

BRRD: Overview of the EBA’s level 2 regulation

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The recent financial crisis pointed out the need to develop a common regulation framework to deal with failed banks. The main objective is to resolve banks in an easier, faster and more reliable manner that minimizes the use of public funds and that ensures the stability of financial and banking services.

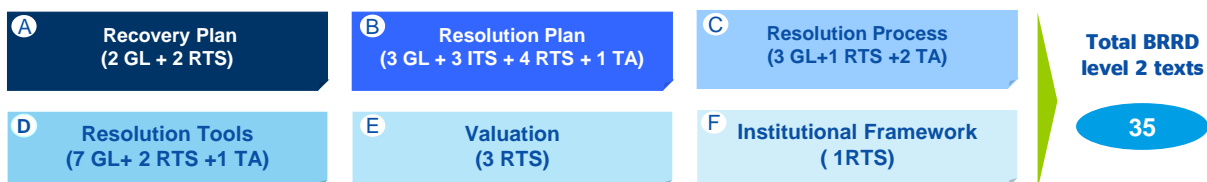
This goal has been achieved in Europe with the Bank Recovery and Resolution Directive (BRRD¹). It was adopted in spring 2014 after a long period of legal negotiations due to the different and controversial interests inherent in the EU. The Directive provides authorities with comprehensive and effective arrangements to deal with failing banks at a national level, as well as cooperation agreements to tackle cross-border banking failures.

The approval of the Directive did not mark the end of the road for the development of the EU Crisis Management framework. In fact, at this point in time, the EBA took the responsibility to elaborate the level 2 legislative process in order to clarify and complete certain sections of the BRRD. Indeed, the BRRD empowers the EBA to develop a wide range of binding technical standards, guidelines and reports on key areas of recovery and resolution, with the aim of ensuring effective and consistent procedures across the European Union.

The role of the EBA has been decisive to complete and clarify more technical topics. In this sense, EBA has shed light on crucial matters, and has achieved harmonized definitions among Member States also. Without EBA’s specifications, a homogenous implementation of the BRRD’s principles would not be possible.

So far the EBA has published a total of thirty five BRRD level 2 texts (more than 1,000 pages) that can be classified in six main areas. The first set of documents is related to the details of the content and design of the recovery plan. Regarding the development of the resolution plan the EBA has released eleven papers, among which, the one related to MREL stands out. The third category compiles six reports that specify the resolution process (highlighting the early intervention and resolution triggers and the procedure of notification). The fourth group focuses on the resolution tools, emphasizing the bail-in mechanism that will take effect on 1 January 2016. The fifth concerns valuation papers of the assets and liabilities under the resolution. Finally, there is one document describing the institutional framework. Currently, out of the thirty five documents, the final version of seven of them must be released by the end of 2015.

BRRD Level 2 texts developed by EBA



(*) Abbreviations: ITS: Implementing Technical Standards; GL: Guidelines; RTS: Regulatory Technical Standards; TA: Technical Advice

Source: BBVA Research

¹ Directive 2014/59/EU of 12 June 2014

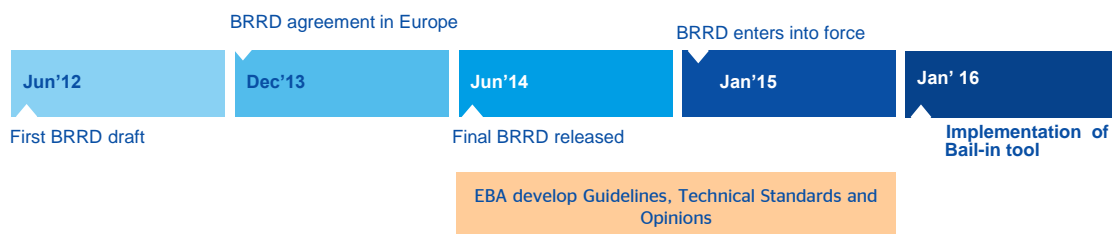
Following BRRD's approval level 2 regulation is needed

The recent crisis has shown that dealing with failed banking groups has become a difficult and costly task, and more important, that their failure can threaten the financial stability of the economy in general. Therefore, a broad consensus was reached on the need to find a better legal framework that enables authorities to resolve banks in a quick process, avoiding negative spill-over effects to the rest of the financial system. In this way, the critical financial services that they provide can be continued, but without the need to rely on the use of public funds and thus protecting tax payers. To this end, in 2011 the G20 leaders and the Financial Stability Board (FSB) submitted new international standards for effective resolution regimes.²

The development of the Bank Recovery and Resolution Directive (BRRD), which is the transposition of the FSB's key principles on resolution in Europe, between 2012 and 2014, involved a long and complicated process of negotiations between the European Commission, the European Council and the European Parliament due to the different and controversial interests inherent in an EU level discussion. The main milestones in the BRRD development were the following:

Figure 1

Milestones in the BRRD implementation process



Source: BBVA Research

- On 6 June 2012, the European Commission published the first proposal of a Directive on a recovery and resolution framework for financial institutions setting out the necessary steps and powers to ensure that bank failures across the EU can be managed in a way which avoids financial instability and minimizes costs for taxpayers.
- One year later, in June 2013, the finance ministers of the Member States agreed on a general approach on the draft of the Directive. This opened the way for trilogue negotiations involving the Council, the Commission and the Parliament. Then, after several months of debates, on 12 December 2013, the European leaders agreed the final text of the BRRD.
- Finally, on 12 June 2014, the BRRD was published in the Official Journal of the European Union. And it entered into force on 1 January 2015, with the bail-in provisions applying from 1 January 2016 onwards. So, as a next step, Member States had to transpose the Directive into their national legislation within the defined timeline which was 31 December 2014.

The approval of the Directive in June 2014 did not mark the end of the road for the legislative process. In fact, this is when the EBA took the responsibility to elaborate the level 2 legislative process in order to clarify and complete certain sections of the BRRD. Indeed, the BRRD empowers the EBA to develop a wide range of binding technical standards, guidelines and reports on key areas of recovery and resolution, with the aim of ensuring effective and consistent procedures across the European Union.

