

EBA/CP/2014/21

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22 September 2014

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# Consultation Paper

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Draft Guidelines

on triggers for use of early intervention measures pursuant to  
Article 27(4) of Directive 2014/59/EU

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# 1. Responding to this Consultation

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The EBA invites comments on all proposals put forward in this paper and in particular on the specific questions summarised in 5.2.

Comments are most helpful if they:

- respond to the question stated;
- indicate the specific point to which a comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed / rationale proposed; and
- describe any alternative regulatory choices the EBA should consider.

## Submission of responses

To submit your comments, click on the 'send your comments' button on the consultation page by **22.12.2014**. Please note that comments submitted after this deadline, or submitted via other means may not be processed.

## Publication of responses

Please clearly indicate in the consultation form if you wish your comments to be disclosed or to be treated as confidential. A confidential response may be requested from us in accordance with the EBA's rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

## Data protection

The protection of individuals with regard to the processing of personal data by the EBA is based on Regulation (EC) N° 45/2001 of the European Parliament and of the Council of 18 December 2000 as implemented by the EBA in its implementing rules adopted by its Management Board. Further information on data protection can be found under the Legal notice section of the EBA website.

## 2. Executive Summary

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These Guidelines developed pursuant to Article 27(4) of Directive 2014/59/EU are addressed to competent authorities and aim at promoting the consistent application of triggers for the decision on the application of early intervention measures set out in Article 27(1) of Directive 2014/59/EU. The Guidelines provide competent authorities with guidance on the circumstances under which they should consider the application of early intervention measures to institutions. Specifically, the Guidelines identify triggers within the proposed common European supervisory review and examination process (SREP) framework and elaborate on the circumstances prompting the consideration of whether to apply early intervention measures. The Guidelines do not establish any quantitative thresholds for indicators that could be perceived as new levels for regulatory requirements for capital or liquidity.

The triggers provided in these Guidelines do not oblige competent authorities to automatically apply early intervention measures in any case. Neither do the Guidelines prevent competent authorities from applying early intervention measures where such triggers are not met, but competent authorities see a clear need for early intervention.

The triggers for the decision on the application of early intervention measures established by these Guidelines are closely linked to the outcomes of SREP conducted by the competent authorities in accordance with the EBA Guidelines on the common procedures and methodologies for SREP in accordance to Article 107 of Directive 2013/36/EU. In particular, the triggers are based on the scores supporting the outcomes of the assessment of various SREP elements and the Overall SREP assessment indicating any threat to the viability of an institution.

The Guidelines recognise that the early intervention measures can be triggered also on the basis of other circumstances which are not immediately factored into the outcomes of the SREP assessment. In particular, they can be triggered by material deterioration or anomalies identified in the monitoring of key indicators performed as part of SREP, even before the assessment of the respective SREP element is updated. Moreover, the early intervention measures could be triggered by the events of significant importance (significant events) when they bear a risk of having significant prudential impact on the institution.

These Guidelines should be read in conjunction with EBA Guidelines on the common procedures and methodologies for SREP and Guidelines on the interpretation of the different circumstances when an institution shall be considered as 'failing or likely to fail'.

The Guidelines are issued for the public consultation and are expected to be applied by XX XXXXX 2015 taking into account the results of the public consultation. Certain elements linked to the implementation of the common European SREP framework will need to be implemented following the implementation of the EBA Guidelines on the common procedures and methodologies for SREP.

### 3. Background and rationale

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Early intervention constitutes a key component of supervisory action and is defined by the Basel Committee Core Principles for Effective Banking Supervision in the following way: ‘adopting a forward-looking approach to supervision through early intervention can prevent an identified weakness from developing into a threat to safety and soundness. This is particularly true for highly complex and bank-specific issues (e.g. liquidity risk) where effective supervisory actions must be tailored to a bank’s individual circumstances’.

Many competent authorities in the past have developed their own approaches for early intervention in order to strengthen their capability to intervene when the financial situation of an institution is deteriorating, becoming vulnerable, threatening to reach the point of non-viability, and/or presenting a risk for the financial stability. In general, a framework of early intervention was complementary to the ongoing supervision resulting in the application of supervisory measures based on the outcomes of the ongoing supervision.

At the EU level, Article 104 of Directive 2013/36/EU already includes a list of supervisory powers that competent authorities can apply at an early stage to address relevant problems faced by institutions based on the results of ongoing supervision. In addition, some Member States have assigned to the competent authorities additional, ‘more intrusive’ measures to complement the Union-wide toolkit. Such measures could be applied both based on the ongoing supervision and as a part of early intervention actions.

