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European Banking Authority
Floor 46
One Canada Square
London
E14 5AA

Submitted via the EBA website

Consultation paper on draft 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

Dear Sir / Madam

Please find enclosed AFME's response to the EBA consultation paper on draft 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 (EBA/CP/2014/22).

Please do not hesitate to contact us if you have any questions.

Yours faithfully



Oliver Moullin
Director, Resolution and Crisis Management
AFME

Association for Financial Markets in Europe

London Office: St. Michael's House, 1 George Yard, London EC3V 9DH T: +44 (0)20 7743 9300 F: +44 (0)20 7743 9301

Brussels Office: Rue de la Loi 82, 1040 Brussels, Belgium T: +32 (0)2 788 3971

Company Registration No: 6996678 Registered Office: St. Michael's House, 1 George Yard, London EC3V 9DH

www.afme.eu

Consultation response

EBA consultation paper on draft 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 (EBA/CP/2014/22)

17 December 2014

The Association for Financial Markets in Europe (“**AFME**”) welcomes the opportunity to comment on the European Banking Authority (“**EBA**”) Consultation Paper (the “**CP**”) on draft 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 (the “**BRRD**”) (EBA/CP/2014/22).

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.¹

We set out below our comments in response to questions raised in the CP. References to paragraphs are references to paragraphs of the draft guidelines set out in the CP unless otherwise stated. References to articles are to articles of the BRRD.

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

We support 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 particular, we would like to emphasise that the breach of an indicator such as a particular SREP score or the failure of a particular recovery option should trigger discussion among the supervisory and resolution authorities and also the bank’s management rather than trigger the resolution process. The objective elements such as a SREP score equal to “F” or 4 should not automatically lead to a determination that the bank is failing or likely to fail. It should also be acknowledged in the guidelines that SREP is a supervisory process designed for that purpose

¹ AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia. AFME is listed on the EU Register of Interest Representatives, registration number 65110063986-76.

and not all factors considered in SREP, such as strategy or deviation from budget are likely to be relevant to determining whether a firm is failing or likely to fail.²

We support the inclusion of guidelines on consultation and information exchange between competent authorities and resolution authorities which we regard as essential for efficient decision-making.

We support the proposed inclusion of the assessment of the capital and liquidity position of the institution in the general criteria. In relation to the third category of “other requirements for continuing authorisation”, the guidelines should emphasise that the elements under this category must be considered only to the extent that they indicate that the requirements of article 32(4)(a) are met, i.e. that 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.

We strongly support the requirements of paragraph 18 in respect of macroeconomic and market based indicators. No decision that an institution is failing or likely to fail should be made solely on the basis of macroeconomic or market based indicators without assessment of the institution’s actual position. For example the institution’s share price, which is referred to in paragraph 17(j) may be influenced by other factors and may not be an accurate indicator of whether the institution is actually failing or likely to fail.

There should be consistent criteria applied to the decision of whether an institution is failing or likely to fail irrespective of whether the determination is being made by the competent authority or the resolution authority. We are concerned that the proposed guidelines could suggest that different elements should be considered depending upon whether the competent authority or the resolution authority is making the determination.

While we understand 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, as recognised in Title III of the draft guidelines. 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.

We therefore suggest that sections two and three of Title II of the guidelines are merged to set out criteria that apply to both competent authorities and resolution authorities. The elements to be considered by whichever authority could include the outcome of the SREP assessment but also the broader elements which currently only apply to resolution authorities. As currently drafted, the draft guidelines appear to expect the competent authority to rely almost entirely on the SREP assessment score. Furthermore we note that the description of what constitutes an “F” rating in the SREP guidelines refers back to the concept of ‘failing or likely to fail’ under the BRRD, so currently the assessment is circular.

We also consider that coordination and cooperation between the competent authority and the resolution authority is necessary and should be focused not only on consultation and

² As AFME stated in our response to the EBA consultation on guidelines on SREP, “for the sake of clarity and consistency, we think that a clear separation must be established between matters relating to the SREP as described by Directive 2013/36/EU, and matters relating to the implementation of the BRRD and, more generally, to decisions pertaining to recovery and resolution. For example, as regards scores of the SREP assessment, the introduction of an ‘F’ score as currently proposed (defined as ‘the institution is considered as failing or likely to fail’), seems to exceed the remit of the SREP analysis and it orientates the SREP analysis towards the question of the ‘viability’ of an institution, departing from a going-concern approach. The determination of whether an institution is failing or likely to fail should be done pursuant to the terms of article 32 of the BRRD and the guidelines under that article.”

information exchange, but also more broadly in the way that the authorities interact with banks, particularly if the SREP is to be a factor in determining whether an institution is failing or likely to fail.