² See FSB (October 2011), "Key attributes of Effective Resolution Regimes for Financial Institutions"

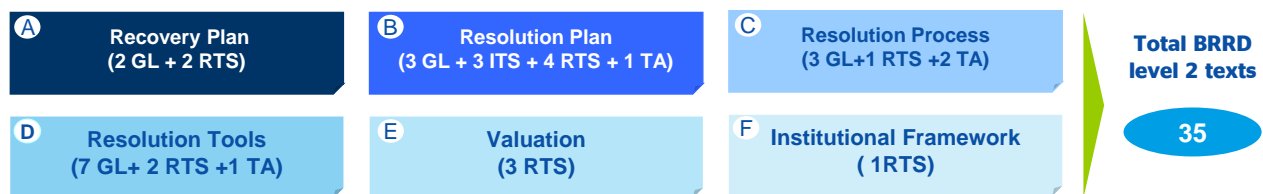
The EBA has a key role to clarify the BRRD

The EBA is the competent body in charge of, among other tasks, ensuring an effective and consistent level of prudential regulation and supervision across the European banking sector. Through the adoption of binding technical standards and guidelines it also contributes to the creation of the European Single Rulebook that helps establishing a level playing field for financial institutions across the EU.³

EBA's role as advisor in the technical standards and guidelines is essential due to the complexity of this new resolution framework. The European policy-makers were already aware of this, and they empowered the EBA through the BRRD to produce a considerable amount of regulatory and non-regulatory documents. The goal is to provide further specification of essential elements to ensure the effectiveness of the resolution regime established by the BRRD.

Since the publication of the BRRD in the Official Journal of the EU, the EBA has released thirty five BRRD Level 2 texts. These specify and clarify how the primary legislation should be applied in order to promote convergence of practices of national competent authorities by setting out EBA's view on appropriate supervisory practices. The BRRD level 2 texts can be grouped into six categories that reflect the critical elements of the BRRD. As shown in Figure 2, in each category EBA has issued different recommendation documents (guidelines, technical standards, and technical advices).

Figure 2
BRRD Level 2 texts developed by EBA



(*) Abbreviations: ITS: Implementing Technical Standards; GL: Guidelines; RTS: Regulatory Technical Standards; TA: Technical Advice

Source: BBVA Research

The procedure of drafting a document by the EBA is long and complex also. As a first step, the EBA has to prepare a preliminary version which should be shared with national experts from different member states. Then, it has to take into account the feedback of the Banking Stakeholder Group (BSG) and financial industry during the public consultation period. It is important to highlight the role of the BSG. Its Technical Working Group on Recovery, Resolution and Systemic Issues is composed of nineteen experts from consumers, users of financial services, academics and representatives of SMEs and its responses to BRRD consultation papers are highly valued by the EBA⁴. In this regard, the EBA publishes the documents for consultation and holds a public hearing to gather comments together with alternative regulatory choices. As a last step, the EBA submits the final draft to the European Commission for endorsement, following which it undergoes the scrutiny of the European Parliament and the Council before it is published in the Official Journal of the European Union.

Below we list and summarize the BRRD level 2 texts released by the EBA highlighting the objective and main characteristics of each paper.

³ See EBA mission: <https://www.eba.europa.eu/about-us/missions-and-tasks>

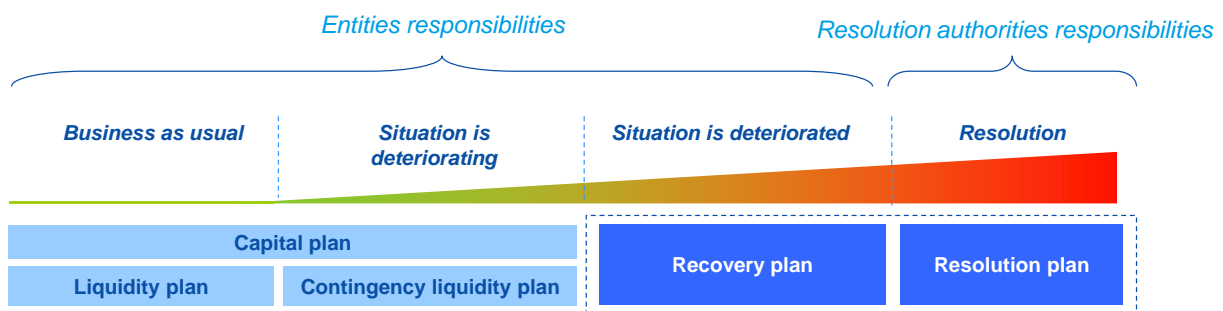
⁴ See members of the standing Technical Working Groups on Recovery, Resolution and Systemic issues of the BSG. <http://www.eba.europa.eu/documents/10180/17417/EBA+BSG+2014+26+Rev1+%28BSG+Members+of+Standing+Technical+Working+Groups++update+June+2014%29.pdf/3bb43b8a-c71f-4c3b-ae03-f1f27681983a>

A. Recovery plan (2 guidelines and 2 technical standards)

BRRD establishes that institutions have to prepare and regularly update recovery plans as part of the preparation and prevention stage in the crisis management framework. The objective of a recovery plan is to identify the options that might be available to counter both an idiosyncratic and a system-wide crisis and to assess whether these options are robust enough and sufficiently varied to cope with a wide range of shocks of different nature. As shown in Figure 3, the recovery plan complements the existing policies and risk management frameworks in respect of capital and liquidity by including and analysing a menu of management actions under recovery situations.

Figure 3

Integration of the recovery and resolution plans with other management policies



Source: BBVA Research

The EBA has published four BRRD Level 2 documents in the recovery plan field that should be read in conjunction to complete the development of the plan by each institution.

- Guidelines on the range of scenarios to be used in recovery plans (EBA/GL/2014/06).⁵ The scenario in the recovery plan aims at testing the effectiveness of recovery options and the adequacy of the indicators contained in recovery plans. The EBA clarifies that each recovery plan should include at least three scenarios: a system-wide event, an idiosyncratic event and a combination of system-wide and idiosyncratic events. Additionally, in line with the principle of proportionality, global systemically important institutions (G-SIIs) and other systemically important institutions (O-SIIs) should include one more scenario. It is important to remark that reverse stress testing should be considered as a starting point for developing scenarios that should be 'near-default' only.
- Technical Standards on the content of recovery plans (EBA/RTS/2014/11).⁶ The EBA sets the minimum content of recovery plans which is the basis of the assessment that the SSM, the National Supervisor and the EBA will have to carry out annually. In particular, the recovery plan should include at least the following sections: i) the summary of the recovery plan; ii) information on governance; iii) a strategic analysis; iv) a communication plan; and iv) a description of preparatory measures.

Due to the fact that the recovery plan is a new requirement which entered into force in 2015, practical supervisory experience and adjustment on the technical standards would be needed in the coming years

⁵ <https://www.eba.europa.eu/documents/10180/760136/EBA-GL-2014-06+Guidelines+on+Recovery+Plan+Scenarios.pdf>

⁶ <https://www.eba.europa.eu/documents/10180/760167/Draft+RTS+on+content+of+recovery+plans.pdf>

with the aim of strengthening harmonization in Europe, and thus enhancing the effectiveness of the recovery plan.