In order to give competent authorities stronger capabilities to handle crises in ailing institutions the new regulatory framework for recovery and resolution introduced an additional common set of early intervention measures. These measures are listed in Article 27(1) of Directive 2014/59/EU and must be available for competent authorities in cases where an institution infringes or is likely in the near future to infringe the requirements of Directive 2013/36/EU or Regulation (EU) No 575/2013. The Directive 2014/59/EU sets out a common European recovery and resolution framework which is composed of three pillars: preparation, early intervention and resolution. The second pillar is composed of early intervention measures specified in Article 27(1) of Directive 2014/59/EU, removal of senior management and management body (Article 28) and an appointment of a temporary administrator (Article 29).

The additional set of early intervention measures from the recovery and resolution framework is intended to supplement rather than replace the existing supervisory process carried out according to provisions of Directive 2013/36/EU, and supervisory measures applied based on the outcomes of SREP.

The EBA was assigned a mandate to issue guidelines promoting the consistent application of the trigger for the decision on the application of early intervention measures identified in Article 27(1) of Directive 2014/59/EU.

Assessment of the compliance of an institution with the requirement of Directive 2013/36/EU and Regulation (EU) No 575/2013 is also the focus of the SREP as specified in Articles 97 of Directive 2013/36/EU. Pursuant to Article 102 of that Directive, the competent authorities shall apply supervisory measures where there is evidence that the institution does not meet or is likely to infringe the requirements of Directive 2013/36/EU and Regulation (EU) No 575/2013 within 12 months. This implies that there is a clear link between the objective elements prompting the application of both supervisory measures (in the meaning of Directive 2013/36/EU) and early intervention measures. That is to say that the assessment of whether an institution ‘infringes or is likely to infringe’ the requirements of Regulation (EU) 575/2013 and Directive 2013/36/EU is done by competent authorities based on their comprehensive assessment, including by means of SREP as described in Article 97 of Directive 2013/36/EU and further specified in the EBA Guidelines for common procedures and methodologies for SREP, developed in accordance with Article 107 of Directive 2013/36/EU.

However, the early intervention measures can be triggered also on the basis of other circumstances which may not be immediately factored into the outcomes of the SREP assessment. In particular, they can be triggered by a material deterioration or anomalies identified in the monitoring of key indicators performed as part of SREP, even before the assessment of the respective SREP element is updated. Moreover, the early intervention measures could be triggered by the events of significant importance (significant events) when they bear a risk of significant prudential impact on the institution.

These Guidelines provide competent authorities with guidance on the circumstances under which they should consider the application of early intervention measures towards institutions. Specifically, the Guidelines identify triggers within the proposed common European SREP framework and elaborate on circumstances prompting the consideration of whether to apply early intervention measures. The Guidelines do not establish any quantitative indicators or their thresholds that could be perceived as new levels for regulatory requirements for capital or liquidity.

The triggers provided in these Guidelines do not oblige competent authorities to automatically apply early intervention measures in any case. On the contrary, the objective of introducing these triggers is to help competent authorities in deciding whether to apply early intervention measures while minimising the risk that their decisions and actions might be challenged by entities under their supervision. The Guidelines also aim at introducing a consistent approach to the triggers for the decision on the application of early intervention measures across the European Union. The set of triggers described in these Guidelines does not prevent competent authorities from applying early intervention measures where such triggers are not met, but competent authorities see a clear need for early intervention.

The triggers for the decision on whether to apply early intervention measures provided in these Guidelines refer to the application of all measures listed in Article 27(1) of Directive 2014/59/EU without specifying which circumstances should trigger particular measures. Therefore, upon determining that early intervention is appropriate, the competent authorities should choose the

most appropriate early intervention measures and act with a response proportionate to particular circumstances.

These Guidelines focus on situations where the application of early intervention measures, listed in Article 27(1) of Directive 2014/59/EU, is reasonably likely to be sufficient to remedy a deteriorating situation of an institution and the competent authorities do not consider it necessary to use more severe tools such as: removing of all or individual members of the senior management and management body (pursuant to Article 28 of Directive 2014/59/EU); appointing a temporary administrators (according to Article 29); or taking more actions by the resolution authorities such as writing down or converting capital instruments (pursuant to Articles 59-62) or applying resolution tools (according to Articles 31-58).

The determination that the institution meets the conditions for early intervention pursuant to Article 27 of Directive 2014/59/EU is also important in the context of applying the intragroup financial support measures.

These Guidelines should be read in conjunction with other regulatory products developed by the EBA pursuant to Directive 2014/59/EU (in particular with Guidelines on the interpretation of the different circumstances when an institution shall be considered as 'failing or likely to fail') and also with the EBA Guidelines on the common procedures and methodologies for SREP developed in accordance to Article 107 of Directive 2013/36/EU.

