resolution authority in determining that an institution is failing or likely to fail?</p>	<p>1. Several respondents thought that the elements in paragraph 30 should only justify determination of failing or likely to fail where there are other elements related to capital and/or liquidity. Therefore the wording ‘in most cases’ should be deleted from para. 30.</p> <p>2. One respondent thought that problems with governance are a less important element for the assessment of failure and should therefore rather be part of recovery plans and early intervention measures.</p> <p>3. Another respondent suggested rephrasing the last bullet-point before Box 2 to ‘an accumulation of material deficiencies in key areas of governance arrangements, <u>resulting in a SREP score of ‘4’ for internal governance and institution-wide internal controls</u>, where this would have a serious prudential impact on the institution. Box 2 should then be deleted because it would no longer be necessary.</p>	<p>1. Article 32(4)(a) of Directive 2014/59/EU requires only that the requirements for continuing authorisation be infringed in a way that justifies withdrawal of authorisation. Article 18 of Directive 2013/36/EU does not require that breach of governance requirements justify withdrawal of authorisation only where other elements related to capital or liquidity are also present.</p> <p>2. If problems with governance are so severe that they justify the withdrawal of authorisation then the requirements of Article 32(4)(a) of Directive 2014/59/EU are met. Therefore governance issues can be relevant for the determination of failing or likely to fail.</p> <p>3. The structure of the Guidelines has been changed to set out all elements to be reviewed by the competent and resolution authorities. Then two separate sections are dealing with the assessment procedure to be carried out by the competent and the resolution authority. Assessment by competent authority will be done by means of SREP. The Guidelines then include a reference to overall SREP score of ‘4’ or ‘F’ which also applies to the determination of failing or likely to fail with respect to governance issues.</p>	<p>1. No change</p> <p>2. No change</p> <p>3. Examples provided Box 2 of the draft Guidelines were incorporated into the text of the final Guidelines.</p>



Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>4. One respondent asked for clarification on the process that the resolution authority would use to detect serious weaknesses in governance arrangements.</p> <p>5. Another respondent thought that ‘significant rating downgrade’ should be specified by ‘downgrade of more than three notches’ as grounds for determination of failing or likely to fail should exceed the LCR downgrade scenario.</p>	<p>4. The process for the resolution authority to make an assessment of governance issues will rely to a large extent on information provided to the resolution authority by the competent authority in line with Article 90 of Directive 2014/59/EU.</p> <p>5. We think that the number of notches should not be further specified because it will depend on the situation of each institution as to what should be regarded to be a ‘significant rating downgrade’. If the financial situation of an institution is already difficult, a downgrade of one or two notches might be a sufficient indicator.</p>	<p>4. No change</p> <p>5. No change</p>
<p>Question 9.</p> <p>Do you have any comments on the proposed specification of the circumstances, related to an institution’s operational capacity to provide regulated activities, which should be taken into account by the resolution authority in determining that an institution is failing or likely to fail?</p>	<p>Many respondents thought that that the proposed indicators in paragraph 31 are already addressed by other areas of the Guidelines. For example, where an institution can no longer be relied upon to fulfil its obligations to its creditors or becomes unable to make or receive payments, it is likely to be unable to pay its debts as they fall due.</p>	<p>The chapter on operational capacity to provide regulated activities reflects Article 18 of Directive 2013/36/EU concerning the reasons for withdrawal of authorisation. Therefore it will be kept in the Guidelines even if there may be overlap with other conditions of Article 32(4) of Directive 2014/59/EU.</p>	<p>No change</p>

<b>Comments</b>	<b>Summary of responses received</b>	<b>EBA analysis</b>	<b>Amendments to the proposals</b>
Question 10. Do you agree with our analysis of the impact of the proposals in this Consultation Paper? If not, can you provide any evidence or data that would explain why you disagree or might further inform our analysis of the likely impacts of the proposals?	Respondents agreed with the EBA's analysis of the impact of the proposals.	The EBA welcomes positive feedback	No change