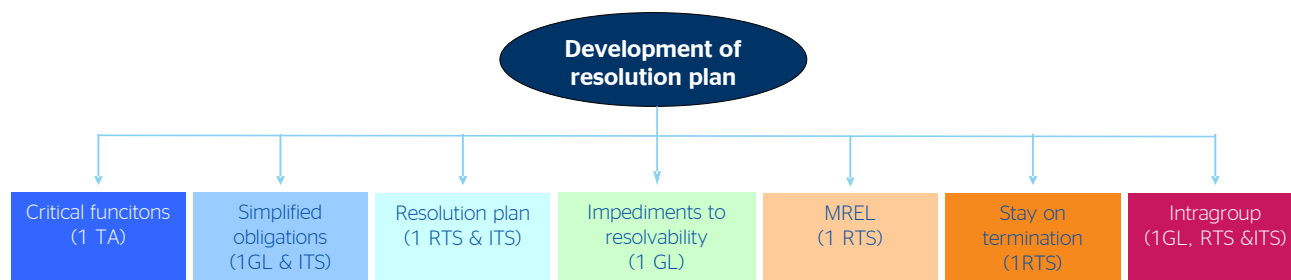
- Technical Standards on the assessment of recovery plans (EBA/RTS/2014/12).⁷ It specifies the criteria which competent authorities should apply when assessing the recovery plan of an institution or a group. Competent authorities should assess the completeness, the quality and the credibility of the recovery plan. The latter is relevant in terms of ensuring that the recovery options can be effectively implemented.
- Guidelines on the minimum list of recovery plan indicators (EBA/GL/2015/02).⁸ The document indicates the minimum list of qualitative and quantitative indicators that institutions should include in their plans. They are grouped into different categories such as capital, liquidity, profitability and asset quality. Where relevant to the characteristics of the specific institutions, macroeconomic and market-based indicators should also be included. These indicators will serve to identify the points at which appropriate decision-making action and internal discussions may be triggered. However, it does not mean an activation of specific recovery measures. Finally, it is worth mentioning that those indicators should be closely aligned with the management indicators used by the institution and those included in the supervisory processes.

B. Resolution plan (3 guidelines, 7 technical standards, 1 technical advice)

The resolution plan is another pre-emptive tool which complements the recovery plan. In essence, resolution authorities should describe ex-ante how they would resolve a bank maintaining any critical economic functions and minimizing the cost supported by tax-payers. But perhaps most importantly, the resolution authorities should identify any material impediments to resolvability and, where necessary and proportionate, outline relevant actions to address those impediments.

Figure 4

[EBA documents related to the resolution plan](#)



Source: BBVA Research

The resolution plan is an absolute novelty. Moreover, the BRRD empowers the resolution authority to potentially impose legal, operational and funding changes in banking groups. The BRRD provisions are generic and the European policy-makers rightly acknowledge the need for further clarification on how the resolution plan should be developed. As shown in Figure 4 and described below, the EBA published eleven level 2 texts on different topics related to the development of the resolution plan.

⁷ <https://www.eba.europa.eu/documents/10180/760181/EBA-RTS-2014-12+Draft+RTS+on+assessment+of+recovery+plans.pdf>

⁸ <https://www.eba.europa.eu/documents/10180/1064487/EBA-GL-2015-02+GL+on+recovery+plan+indicators.pdf>

- Technical Advice on the delegated acts on critical functions and core business lines (EBA/OP/2015/05).⁹ Authorities should assess the materiality of the potential impact that the failure to provide any function would have on both the real economy and financial markets. The critical economic functions in an institution may play a critical role in resolution. Therefore the BRRD empowers the European Commission to develop a Delegated Act specifying the criteria for defining critical functions and core business lines. Because of its relevance, the EBA has also carried out a comparative report on the approach to determining critical functions and core business lines in the recovery plans developed in 2013 and 2014 (The EBA's "Comparative report on the approach to determining critical functions and core business lines in recovery plans" was published alongside the advice).

The EBA proposes that the resolution authority should consider the size, market share, external and internal interconnectedness, complexity, and cross-border activities of an institution or group when it assesses whether any functions or activity is critical or not. Two elements acquire particular relevance: i) analysis of the impact of the sudden discontinuance of the function on third parties, and ii) evaluation of the market for the provision of that function, in particular in terms of concentration and substitutability.

- Guidelines and Technical Standards relating to the eligibility of institutions for simplified obligations (EBA/GL/2015/16¹⁰ and EBA/ITS/2015/05¹¹). The BRRD applies to all institutions regardless of their systemic footprint. Therefore, the BRRD's requirements should be tailored to the nature of the institution's business, shareholding structure, legal form, risk profile, size and legal status – in line with the principle of proportionality. The simplified obligations may apply to the following requirements: contents of recovery and resolution plans, date by which recovery and resolution plans should be drawn up, content of information required from institutions and level of detail for the resolvability assessment. The guidelines further specify the criteria in order to promote convergence of practice between the authorities.
- Technical Standards on the content of the resolution plan and the assessment of the resolvability (EBA/RTS/2014/15).¹² The EBA identifies eight categories of information to be included in the resolution plan. Also, it sets out both general and specific requirements to be included in each category to develop the preferred resolution strategy. These eight categories are: a summary, a description of the resolution strategy, arrangements for information, arrangements for operational continuity, financing, communication, conclusions of the assessment of resolvability, and responses from the institution or group.

Additionally, the EBA clarifies how the resolution authorities should carry out the assessment of the resolvability annually. The process established by the EBA is based on a three stage approach. First, resolution authorities should assess whether liquidation under normal insolvency procedures is feasible and credible. If not, as a second step, they should identify a preferred resolution strategy. Finally, they proceed to assess the feasibility and credibility of that strategy. This preferred resolution strategy may be designed as a Single Point of Entry (SPE) or a Multiple Point of Entry (MPE) as shown in Figure 5.

⁹ <https://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-05+Technical+Advice+on+critical+functions+and+core+business++++.pdf>

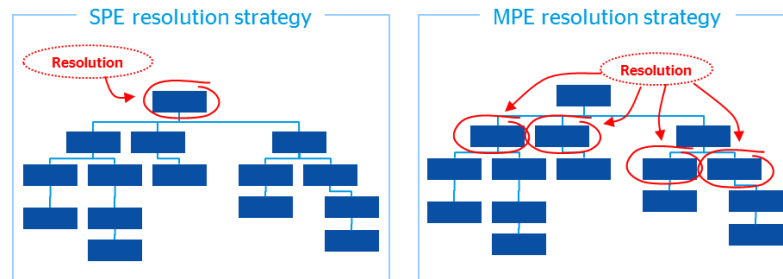
¹⁰ <https://www.eba.europa.eu/documents/10180/1135541/EBA-GL-2015-16+Guidelines+on+simplified+obligations.pdf>

¹¹ <https://www.eba.europa.eu/documents/10180/1135296/EBA-ITS-2015-05+ITS+on+simplified+obligations.pdf>