## 4. EBA Guidelines on triggers for the use of early intervention measures

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In between the text of the draft Guidelines that follows, further explanations on specific aspects of the proposed text are occasionally provided, which either offer examples or provide the rationale behind a provision, or set out specific questions for the consultation process. Where this is the case, this explanatory text appears in a framed text box.

The text also has a number of specific questions, which respondents to the public consultation should consider in their responses.

Q1	Do you have any general comments on the draft Guidelines on triggers for the use of early intervention measures?
Q2	Do you consider the level of detail used in the draft Guidelines to be appropriate?

### Status of these Guidelines

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 (*'the EBA Regulation'*). In accordance with Article 16(3) of the EBA Regulation, competent authorities and financial institutions must make every effort to comply with the guidelines.

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 and financial institutions to whom guidelines are addressed to comply with guidelines. Competent 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

According to Article 16(3) of the EBA Regulation, competent 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, competent authorities will be considered by the EBA to be non-compliant. Notifications should be sent by



submitting the form provided at Section 5 to [compliance@eba.europa.eu](mailto:compliance@eba.europa.eu) with the reference 'EBA/GL/201x/xx'. Notifications should be submitted by persons with appropriate authority to report compliance on behalf of their competent authorities.

Notifications will be published on the EBA website, in line with Article 16(3).

## Title I - Subject matter, scope and definitions

### Subject Matter

1. According to Article 27(1) of Directive 2014/59/EU, in situations where an institution is infringing or is likely in the near future to infringe the requirements of Regulation (EU) No 575/2013, Directive 2013/36/EU, Title II of Directive 2014/65/EU or any of Articles 3 to 7, 14 to 17, and 24, 25 and 26 or Regulation (EU) No 600/2014 including national legal acts implementing Directive 2013/36/EU or of the EBA technical standards adopted by the Commission in accordance with Regulation (EU) No 575/2013 or Directive 2013/36/EU, the competent authorities shall have at their disposal at least the set of early intervention measures listed in Article 27(1) of Directive 2014/59/EU, without prejudice to the supervisory powers referred to in Article 104 of Directive 2013/36/EU. Pursuant to Article 27(2) of Directive 2014/59/EU, these Guidelines promote the consistent application of the triggers for the use of such early intervention measures.
2. In order to increase consistency in supervisory practices in relation to the application of the triggers, the Guidelines also clarify requirements that competent authorities should follow when setting triggers related to financial and risk indicators to be routinely monitored under supervisory review and evaluation process (SREP), and the procedures to follow in case of breaches of these triggers. The Guidelines do not address the interaction between the competent and resolution authorities in relation to breaches of the triggers, which is provided in Article 27(2) of Directive 2014/59/EU.
3. The assessment of whether an institution 'infringes or is likely to infringe in the near future' the requirements of Regulation (EU) No 575/2013 or Directive 2013/36/EU is carried out by the competent authorities based on their comprehensive assessment, including by means of SREP as described in Article 97 of Directive 2013/36/EU and further specified in the EBA Guidelines for common procedures and methodologies for SREP developed in accordance to Article 107 of Directive 2013/36/EU.

### Definitions

4. The following definitions apply for the purposes of these Guidelines:
  - a. 'Trigger' refers to the outcomes of the SREP or combination of events specified in these Guidelines suggesting that an institution infringes or is likely to infringe the

requirements of Regulation (EU) No 575/2013 or Directive 2013/36/EU, and requiring competent authorities to decide whether to apply early intervention measures as specified in Article 27(1) of Directive 2014/59/EU.

- b. 'Material deterioration or anomaly' is a worsening of the institution's financial condition and/or risk profile that may develop into a serious threat to its safety and soundness; such deterioration should be identified by the competent authorities while carrying out the monitoring of key indicators supporting SREP and aimed at monitoring changes in the financial condition and risk profile of institutions, where necessary, prompting update of the assessment of SREP elements.
- c. 'Early intervention measures' means the early intervention measures set out in Article 27(1) of Directive 2014/59/EU.
- d. 'SREP' means supervisory review and evaluation process as defined in Article 97 of Directive 2013/36/EU and further specified in the EBA Guidelines for common procedures and methodologies for SREP developed in accordance to Article 107 of Directive 2013/36/EU.
- e. 'Overall SREP assessment' as defined in the EBA Guidelines for common procedures and methodologies for SREP, is the up-to-date assessment of the overall viability of an institution based on assessment of SREP elements.
- f. 'Overall SREP score' as defined in the EBA Guidelines for common procedures and methodologies for SREP, is the numerical indicator of the overall risk to the viability of an institution based on the Overall SREP assessment.
- g. 'SREP element' as defined in the EBA Guidelines for common procedures and methodologies means one of the following components of the SREP framework: business model analysis, assessment of internal governance and institution-wide risk controls, assessment of risks to capital, SREP capital assessment, assessment of risks to liquidity and funding, and SREP liquidity assessment.
- h. 'Significant event' is an event or combination of events of significant importance bearing a risk of significant prudential impact on the institution, generally being outside of the direct control by an institution or competent authorities.

