BANCO DE ESPAÑA
Eurosistema

Guidelines on the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail

(EBA/GL/2015/07)

These guidelines are addressed to the competent authorities and the resolution authorities in those cases where they have assigned competences to assess whether an institution is failing or likely to fail.

The guidelines contain a detailed list of the objective elements for determining whether an institution is failing or likely to fail and whose assessment is performed within the supervisory review and evaluation process (SREP). In addition, the Guidelines specify different sets of procedural rules addressed to each of these authorities and, finally, the Guidelines also include a specific section focused on the consultation and exchange of information between these authorities with the aim of determining non-viability.

Guidelines do not restrict the discretionarily of the authorities to determine non-viability, therefore the existence of objective elements does not imply to determine the non-viability automatically.

EBA published these guidelines on 06.08.2015. Banco de España's Executive Commission adopted them as their own on 30.09.2015.

EBA/GL/2015/07

06.08.2015

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

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

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 06.10.2015. 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 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[1].

    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 1093/201 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.

[1] 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.