¹² [https://www.eba.europa.eu/documents/10180/933992/EBA-RTS-2014-15+\(Final+draft+RTS+on+Resolution+Plan+Contents\).pdf](https://www.eba.europa.eu/documents/10180/933992/EBA-RTS-2014-15+(Final+draft+RTS+on+Resolution+Plan+Contents).pdf)

Figure 5

Illustrative example of the Single Point of Entry (SPE) and the Multiple Point of Entry (MPE) resolution strategy

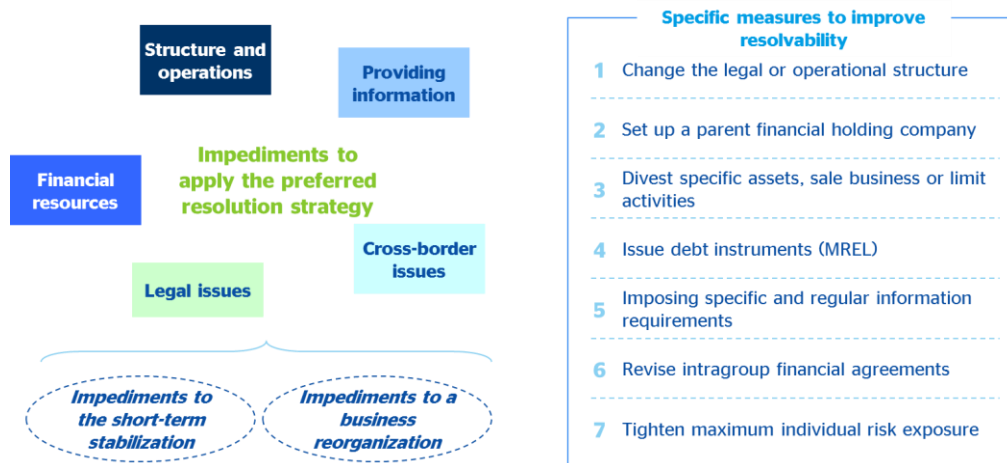


Source: BBVA Research

- Guidelines on measures to reduce or remove impediments to resolvability (EBA/GL/2014/11).¹³ One of the cornerstones of the BRRD is to identify barriers that impede resolution authorities to carry out an efficient resolution process. These guidelines clarify how the resolution authority should identify those barriers and the appropriate measures to remove them. The EBA groups these measures into three headings:
 - structural measures concerning the organizational, legal and business structure of an institution
 - financial measures relating to its assets, liabilities, and products
 - additional information requirements

Figure 6

Impediments to resolvability and potential measures proposed by the BRRD



Source: BBVA Research

The limited practical experience in the use of powers to address or remove impediments to resolvability, among other things, is another reason why this guidance should be followed carefully. In fact, this is one of the main concerns of the financial industry because measures need to be “suitable, necessary and proportionate.”

¹³ [https://www.eba.europa.eu/documents/10180/933988/EBA-GL-2014-11+\(Guidelines+on+Impediments+to+Resolvability\).pdf](https://www.eba.europa.eu/documents/10180/933988/EBA-GL-2014-11+(Guidelines+on+Impediments+to+Resolvability).pdf)

- Technical Standards on procedures, forms and templates for resolution planning (EBA/ITS/2015/06).¹⁴ Resolution authorities are responsible for developing the resolution plan. In order to do that, competent authorities and institutions should provide them with all the information needed. The technical standards provide a detailed procedure for requesting information for the purpose of resolution planning and the forms and templates to provide the information. EBA's goal is to harmonize the process for the submission of such information to resolution authorities and also to facilitate the exchange of information between home and host resolution authorities during the resolution planning process for cross-border institutions.
- Technical Standards on a minimum set of the information on financial contracts that should be recorded (EBA/CP/2015/04. Still pending for the final TS).¹⁵ As the BRRD states the authorities have the power to suspend the termination rights of any party to a contract. In order to facilitate the identification of which contract is subject to a suspension of termination rights, banks are required to maintain detailed records of financial contracts. In this sense, the EBA clarifies two elements: i) the circumstances for requiring detailed records of financial contracts to be maintained, and ii) the minimum set of information on financial contracts which should be kept in the detailed records such as parties to the financial contracts, the financial contract type, the details of the transaction, and, finally, the clearing features.
- Guidelines and two Technical Standards on group financial support (EBA/GL/2015/17¹⁶, EBA/RTS/2015/08¹⁷ and EBA/ITS/2015/07).¹⁸ The BRRD mandates the EBA to specify the conditions for the provision of group financial support in order to set out a clear, harmonised framework facilitate group support and enhance legal certainty when the financial support is provided. These conditions mainly affect banks with a Single Point of Entry resolution strategy.

To achieve these goals the EBA specifies the conditions and terms under which one entity of a banking group may provide support to another entity of the same group in financial difficulties. The conditions are: the interest of the providing entity to support the subsidiary, the impact on the entity providing the support, the impact on financial stability, the financial distress of the institution concerned, including the business model, the current market situation and potential further adverse developments.

Finally the EBA determines the form and content of disclosure requirements. In this sense, the disclosure should be made on the institution's website and include relevant information such as the consideration and repayment modalities while respecting the need for confidentiality.

- Technical Standards on Criteria for determining the MREL (EBA/RTS/2015/05).¹⁹ The bail-in tool is one of the cornerstones of the new resolution regime. In order for this new banking rescue philosophy to be effective, the BRRD requires banks to have enough liabilities which could be eligible to bail-in – the so-called "Minimum Required Eligible Liabilities" (MREL).

¹⁴ <https://www.eba.europa.eu/documents/10180/1135507/EBA-ITS-2015-06+ITS+on+reporting+for+resolution+plans.pdf>

¹⁵ [https://www.eba.europa.eu/documents/10180/1006126/EBA-CP-2015-04+\(CP+on+Detailed+records+of+financial+contracts\).pdf](https://www.eba.europa.eu/documents/10180/1006126/EBA-CP-2015-04+(CP+on+Detailed+records+of+financial+contracts).pdf)

¹⁶ <https://www.eba.europa.eu/documents/10180/1137032/EBA-GL-2015-17+Guidelines+on+group+financial+support.pdf>

¹⁷ <https://www.eba.europa.eu/documents/10180/1136980/EBA-RTS-2015-08+RTS+on+financial+support.pdf>

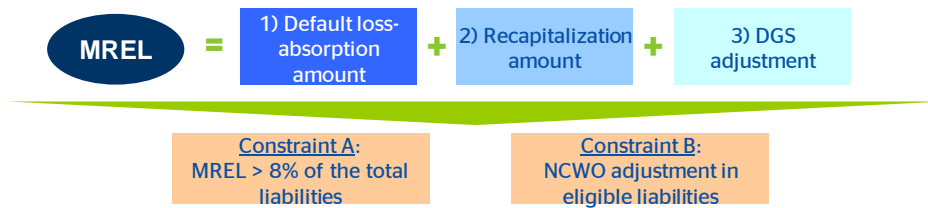
¹⁸ <https://www.eba.europa.eu/documents/10180/1136953/EBA-ITS-2015-07+ITS+on+Disclosure+of+Group+Financial+Support+Agreements.pdf>