### **Scope and level of application**

- 5. These Guidelines are addressed to competent authorities as defined in point (40) of Article 4(1) of Regulation (EU) No 575/2013 including the European Central Bank with regard to specific tasks conferred on it by Regulation (EU) No 1024/2013.

## Title II- Triggers for application of early intervention measures

6. These Guidelines identify triggers for the decision on whether to apply early intervention measures which are based on any of the following elements of equal importance:
  - a. Overall SREP score and pre-defined combinations of the Overall SREP score and scores for individual SREP elements;
  - b. material deterioration or anomalies identified in the monitoring of key financial and non-financial indicators under SREP;
  - c. significant events.
7. Breaching the triggers identified in these Guidelines should prompt the competent authorities (a) to further investigate the situation, if the cause of the breach is not yet known, and (b) taking into account the urgency of the situation and the magnitude of breach in the context of the overall situation of the institution, to make a decision whether to apply early intervention measures.
8. Breaches of the triggers, outcomes of associated further investigations and decisions on the application of early intervention measures, including the reasons for not taking a measure, should be clearly documented by the competent authorities.
9. Upon the breach of the triggers and taking a positive decision to apply an early intervention measure, the competent authorities should choose the most appropriate early intervention measure or measures to act with a response proportionate to the particular circumstances.
10. In particular, when competent authorities assign to an institution an Overall SREP score of “4” they should consider gathering information for the valuation of the institution’s assets and liabilities, as provided in Article 27(1)(h) of Directive 2014/59/EU.

### Triggers based on the outcomes of SREP

11. The results of the Overall SREP assessment and specific pre-defined combinations of the results of the Overall SREP assessment and assessment of individual SREP elements, as defined in the EBA Guidelines for common procedures and methodologies for SREP, should be considered as triggers. In particular, should the competent authority as an outcome of SREP assign to an institution the Overall SREP score of “4” in accordance with the methodology stipulated in the EBA Guidelines for common procedures and methodologies for SREP, it should without undue delay take a decision whether to apply early intervention measures or not, irrespective of the scores assigned for individual SREP elements.
12. In addition, in certain situations, the competent authorities should also consider the outcomes of the assessment of individual SREP elements resulting in scores “4”. Such situation may arise when there is no high risk to the viability of an institution and the Overall SREP score is “3”, but

the assessment of the SREP elements covering the specific areas mentioned in Article 27(1) of Directive 2014/59/EU indicates that an institution may be in condition when it ‘infringes or is likely to infringe in the near future’ the requirements of set there, which may result in score “4” assigned to the corresponding SREP elements.

13. In particular, the competent authorities should decide on whether to apply early intervention measures when the outcomes of SREP as performed in accordance with the Guidelines for common procedures and methodologies for SREP take the form of the following combinations of Overall SREP score “3” and score “4” for the individual SREP elements:

- a. the Overall SREP score is “3” and the score for internal governance and institution-wide controls is “4”;
- b. the Overall SREP score is “3” and the score for business model and strategy is “4”;
- c. the Overall SREP score is “3” and the score for capital adequacy is “4”; or,
- d. the Overall SREP score is “3” and the score for liquidity adequacy is “4”.

14. When deciding whether to apply early intervention measures based on the above SREP scores and choosing the most appropriate measure, competent authorities should address the particular weaknesses identified and highlighted in the narrative of the Overall SREP assessment or the assessment of the particular SREP element.

Example: If the driver leading to the combination of the Overall SREP score “3” and the score for business model and strategy “4” is the concerns over the sustainability of the institutions’ strategy, when deciding on the application of the early intervention measure competent authorities should choose the measure that would address this particular issue. Most likely in case of a positive decision on the application of the measures, the measure would be a requirement to make changes to the institution’s business strategy as provided by Article 27(1)(f) of the Directive 2014/59/EU).

Q3	Do you have any comments on the proposed specification of early intervention triggers based on the outcomes of SREP?
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### **Material deterioration or anomalies identified in the monitoring of key indicators under SREP**

15. The SREP process as outlined in the EBA Guidelines for common procedures and methodologies for SREP requires competent authorities to carry out regular monitoring of key financial and non-financial indicators for all institutions, as stipulated in the EBA Guidelines for common procedures and methodologies for SREP, in order to monitor changes in the financial condition and risk profile of institutions.