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

We have no comments on the level of detail.

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

We assume that this question relates to Box 1. It is helpful that the guidelines clarify that they only relate to the determination of whether an institution is failing or likely to fail and not to the other conditions for resolution in article 32(1)(b) or (c). However, we consider that paragraph 9 of the draft guidelines is sufficiently clear on this point without the need for the examples in Box 1.

If Box 1 is to be retained, example (b) is potentially unhelpful because it suggests that the reason for the institution not meeting the condition in article 32(1)(b) is that the temporary inability to pay does not cause financial instability. It also suggests that a temporary inability to pay for technical reasons indicates that the firm is failing or likely to fail. Instead, if included, we suggest that an example seeking to illustrate the requirements of article 32(1)(b) not being satisfied should be focused on a situation where the firm is failing or likely to fail but there is a reasonable prospect of an alternative private sector solution, such as a private restructuring or takeover that is close to completion.

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?

Please see our general comments above regarding the distinction made in the draft guidelines between a determination made by the competent authority and a determination made by a resolution authority.

The first two bullets of paragraph 19 reference the *results* of supervisory, early intervention, or recovery actions. The backward-looking results of such actions are not necessarily relevant to determining whether an institution is failing or likely to fail, which is a present and forward-looking concept. What is more relevant are the options available to the authorities and firm, and it is the *expected results* of any such actions that should be taken into account here. We suggest an amendment to reflect this.

Paragraph 20(c) suggests that an institution activating an option under its recovery plan which has been unsuccessful indicates that it is failing or likely to fail. While this could be an indicator, the failure of a particular recovery option to restore the institution out of recovery does not necessarily mean that it is failing or likely to fail. We also question whether the availability of recovery options is more relevant to the determination under article 32(1)(b) rather than whether the institution is failing or likely to fail.

It is also unclear what is meant by an institution having “failed in the implementation” of a recovery option and how this would be assessed. If this concept is included in the guidelines, we suggest that it would be better focused on the institution having “exhausted all feasible recovery options that could be achieved in the relevant timeframe”. The same issues also apply to paragraphs 24(c) and 26(c).

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?

A significant decrease in asset value in itself does not mean that an institution is failing or likely to fail. For example an institution might have sufficient capital to support the reduced value of assets. Accordingly we do not consider that it is appropriate to include a quantitative threshold for defining a significant decrease in asset value because it is the impact on the viability of the institution that is relevant rather than the size of the reduction in value. We also believe that a qualitative approach is preferable for the reasons set out in the impact analysis.

Q6. 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?

For the reasons discussed above, we strongly support the requirements of paragraph 18 in respect of macroeconomic and market based indicators.

Paragraph 24(j) refers to “significant non-temporary deterioration” of market indicators. We are unclear on how the “non-temporary” nature of the deterioration would be assessed for these purposes.

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 [sic] failing or likely to fail?

For the reasons discussed above, we strongly support the requirements of paragraph 18 in respect of macroeconomic and market based indicators.

If included, macroeconomic and market based indicators should be evaluated in absolute and relative terms in order to identify and differentiate whether weaker indicators are related to systemic or idiosyncratic events. The impact on banks and potential solutions are likely to be different if the “likely to fail” situation is due to a systemic or idiosyncratic event.

As noted above in relation to paragraph 24, paragraph 25 also makes several references to elements being “non-temporary”. Again it is unclear how this will be assessed and whether authorities will interpret it in a consistent manner.

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?

While we note that the BRRD provides for an institution to be assessed as failing or likely to fail on the basis that it 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 authorisation by the competent authority, we are concerned that the elements relating to governance arrangements in paragraph 30 and Box 2 of the draft guidelines do not necessarily indicate that the institution is failing or likely to fail. We suggest that these elements should only justify a determination that the institution is failing or likely to fail where there are other elements related to capital and/or liquidity. We therefore suggest that “in most cases” is deleted in paragraph 30.

As set out in our general comments above, the guidelines should also emphasise that the elements under this category should be considered only to the extent that they indicate that the requirements of article 32(4)(a) are met, i.e. that 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

We assume that there is a typo in the second bullet point in Box 2 and that this should refer to material weaknesses, deficiencies or issues that were **not** properly and/or timely reported to the management body.

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?

We consider that the proposed indicators in paragraph 31 are sufficiently addressed by other areas of the guidelines. For example, where an institution can no longer be relied on 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. Where there is a loss of confidence such as a bank run, this should be adequately covered by the guidelines on liquidity. Again the authority needs to consider the particular circumstances relating to any operational issues and whether the impact is sufficiently severe that the institution should be considered as failing or likely to fail.