¹⁹ <https://www.eba.europa.eu/documents/10180/1132900/EBA-RTS-2015-05+RTS+on+MREL+Criteria.pdf>

The MREL will be determined case-by-case at individual level in each banking group. Aimed at ensuring a harmonised application throughout Europe, the BRRD empowered the EBA to specify the criteria which resolution authorities are expected to apply when setting the MREL in each institution. Although the MREL is expressed as a percentage of total liabilities and own funds of each institution, its quantum will be determined in monetary terms based on several factors, in which the capital and leverage ratios play a central role. The five criteria for determining the MREL are described below:

Figure 7

Minimum Required Eligible Liabilities (MREL) criteria



Source: BBVA Research

- The default loss absorption amount is the capital requirement currently applicable to an institution or group. An upward or downward adjustment may take place depending on the Supervisory Review and Evaluation Process (SREP) recommendations which will take into account the idiosyncratic characteristics of each institution,
- The recapitalisation amount is the amount necessary to satisfy applicable capital requirements necessary to comply with the conditions for authorization after the implementation of the preferred resolution strategy,
- The DGS adjustment: the MREL may be lowered according to the resolution authority’s assessment on the contribution of the DGS in the resolution process,
- In order to comply with the principle of No Creditor Worse off than in Liquidation (NCWO), the resolution authority may assess whether senior unsubordinated debt can be MREL-eligible,
- Resolution authorities should assess whether the level of MREL is sufficient to ensure the conditions for use of the resolution fund while ensuring that the contribution to loss absorption and recapitalisation is not less than 8% of the total liabilities. This fact only applies to systemic institutions, either global or domestic.

Finally, The MREL could be seen as the European Union’s counterpart to the FSB’s TLAC. Despite having the same purpose, both ratios are different due to their scope and their definitions. The final TLAC proposal will be released in November 2015. Then, the EBA and the European Commission will have the opportunity to review the MREL in order to make both ratios compatible while preserving the local idiosyncrasies in Europe.

For further information about the Technical Standards of MREL see our note “EU loss-absorbing capacity requirement: final MREL guidelines.”²⁰

²⁰ https://www.bbva.com/wp-content/uploads/2015/07/20150707_MREL-Watch8.pdf

C. Resolution process (3 guidelines, 1 technical standards and 2 technical advices)

The powers to trigger the early intervention actions and the resolution procedure are one of the most important features in the BRRD. Many concerns arise regarding the subjective nature of the triggers, suggesting that it could lead to uncertainty and consequently aggravate volatility if the market perceives that an institution may be nearing a situation in which those conditions are met.

As a result of this, and in order to develop a consistent application of the triggers, procedures and contents of resolution notifications, the EBA has developed guidances establishing common parameters for triggering the application of early intervention and resolution tools.

As figure 7 shows, the point of non-viability is understood as the point at which the relevant authority determines that the institution meets the conditions for resolution, while the early intervention trigger implies that the resolution authority will intervene at an early stage when an institution is insolvent or very close to insolvency to the extent that if no action is taken the institution will be insolvent in the near future.

The procedure of resolution also includes all the notifications and procedures that must be considered in the decision making process when a resolution starts (templates and minimum set of information to be sent (to authorities)).

The EBA has published six level 2 texts on different topics related to the resolution process:

- Guidelines on triggers of early intervention (EBA/GL/2015/03).²¹ The aim of these documents is to promote convergence of supervisory practices in relation to the application of early intervention providing competent authorities (supervisors) with guidance on the circumstances under which they should apply early intervention measures to institutions.

The triggers are direct outcomes of the supervisory review and evaluation process (SREP), of the assessment of various SREP elements and the Overall SREP assessment indicating any threat to the viability of an institution and whether an institution infringes or may infringe requirements of the relevant EU and national implementing legislation (capital, liquidity, governance). Additionally, the guidelines recognize that the early intervention measures can also be triggered on the basis of other circumstances as material changes or anomalies identified in the monitoring of key indicators performed as part of SREP).

It is important to highlight that the triggers do not oblige competent authorities to automatically apply early intervention measures in all cases. 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.

- Guidelines on the interpretation of failing or likely to fail (triggers for resolution) (EBA/GL/2015/07).²²

These documents clarify and define the conditions to trigger the Point of non-vitality (PONV) to ensure a consistent approach that determines the moment when the resolution process should start as the institution is failing or likely to fail. It is important to stress that the early intervention trigger is defined by the supervisor whereas the PONV is set by the supervisor together with the resolution authority.

The guidelines list all objective elements for determining whether an institution is failing or likely to fail which are applicable to both supervisors and resolution authorities. In addition, the report specifies

²¹ <http://www.eba.europa.eu/documents/10180/1067473/EBA-GL-2015-03+Guidelines+on+Early+Intervention+Triggers.pdf>

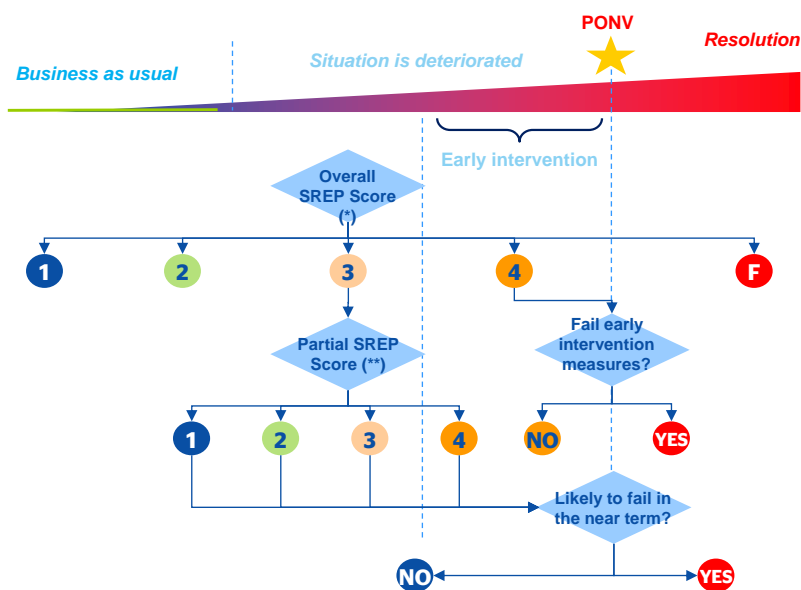
²² <https://www.eba.europa.eu/documents/10180/1085517/EBA-GL-2015-07+GL+on+failing+or+likely+to+fail.pdf>

different sets of procedural rules addressed to each of these authorities, and establishes the link between SREP and failing or likely to fail determination made by the supervisors.