16. For the purposes of defining triggers for taking the decision of whether to apply early intervention measures, competent authorities should establish monitoring systems and patterns allowing for the identification of material deteriorations and anomalies in the behaviour of indicators, and set thresholds, where relevant. Competent authorities should also establish escalation procedures for all relevant indicators (or combination of indicators) covered by the monitoring to ensure that investigation of the material deterioration and anomalies and their causes, occurs.
17. In particular, competent authorities should use combination of absolute and relative thresholds identified for key indicators covered by the monitoring aimed at identifying weaknesses in the financial conditions and risk profile of an institution before they develop into a threat to safety and soundness of an institution.
18. Where the monitoring reveals a material deterioration in the risk profile, or other anomalies, competent authorities should investigate the causes and, where relevant, update the assessment of the relevant SREP element in light of the new information.
19. Competent authorities should tailor the set of indicators and their thresholds (considering using combination of absolute and relative thresholds) to the specificities of individual institutions or groups of institutions sharing similar characteristics (peer groups). The framework of indicators, monitoring patterns and thresholds should reflect an institution's size, complexity, business model and risk profile, as well as macro-economic conditions in the geographies, sectors and markets in which it operates.
20. Competent authorities should identify the indicators for monitoring using definition from the common reporting standards<sup>1</sup>. Where relevant, the EBA dashboards or indicators being monitored by the EBA may be used as a source of information against which individual institutions can be monitored. The set of indicators for the monitoring should also include market based indicators and macro-economic indicators.
21. The indicators to be monitored should cover all areas stipulated in Article 27(1) of Directive 2014/59/EU and include at least the following institution-specific indicators:
- a. financial and risk indicators addressing all risk categories covered by the EBA Guidelines for common procedures and methodologies for SREP and other risks that are material to an institution;
  - b. all ratios directly derived from Regulation (EU) No 575/2013 and by Directive 2013/36/EU and used for the calculation of minimum prudential requirements (e.g. CT1, LCR, NSFR etc.);
  - c. the minimum requirement for own funds and eligible liabilities (MREL), set for an institution pursuant to provisions of Directive 2014/59/EU;

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<sup>1</sup> The EBA ITS on supervisory reporting developed by the EBA pursuant to Regulation (EU) No 575/2013.

d. relevant market-based indicators (e.g. equity price, CDS spread etc.).

22. Competent authorities should accompany institution-specific indicators with relevant macro-economic indicators, where available, in the geographies, sectors and markets where the institution operates. The competent authorities should, however, assess whether market based indicators and macro-economic indicators are not relevant given the specificities of an institution.
23. Material deterioration or anomalies in indicators, including breaches of thresholds, identified through the monitoring of indicators should be considered as a prompt for further investigation. Specifically, the competent authorities should:
- 1) determine the cause and make an assessment of materiality of potential prudential impact on an institution;
  - 2) document the cause and outcomes of the assessment (in order to ensure that SREP procedures are followed by all staff members of the competent authorities and to keep track of results of previous investigations); and
  - 3) review the risk assessment and SREP score, where relevant, in light of any material new findings according to the requirements of the EBA Guidelines for common procedures and methodologies for SREP.
24. Where an institution's financial condition and risk outlook and SREP score for the respective element deteriorates significantly and impacts one of the triggers based on the combination of the Overall SREP score and scores for individual SREP elements (conditions described in paragraph 13 are met), the competent authorities should take a decision on whether to apply early intervention measures.
25. Depending on the significance of the deterioration or anomalies in indicators, their causes and materiality of the potential prudential impact on the institution, competent authorities, in the interest of time, may decide to apply early intervention measures immediately upon determination of the cause and the overall impact of the anomaly and without updating the assessment of the respective SREP element.
26. Where competent authorities, for the purposes of monitoring of key indicators, set thresholds for capital adequacy indicators at a level of 1.5 percentage point above institution's own funds requirements as referred to in Article 27(1) of Directive 2014/59/EU, competent authorities should consider both own funds requirements, as specified in Article 92 of Regulation (EU) No 575/2013, and additional own funds requirements set in accordance with Article 104(1)(a) of Directive 2013/36/EU as explained in the EBA Guidelines for common procedures and methodologies for SREP.

Q4	Do you have any comments on the proposed approach to use material deterioration or anomalies in key indicators in deciding whether there is a need to apply early intervention measures?
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### Significant events

27. Certain events bearing a risk of significant prudential impact on the institution should be generally considered as a trigger requiring further investigations of an affected area. Examples may include: major operational risk loss event/incident, regulatory sanctions, significant remarks from external auditors, major reputational incident, clear and unambiguous signals of the need to review the quality of assets and/or conduct independent valuation of specific portfolios/assets).

