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***Launched in 1960, the European Banking Federation is the voice of the European banking sector from the European Union and European Free Trade Association countries. The EBF represents the interests of some 4,500 banks, large and small, wholesale and retail, local and cross-border financial institutions. Together, these banks account for over 80% of the total assets and deposits and some 80% of all bank loans in the EU alone.***

## EBF Response to Consultation paper on draft Guidelines on the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail (EBA/CP/2014/22)

Answer to specific questions

**Q1: Do you have any general comments on the draft Guidelines for determining that an institution is failing or likely to fail?**

Triggers to determine if an entity is failing or likely to fail should be as objective, transparent and predicable as possible; they should however not be automatic, but subject to supervisory judgment.

In particular, we would like to emphasise that the breach of any particular indicator (i.e. SREP) or the failure to implement a concrete recovery option should trigger discussion among authorities – supervisors and resolution authorities – and the bank management rather than trigger the resolution process. In fact, before any public action, supervisors and resolution authorities should carry out an internal in-depth review of the fundamentals, business model and relevant peers of the bank as Figure 1 shows



Also, the EBF would welcome some clarifications on whether the timing of the SREP assessments is appropriate for making the ‘failing or likely to fail’ determination.

In addition, we consider that the implementation of the trigger should be consistent across competent authorities and/or resolution authorities. Gold-plating practices should be completely avoided and national implementation should be monitored carefully, in order not to jeopardise certain funding markets and to maintain the level playing-field.

In that vein, some concerns arise about the possibility of considering different elements, depending upon whether the competent authority or the resolution authority is making the determination. While we consider that the competent authority has the benefit of conducting the SREP assessment itself, the resolution authority should also be able to benefit from this information. Currently, the draft guidelines suggest that certain elements are only relevant to a determination by a resolution authority, for example the outcome of an AQR exercise.

In order to avoid misunderstanding in the determination that an institution is failing or likely to fail, sections two (determination made by the competent authority) and three (determination made by the resolution authority) of Title II of the guidelines should be merged to ensure the consistency of the criteria (SREP assessment and others that only apply to the resolution authority).

We also note that the description of what constitutes an “F” rating in the SREP guidelines refers back to ‘failing or likely to fail’ under the BRRD so is circular.

Finally, the SREP consultation indicates that the SREP guidelines must be implemented by 1 January 2016, which comes after the entry into force deadline imposed to the Member States for the BRRD. This means the SREP guidelines may not have been incorporated into their supervisory processes and procedures before this Paper requires them to be used for the purposes of the BRRD.

**Q2: Do you consider the level of detail of these draft Guidelines to be appropriate?**

The European Banking Federation considers that the level of detail used in the draft guidelines is generally appropriate. 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.

**Q3: Do you consider the examples provided in Box 2 to be sufficiently clear and providing useful guidance?**

This question needs to be clarified as it probably refers to Box 1. If so, we consider that Box 1 is useful and helpful in explaining § 9 of the draft guidelines.

**Q4: 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?**

The 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. It could be an unsuccessful measure, but the institution could still be recoverable with additional measures/actions.

**Q5: Do you reckon that a significant decrease in asset value can be predefined in a quantitative manner? If yes, which threshold would you suggest for that purpose?**

The forward looking element in the concept of assessing whether an institution "is likely to fail" and "is likely to incur losses" (for instance as used in para 23 of the guideline) is complicated. There will always be a speculative, subjective element in such an assessment, where the authorities also are quite likely to have a negatively biased assessment of the future prospects of the institution.

It is also very likely that these assessments will be made on the basis of the present situation in a crisis, where asset valuations are typically very depressed by lack of buyers in asset markets, meaning that assets can only be sold at "fire sale" valuations.  One sign that this is often the case is that banks tend to do large write downs of credit portfolios in severe downturns, and then write back substantial portions of these provisions when the economy recovers. It is important that authorities are doing these forward looking assessments in an unbiased matter, assessing the value of the institution and its asset with a long term going concern view.

The guidelines should be clear about when the word "likely" is used in the above mentioned meaning. It should be an unbiased assessment where it is more likely than not that the assessment is actually correct. With these aspects in mind, it looks inappropriate to try to prescribe a particular decrease in asset value in these guidelines, also bearing in mind that institution's business models vary substantially, and that the composition of the asset base might look very different in different institutions.

European banks don’t think a significant decrease in asset value in itself means that an institution is failing or likely to fail. For that reason, a quantitative threshold for defining a significant decrease in asset value is unnecessary.

**Q6: Do you have any comments on the proposed specification of objective elements related to the capital position which should be taken into account by the resolution authority in determining that an institution is failing or likely to fail?**

The indicators in points f) to j) are useful indicators when assessing the severity of distress in a problematic institution. But they can never in themselves be sufficient evidence for the assessment that an institution is likely to fail. In financial crises, market participants often get extremely risk averse, leading to market values of instruments (both equities and debt instruments) issued by the institution loosing large proportions of their values. These do not necessarily reflect fair valuations of the institutions payment capacity or economic value. With a credible resolution framework in place, market reactions to problematic institutions will probably become even more dramatic than in the past, because the likelihood of support for the institution will be lower in the future. This means that it will be very risky to rely too much on market reactions when assessing whether an institution is failing or likely to fail. The guidelines should be more clear that these indicators are only indicators, and that the assessment must mainly be built around the other criteria (points a to e in para 24).

Macroeconomic and market-based indicators should be evaluated in 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.

**Q7: 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 as failing or likely to fail?**

When it comes to the liquidity position, it is of particular importance that institutions are allowed to use their liquidity buffers in a stressed situation, and that the liquidity stress in itself does not lead to the authorities designating the institution as failing. It is inherent in banking, that problems with regard to the confidence of an institution may lead to a run on the bank, and that the confidence problems in the bank might become self-fulfilling. Because of that, it has been clear in the reasoning behind the LCR requirements that a liquidity buffer is there to be used in a stress situation, where the breach of the LCR requirement is accompanied by a contingency funding plan to resolve the crisis and rebuild the liquidity buffer requirement. Therefore, a breach of the liquidity requirement as such should not be deemed to be a proof in itself of an institution failing. This should be reflected in para 26 of the guideline. With the same reasoning, the inherent liquidity risks in banking have led to the principle that central banks should be able to extend liquidity support to solvent banks. The guidelines do not develop guidance on how any use of central bank liquidity should be assessed when the authorities are to judge whether an institution is failing. It would be appropriate to have some clear guidance with the content that use of central banks facilities should not be regarded as a sign that an institution is likely to fail.

Our comments are related to the answer to question n°6 of the consultation paper.

**Q8: 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?**

It seems that § 30 and Box 2 of the guidelines, referring to governance arrangements, do not necessarily indicate that the institution is either failing or likely to fail. We believe that 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. In line with this we propose to delete the wording ‘in most cases’ in order to avoid misunderstanding.

**Q9: Do you have any comments on the proposed specification of the circumstances, related to the 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?**

The indicators proposed in paragraph 31 are sufficiently laid down and covered by other concepts and areas of the guidelines. For that reason we consider it unnecessary to repeat them.

**Q10: 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?**

We don’t have any comments on this topic.