The above mentioned guidelines encourage a consistent application of triggers in the EU. Figure 8 shows, in a simplified and illustrative manner, the scheme to activate both triggers defined by the EBA:

Figure 8

SREP and triggers for early intervention & resolution



Those criteria are complemented by macroeconomic and market indicators and weakness in the governance framework

(*) Overall SREP Score: 1- no risk, 2-low risk, 3,-risk, 4-high risk, F-Fail

(**) Partial SREP Score refers to the following areas: capital, liquidity, internal governance, and business model

Source: BBVA Research

- Guidelines on public support measures to enter into resolution (EBA/GL/2014/09).²³ These guidelines state the types of tests, reviews or exercises to determine when the provision of extraordinary public support to a bank will not trigger resolution action under the BRRD. They specify the main features of the types of tests, reviews or exercises that may lead to support measures including a timeline, a scope, a time horizon, a reference date, a quality review process, a common methodology and, where relevant, a macro-economic scenario and hurdle rates, as well as a timeframe to address the shortfall.
- Technical Advice on arrangements in a partial property transfer (EBA/Op/2015/15).²⁴ The EBA gives its opinion in response to a request for advice from the European Commission specifying the classes of arrangements that are protected in a partial property transfer. The document lists five general categories of arrangements which may be protected (security arrangements, title transfer collateral arrangements, set-off arrangements, netting arrangements, covered bonds and structured finance arrangements). As these categories are quite broad, the scope needs to be further specified, and the Commission is empowered to do so in its delegated acts.

²³ [https://www.eba.europa.eu/documents/10180/821335/EBA-GL-2014-09+\(Guidelines+on+Public+Support+Measures\).pdf](https://www.eba.europa.eu/documents/10180/821335/EBA-GL-2014-09+(Guidelines+on+Public+Support+Measures).pdf)

²⁴ <http://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-15+Opinion+on+protected+arrangements.pdf>

- Technical Standards on procedures and contents of resolution notifications (EBA/RTS/2015/04).²⁵ This document specifies the procedures and contents related to the notification that a banking institution is failing. The objective is to achieve a uniform approach in sending notifications and to enable the resolution authority to take adequately informed and swift resolution decisions.

The technical standards establish three different steps: i) the management body of an entity should notify the competent authority if they consider the entity to be failing or likely to fail; ii) the competent authority should inform the resolution authorities of any notification received from an entity as well as any measures that the competent authority requires the entity to take. The resolution authority should make a decision on whether or not to take resolution action, and iii) the relevant authorities (EBA, Governments, EU COM) should receive a communication from the competent authority or the resolution authority.

In addition, the EBA defines a minimum set of information to be sent (entity name, address, legal identifier, financial information).

- Technical Advice on deferral of ex post contributions to financial arrangements (EBA/Op/2015/06).²⁶ The EBA issues advice to the European Commission on the deferral of ex-post contributions to the resolution fund provided by the BRRD and to which all EU institutions have to contribute. In this regard, EBA's document recommends that national authorities analyze the impact on solvency and liquidity of institutions before allowing for ex-post contributions, which should only be applied in exceptional cases.

D. Resolution tools (7 guidelines, 2 technical standards, and 1 technical advice)

This section includes all the EBA's documents related to resolution tools (sale of business, bridge bank, asset separation and bail-in) that resolution authorities have at their disposal to resolve an institution when the trigger conditions for resolution are reached. EBA's documents have shed light on these crucial topics, and have also achieved harmonized definitions among Member States.

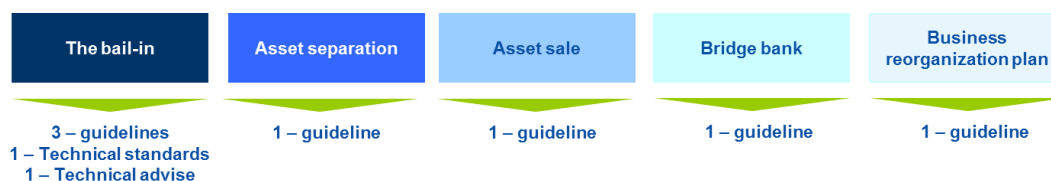
The bail-in tool is the cornerstone of the new resolution regime and the EBA has made an extra effort to develop all the corresponding level 2 texts. These texts aim at ensuring that the bail-in power is an effective way of absorbing losses and recapitalising banks in resolution, and that resolution authorities and market participants have a clear understanding of the terms on which it should be applied. Finally, it is worth mentioning that the bail-in tool will take effect on 1 January 2016. At the time of drawing up the note, there are several documents whose final draft is still pending, but they should be released by end of 2015.

²⁵ <http://www.eba.europa.eu/documents/10180/1132842/EBA-RTS-2015-04+Final+Draft+RTS+on+Notifications.pdf>

²⁶ <https://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-06+Technical+Advice+on+deferral+of+ex+post+contributions.pdf>

Figure 9

BRRD Level 2 texts on resolution tools



Source: BBVA Research

Below we describe the main characteristics of the five level 2 texts related to the bail-in tool:

- Guidelines on the treatment of shareholders in bail-in (EBA/CP/2014/40).²⁷ The document clarifies the circumstances which should guide the choice, whether applying the bail-in tool or the write down or conversion of capital instruments power in the BRRD. The following actions are allowed: i) cancellation of existing shares or other instruments of ownership or transfer them to bailed-in creditors; and/or ii) dilution of existing shareholders and holders of other instruments of ownership as a result of the conversion of relevant capital instruments or eligible liabilities to equity.
- Guidelines on the rate of conversion of debt to equity in bail-in (EBA/CP/2014/39).²⁸ The guidelines clarify when and how different conversion rates from debt to equity should be set for different types of liabilities. The document establishes that when setting conversion rates resolution authorities should seek to ensure that no shareholder or creditor is expected to receive a worse treatment than in insolvency (the no-creditor-worse-off principle); and subject to achieving the above, resolution authorities should only set differential conversion rates in order to respect the general principles governing resolution.
- Guidelines on write down conversion in bail-in (EBA/CP/2014/29).²⁹ The guidelines provide general rules which should be applied in cases where there is potential ambiguity about which category of the write down sequence a particular instrument belongs to, and discusses their application to particular cases.

The three above mentioned guidelines are still pending final publication

- Technical Standards on the contractual recognition of bail-in (EBA/RTS/2015/06).³⁰ The report aims to ensure the cross-border effectiveness of the bail-in power where liabilities are governed by the law of a third country. This RTS will be effective through the inclusion of a contractual recognition term, in this sense, the document specifies the minimum contents of the contractual terms. These include provisions specifying the express acknowledgement and consent of the counterparty to the application of write-down and conversion powers by the Member State resolution authority and their potential effects in terms of the liability under the agreement.