28. In this circumstance, upon becoming aware of the occurrence of such significant event, the competent authorities should identify the cause and assess the potential prudential impact on the institution and document its assessment.

29. The competent authorities should update the risk assessment and score of the respective SREP element in light of any new material findings according to the requirements of the EBA Guidelines for common procedures and methodologies for SREP. Where, as a result of the updated analysis the Overall SREP score or combination of Overall SREP score and scores for SREP elements deteriorates and impacts one of the triggers based on the outcomes of SREP when the conditions specified in paragraph 13 are met, the competent authorities should take a decision on the need to take intervention measures.

30. Depending on the magnitude of such significant event and materiality of the potential prudential impact on the institution, competent authorities, in the interest of time, may decide to apply early intervention measures immediately upon determination of the cause and the overall impact of the significant event and without updating the assessment of the respective SREP element.

Examples of significant events that should be considered as possible triggers for the decision whether to apply early intervention measures when they bear a risk of significant prudential impact on the institution:

- operational loss event (e.g. rogue trading, fraud, natural disaster) having significant impact on the institution's ability to meet the requirements set forth in Regulation (EU) No 575/2013 or in Directive 2013/36/EU;
- signals of the need to review the quality of assets and/or conduct independent valuation of specific portfolios/assets, for instance:
  - outcomes of the assessment of SREP elements, suggesting that there is a concern that assets might be lower than liabilities;

- emphasis of matter paragraph<sup>2</sup> given in the external auditor's opinion on the financial statement of the institution, indicating material uncertainty;
- unfavourable events that occur between the end of the reporting period and date when the financial statement are authorized for issue, which provide evidence of conditions that arose after the reporting period and therefore do not require adjustment/restatement of financial statements (non-adjusting events); for each material category of non-adjusting events the institution should disclose the nature of the event and estimate of its financial effect, or a statement that such an estimate cannot be made);
- perpetual and material adjustments to the institution's financial statements due to the errors in valuation of assets/ liabilities, frequent changes in the accounting assumptions.
- adverse court rulings, negative results of on-going supervisory investigations and tax litigations, complaints by employees and minority shareholders, significant fines imposed on the institution;
- significant outflow of retail deposits caused by the reputational damage of the institution; unexpected loss of senior management which was not replaced;
- one or more members of the management body fail to comply with regulatory requirements specified in Directive 2013/36/EU to become or remain a member of the management body;
- significant rating downgrades by one or more external rating agencies, potentially leading to substantial outflows of funds, inability to renew funding or activation of contractual covenants related to external ratings.

Q5	Do you have any comments on the proposed description of significant events that should be considered as possible triggers for the decision whether to apply early intervention measures?
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31. The determination of the fact that institution can be considered as 'failing or likely to fail' in the meaning of Article 32 of Directive 2014/59/EU suggested by the resolution authorities for consultation with the competent authority should be considered as a significant event in the meaning of these Guidelines. Such determination should prompt the decision on the

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<sup>2</sup> An emphasis of matter paragraph is a type of paragraph in, or section of an external auditors' opinion on financial statements which is added to draw users' attention to a matter which is appropriately presented or disclosed in the financial statements, but it is of such importance that it is fundamental to users' understanding of the financial statements (e.g. information about an uncertainty relating to the future outcome of exceptional litigation or regulatory action; a major catastrophe that has had, or continues to have, a significant effect on the entity's financial position). The emphasis of matter paragraph does not qualify the auditors' opinion; therefore it does not mean that financial statements do not present a true and fair view of the financial position.



application of early intervention measures by the competent authorities before the decision on the application of a resolution action, in case such early intervention measures have not been previously applied.

## Title IV- Final Provisions and Implementation

32. Competent authorities should implement these Guidelines by incorporating them in their supervisory processes and procedures by XX XX 2015.
33. Implementation of the parts of these Guidelines, which are conditional on the implementation of the EBA Guidelines for common procedures and methodologies for SREP, in particular setting up monitoring of key indicators and using SREP scores is conditional on the implementation schedule for the EBA Guidelines for common procedures and methodologies for SREP.
34. Implementation of these Guidelines and triggers described in the Guidelines do not prevent competent authorities from applying early intervention measures where such triggers are not met, but competent authorities see a clear need for early intervention.

## 5. Accompanying documents

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### 5.1. Cost-Benefit Analysis / Impact Assessment

#### Introduction

The Directive 2014/59/EU requires the EBA to develop Guidelines that promote the consistent application of the triggers for the use of early intervention measures listed in Article 27(1) of that Directive.

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

This annex presents the impact assessment of the policy options considered in the Guidelines described in the Consultation Paper. Given the nature of the study, the Impact Assessment is high level and qualitative in nature.

#### Problem definition

The core problem that these Guidelines aim to address is the lack of common rules and practices in applying early intervention measures by the competent authorities across the EU. The Directive 2014/59/EU specifies that such measures should be at the disposal of the competent authorities in cases where the institution infringes or is likely in the near future to infringe the requirements of Regulation (EU) No 575/2013, Directive 2013/36/EU, Title II of Directive 2014/65/EU or any of Articles 3 to 7, 14 to 17, and 24, 25 and 26 or Regulation (EU) No 600/2014. In addition to the general description of the trigger (actual or likely infringement or regulatory requirements), the Directive 2014/59/EU provides the following examples of early intervention triggers: a rapidly deteriorating financial condition, including deteriorating liquidity situation, increasing level of leverage, non-performing loans or concentration of exposures, as assessed on the basis of a set of triggers, which may include the institution's own funds requirement plus 1,5 percentage points. With the exception of the last quantitative trigger, such examples are largely subjective and formulated in a general manner. Therefore, there is a risk that Member States would apply different practices in assessing whether an institution is infringing or likely to infringe the regulatory requirements in a way that could require application of early intervention measures. It is reasonable to expect that the divergences in triggering early intervention could lead to the following problems:

- Distortions in the functioning of the European banking sector due to suboptimal supervisory decisions. The literature<sup>3</sup> refers to the trade-off between the Type I error of missing a required early intervention (which could also eventually increase the costs of resolving the institution) and the Type II error of incorrectly initiating the early intervention.
- Competent authorities abstaining from implementation of early intervention measures if there is a lack of clarity about the circumstances when these actions can be taken. This may lead to the problem of supervisory forbearance and moral hazard.
- Asymmetric information between competent authorities in different Member States when there is a need for cooperation in cross-border cases.
- 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 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 jurisdictions with more favourable regulatory frameworks.

This Impact Assessment presents a qualitative assessment of the alternative options and identifies a set of options that can effectively address the identified problems.

## Objectives of the Guidelines

The objective of these Guidelines is to promote the consistent application of the triggers for the use of early intervention measures enlisted in the Directive 2014/59/EU. A central element is to specify a common set of indicators and conditions which can be used by the competent authorities across Member States when assessing if there is a need to apply early intervention measures. A common framework is also expected to facilitate cooperation among the competent authorities in EU Member States with regard to cross-border banking groups. The framework ultimately aims to reduce the problem of moral hazard and promote the effective and efficient functioning of the EU banking sector.

## Assessment of technical options

When developing these Guidelines the EBA has considered alternative options under the two main areas: (A) Link to SREP, and (B) Type of triggers for early intervention – as described below.

### A. Link to SREP process

**Option A1: The assessment of the need to apply early intervention measures is embedded into the SREP process**

**Option A2: The competent authorities conduct a separate analysis, parallel to SREP, in order to decide whether there is a need to apply early intervention measures**

<sup>3</sup> Betz et al. (2013). 'Predicting Distress in European Banks.' ECB Working Paper Series, No. 1597.

Under Option A1 the assessment of the need to apply early intervention measures will be integrated into a SREP conducted by the competent authorities following the EBA Guidelines for common methodologies and process for SREP and would make an extensive use of the SREP results. Embedding the early intervention assessment into the SREP process would avoid duplication of supervisory work and eliminate any inconsistencies which may arise from running two separate assessments (especially because the SREP is focused on the assessment of the compliance of an institution with the requirement of Directive 2013/36/EU and Regulation (EU) No 575/2013). This approach would also reflect the similar nature of early intervention measures from Directive 2014/59/EU and the supervisory powers from Directive 2013/36/EU which are applied on the same basis of SREP assessment.

Under Option A2 the competent authorities, apart from SREP, would also run a separate analysis in order to determine whether there is a need to apply early intervention measures towards an institution. This parallel analysis would not rely on the SREP findings but instead it will be based on a distinct set of indicators established solely for the purpose of determining whether the institution is infringing or likely to infringe regulatory requirements in a way that would justify application of early intervention measures. Such distinct indicators would have to be monitored by the competent authorities on a regular basis.