²⁷ <https://www.eba.europa.eu/documents/10180/890569/EBA-CP-2014-40+CP+on+GL+on+shareholders+treatment+in+bail-in.pdf>

²⁸ <https://www.eba.europa.eu/documents/10180/890758/EBA-CP-2014-39+CP+on+GL+on+conversion+rates.pdf>

²⁹ <https://www.eba.europa.eu/documents/10180/833064/EBA-CP-2014-29+%28CP+on+GL+on+Interrelationship+BRRD+and+CRR-CRD%29.pdf>

³⁰ <https://www.eba.europa.eu/documents/10180/1132911/EBA-RTS-2015-06+RTS+on+Contractual+Recognition+of+Bail-in.pdf>

Additionally, the document determines the cases in which the requirement to include the contractual term does not apply and it also specifies liabilities that are fully secured in accordance with EU regulatory requirements or equivalent third country law.

- Technical Advice on the delegated acts on the circumstances when exclusions from the bail in tool are necessary (EBA/OP/2015/07)³¹. The advice recommends that exclusions should be used restrictively, as they are exceptions to the principle of equitable treatment of creditors of the same class and with a view to respecting the no-creditor-worse-off principle (the resources for absorbing losses despite exclusions are limited). Moreover, the document points out that the exemptions should be considered on a case-by-case basis, rather than by considering the specific nature of concerned institutions in isolation, as this could result in competitive imbalances and set wrong incentives for bank structures.

Apart from the EBA's guidelines on bail-in issues, the EBA has also developed four guidelines clarifying key elements of the other resolution tools and the business reorganization plan in order to facilitate the implementation of resolution tools in the banking sector across the EU.

- Guidelines on minimum list of service of the sale of business (EBA/GL/2015/04)³² These guidelines specify the circumstances and elements to assess when applying this tool, in particular details when authorities may deviate from certain marketing requirements for the sale of the business of an institution under resolution to avoid significant adverse effects on financial stability.
- Guidelines on asset separation tool (EBA/GL/2015/05)³³ The document defines what assets may be transferred under the asset separation tool to an asset management vehicle ('bad bank') and specifies that the analysis on the assets should be carried out over three steps: assessing the market situation, the impact that their liquidation may have on markets and the effects that may result on financial stability.
- Guidelines on the minimum list of services in a business transferred (EBA/GL/2015/06)³⁴ The guidelines define a minimum list of necessary critical services that resolution authorities may require from institutions under resolution (i.e. the purchaser after a sale of business, a bridge bank or the transferee after a transfer of assets). This list aims to be as comprehensive as possible in order to allow for the highest possible degree of harmonization of practices across the EU.
- Technical Standards and guidelines on business reorganisation Plans (EBA/CP/2015/05)³⁵ Still pending for the final TS and GL. These documents further specify the minimum criteria elements and contents that should be included in a business reorganisation plan to be approved by the resolution and competent authorities. Thus, the plan must identify the causes of the failure, address them and show that the institution can operate viably in the long-term. The plan should include projections on the

³¹ <https://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-07+Tehcnical+Advice+on+exclusion+from+the+bail-in+tool.pdf>

³² <https://www.eba.europa.eu/documents/10180/1080767/EBA-GL-2015-04+Guidelines+on+the+sale+of+business+tool.pdf>

³³ <https://www.eba.europa.eu/documents/10180/1080779/EBA-GL-2015-05+Guidelines+on+the+asset+separation+tool.pdf>

³⁴ <https://www.eba.europa.eu/documents/10180/1080790/EBA-GL-2015-06+Guidelines+on+the+minimum+list+of+services.pdf>

³⁵ <https://www.eba.europa.eu/documents/10180/1008804/EBA-CP-2015-05+%28CP+on+RTS+and+GL+on+Business+reorganisation+plan%29.pdf>

financial performance of the institution during the reorganisation period with relevant milestones and indicators for a base-case, as well as best- and worst-case scenarios. The institution should regularly report the implementation of the plan to the resolution authority through Progress Reports. Additionally, the documents require that the authorities assess the credibility of the Plan and its assumptions, as well as the appropriateness of the strategy and measures.

E. Valuation (3 technical standards)

For the purpose of protecting the rights of shareholders and creditors and carry out an efficient resolution process, clear obligations should be laid down concerning the valuation of the assets and liabilities of the institution under resolution. As a general principle, the valuation should be based on fair, prudent and realistic assumptions at the moment when the resolution tools are applied. There are three technical standards that help to clarify how valuation should be carried out.

- Technical Standards on valuation (EBA/CP/2014/38. Final TS is still pending).³⁶ The BRRD requires resolution authorities to carry out valuation for three distinct purposes grouped in two categories:
 - Ex ante valuations which include i) whether the conditions for resolution or the write-down or conversion of capital instruments are met, ii) the choice of resolution action to be adopted.
 - Ex post valuation to assess the potential compensation rights to shareholders and/or creditors.

Although the EBA does not seek to provide detailed valuation rules, it aims at promoting the consistent application of the valuation methodologies. In this regard, the EBA sets the factors that should be focused on the valuation process such as loans, fair value assets, goodwill, etc. Additionally it provides some general rules for estimating and discounting expected cash flows, among other criteria. Finally, considering that the valuation is subject to a significant uncertainty (especially in the ex-ante valuations), the EBA proposes to include buffers for additional losses.

- Technical Standards on the valuation of derivatives (EBA/CP/2015/10 Still pending final TS).³⁷ Derivatives are liabilities that are not excluded from the bail-in, but their technical characteristics such as the role of the netting agreements or closing-out provisions make them difficult to value. Therefore, the EBA provides general principles for the valuation ensuring that the discipline brought in by the new bail-in tool can be extended to these liabilities effectively. These methodologies and principles are focused on three elements:
 - Determining the value of classes of derivatives taking into account netting agreements.
 - Establishing the relevant point in time at which the value of a derivative position should be established.
 - Comparing the destruction in value that would arise from the close-out and bail-in of derivatives with the amount of losses that would be borne by derivative liabilities in a bail-in.

³⁶ <https://www.eba.europa.eu/documents/10180/886895/CP+on+draft+RTS+on+valuation+-+EBA-CP-2014-38.pdf>

³⁷ <https://www.eba.europa.eu/documents/10180/1073039/EBA-CP-201-10+CP+on+RTS+on+derivatives+valuation.pdf>

- Technical Standards on independent valuers (EBA/RTS/2015/07).³⁸ Independent valuers shall be appointed to perform valuations of the assets and liabilities of institutions or entities. The document sets out the criteria against which valuers should be assessed: qualifications, experience, ability, knowledge, etc. It will ensure that the assessment of independence is done in a consistent manner across the EU, thereby increasing legal certainty, enhancing confidence in the valuation process and ensuring a level playing field.