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

**Table 1: Potential advantages and disadvantages associated with the link to SREP**

	Potential Advantages	Potential Disadvantages
<b>A1. Assessment embedded into SREP</b>	No duplication of supervisory work	Limitations resulting from timing of conducting SREP evaluation and the scope of the information assessed by SREP
	Ensuring continuum and consistency between on-going supervision of the institution (SREP) and early intervention	The harmonisation to some extent is dependent on the convergence of SREP processed among the Member States and proper calibration of SREP scores
	Applying a similar approach to the one applied for supervisory powers enlisted in Article 104 of Directive 2013/36/EU	
<b>A2. Separate assessment</b>	Increased ability to take into account sources of information which are not assessed under SREP or increase the frequency of monitoring of particular factors/indicators	Duplication of supervisory work (administrative and operational costs for competent authorities) and excessive burden on institutions from information requests/on-site/off-site examinations
	Early intervention triggers may be based on a set of indicators tailored specifically for the purpose of applying early intervention measures	Inconsistencies and lack of continuum between on-going supervision and early intervention

	Harmonisation in triggering early intervention across the EU can be achieved even without a full convergence of SREP assessments	
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### Preferred option

The preferred option applied in these Guidelines is to embed the assessment (whether there is a need for early intervention) into the on-going SREP analysis and to make an extensive use of SREP results. Nevertheless, in order to eliminate the potential disadvantages of Option A1 it was decided that early intervention triggers, in certain cases, should also include circumstances which are not immediately factored into the outcomes of the SREP assessments (such as material deterioration or anomalies identified in the monitoring of key indicators; as well as significant events having negative prudential impact on the institution). Hence, the preferred option includes also some elements of Option A2.

### B. Type of triggers for early intervention

#### Option B1: Qualitative Based Framework

#### Option B2: Quantitative Based Framework

Under Option B1 a qualitative based framework could be developed specifying in a descriptive way the factors which should be considered by the competent authorities when assessing whether there is a need to apply early intervention measures. Whilst this approach would increase convergence of the supervisory practices across the EU but the problems related to less precise determination of triggers and a high level of discretion available to the competent authorities would remain.

Under Option B2 a quantitative based triggers could be developed by specifying a set of quantitative indicators with predefined thresholds which, if breached, can inform the decisions about the need to apply early intervention measures. The Guidelines could define the quantitative metrics to be applied across the EU and establish the appropriate thresholds for triggering early intervention. Alternatively 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 support the determination that early intervention measures should be applied towards an institution.

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

Table 2: Potential advantages and disadvantages associated with the type of triggers for early intervention

	Potential Advantages	Potential Disadvantages
<b>B1. Qualitative Based Framework</b>	Triggers can encompass factors and circumstances which cannot be easily quantified	This approach places high requirements on the expertise and quality of judgement on the side of competent authorities
	Harmonisation is achieved to a certain extent through the specification of common factors and qualitative triggers	A lack of consistency across jurisdictions leading to uneven playing field
	A higher level of supervisory discretion can be retained	Regulatory arbitrage, i.e. institutions may cease their operations in Member States where the regulatory framework is less predictable
	The need to select appropriate indicators or to develop and test new models is eliminated	The extensive discretion given to the competent authorities does not eliminate the risk of supervisory forbearance
<b>B2. Quantitative Based Framework</b>	Greater convergence is achieved for supervisory activities across jurisdictions	Space for supervisory judgement is limited and competent authorities may be forced to initiate intervention even in cases where they do not agree that it will produce the optimum result
	Clarity and transparency are provided to market participants as well as institutions regarding the trigger of early intervention measures	Thresholds for individual quantitative indicators could be considered as new regulatory requirements by institutions and markets prompting institutions to stay above in order to avoid early intervention  Markets 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	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 the approach based on the combination of Qualitative and Quantitative Based Frameworks which can achieve a combination of the benefits associated with options B1 and B2 as well as reduce the costs associated with both options. The approach adopted is based on a set of qualitative factors (Option B1) which includes also the institution's Overall SREP score and SREP scores for individual SREP elements. As a result, the assessment whether there is a need to apply early intervention measures indirectly takes into account the quantitative risk assessment of the institution (Option B2). According to the Guidelines for common procedures and methodologies for SREP each competent authority should establish monitoring systems of key risk indicators (KRI) and set thresholds for the purpose of identifying material deteriorations and anomalies in the behaviour of KRI. 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. Consequently, in some cases, the Guidelines envisage a possibility to trigger early intervention measures directly on the basis of quantitative KRI monitored under SREP. Nevertheless, the Guidelines do not establish a set of quantitative factors and thresholds which should be applied by the competent authorities across the EU.

Q6	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?
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## 5.2. Overview of questions for Consultation

### Questions related to the draft Guidelines

Q1	Do you have any general comments on the draft Guidelines on triggers for the use of early intervention measures?
Q2	Do you consider the level of detail used in the draft Guidelines to be appropriate?
Q3	Do you have any comments on the proposed specification of early intervention triggers based on the outcomes of SREP?
Q4	Do you have any comments on the proposed approach to use material deterioration or anomalies in key indicators in deciding whether there is a need to apply early intervention measures?
Q5	Do you have any comments on the proposed description of significant events that should be considered as possible triggers for the decision whether to apply early intervention measures?

### Questions related to the Impact Assessment

Q6	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?
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