F. Institutional framework (1 technical standard)

EBA has published one Technical Standards on EU banking resolution colleges (EBA/RTS/2015/03)³⁹ that specify their operational functioning for cross-border banking groups. Its focus is on ensuring that the European resolution authorities cooperate and coordinate with third-country resolution authorities.

The recent crisis has shown that dealing with cross-border banking groups in trouble is a complex task. Cross-border insolvencies involve multiple authorities and differing legal frameworks. The resolution process could be, in most cases, cumbersome as it may not be accepted as legally binding by all relevant stakeholders from different jurisdictions. In this sense, the resolution colleges (known as Crisis Management Groups by the FSB) allow authorities, home and host, to coordinate, share information and agree the preferred resolution strategy of the group. At the end of the day, the objective is to enhance trust and confidence among all authorities involved in the potential resolution of an institution. It is worth noting that the resolution colleges should not be decision-making bodies, but platforms that facilitate decision-making by home and host authorities.

The technical standards cover the whole end-to-end resolution process from preemptive stages developing the resolution plan to the execution of the restructuring of the group if it enters into resolution. The EBA's text is divided in three areas:

- Operational organization of resolution colleges. This section addresses three main areas: the identification of members and observers of the resolution colleges, the equivalence of the confidentiality regime of third-country resolution authorities and the establishment and updating of written arrangements and procedures. A key question to solve is that for larger cross-border banks the number of members and observers in the colleges is likely to be very substantial. In these situations, some degree of flexibility is needed.
- Resolution planning joint decisions. The EBA details the process to achieve a joint decision on the group resolution plan and resolvability assessment. This joint decision covers key areas such as the measures to address substantive impediments to resolvability and the decision on setting the MREL.
- Cross-border group resolution. This section covers the procedure that resolution authorities should follow when a global institution enters into resolution. It includes, among others, the process to achieve a joint decision on the financing arrangements.

Delegated Acts from the Commission

In order to conclude the legislative work related to the implementation of the BRRD, the European Commission has also been mandated to issue five delegated acts to specify: i) the criteria for defining 'critical functions' and 'core business lines'; ii) the circumstances when exclusion of liabilities from the write down or conversion requirements is necessary; iii) the classes of arrangements for which Member States should

³⁸ <https://www.eba.europa.eu/documents/10180/1134100/EBA-RTS-2015-07+RTS+on+independent+valuers.pdf>

³⁹ <https://www.eba.europa.eu/documents/10180/1132831/EBA-RTS-2015-03+Final+draft+RTS+on+Resolution+Colleges.pdf>

ensure appropriate protection in partial transfers; iv) the manner in which institutions' contributions to resolution financing arrangements should be adjusted in proportion to their risk profile; the registration, accounting, reporting obligations and other obligations intended to ensure that the ex-ante contributions are effectively paid; and v) the circumstances and conditions subject to which an institution may be temporarily exempted from paying ex-post contributions.

Due to the relevance of the above mentioned topics, it is of particular importance that the Commission carries out appropriate consultations during its preparatory work, including at an expert level. For that reason, the Commission has requested the EBA to provide technical advice⁴⁰ to support the work on these delegated acts.

Table 1

[List of Commission delegated act](#)

No	Article of BRRD	Topic	Publication date
1	2(2)	The definition of critical functions	Pending
2	44 (11)	The circumstances when exclusions from the bail-in tool are necessary	Pending
3	76 (4)	Safeguard for counterparties in partial transfers	Pending
4	103(7) &103(8)	Ex-ante contributions	21/10/2014
5	104(4)	Extraordinary ex-post contributions	Pending

Source: BBVA Research

At the time of preparing the present report, the EU Commission has only published the Delegated Act on the calculation of contributions to the resolution fund under BRRD and the Single Resolution Mechanism (SRM). The rest of the final delegated acts are still pending to be issued by the Commission.

⁴⁰ The aim of the EBA's advice is to develop a common understanding of the matter. To this end, in the advices the EBA proposes shared definitions and harmonised evaluation criteria to be used, as guidance, by financial institutions, competent authorities and resolution authorities.

List of EBA Recovery and Resolution papers

Table 2

List of BRRD Level 2 texts published by the EB

NO	Article of BRRD	Topic	Final Paper	Paper code	Pub. Date	Category
1	2	Critical functions & core business lines	TA on critical functions and core business lines	EBA/Op/2015/05	06/03/15	R.PI.
2	4 (5)	Simplified obligations	GL on the applications of simplified obligations	EBA/GL/2015/16	07/07/15	R.PI.
3	4 (7)	Simplified obligations	ITS on the uniform formats, templates and definitions for the identification and transmission of information by competent authorities and resolution Authorities to the EBA	EBA/ITS/2015/05	07/07/15	R.PI.
4	5 (7)	Recovery plan -scenarios	GL on recovery plan scenarios	EBA/GL/2014/06	18/07/14	RC.PI.
5	5 (10)	Recovery plan -content	RTS on the content of recovery plans	EBA/RTS/2014/11	18/07/14	RC.PI.
6	6 (8)	Recovery plan -assessment	RTS on the assessment of recovery plans	EBA/RTS/2014/12	18/07/14	RC.PI.
7	9 (2)	Recovery plan -indicators	GL on qualitative & quantitative recovery plan indicators	EBA/GL/2015/02	06/05/15	RC.PI.
8	10 (9) & 12(6) & 15 (4)	Resolution plan -content	RTS on the content of resolution plans & assessment of resolvability	EBA/RTS/2014/15	19/12/14	R.PI.
9	11 (3)	Resolution plan -minimum information	ITS on procedures, forms and templates for resolution planning	EBA/ITS/2015/06	07/07/15	R.PI.
10	17 (8)	Impediments to resolvability	GL on measures to reduce or remove impediments to resolvability	EBA/GL/2014/11	19/12/14	R.PI.
11	23(2) & 23 (3)	Intra-group financial support	GL specifying the conditions for group financial support	EBA/GL/2015/17	09/07/15	R.PI.
12	23(2) & 23 (3)	Intra-group financial support	RTS specifying the conditions for group	RTS/2015/08	09/07/15	R.PI.
13	26 (2)	Intra-group financial support	ITS on the form and content of disclosure of financial support agreements	ITS/2015/07	09/07/15	R.PI.
14	27 (4)	Early intervention	GL on triggers of early intervention measures	EBA/GL/2015/03	08/05/15	R.P.
15	32(4)	Conditions for resolution-extraordinary public financial support	GL on types of tests, reviews or exercises that may lead to support measures to enter into resolution	EBA/GL/2014/09	22/09/14	R.P.
16	32 (6)	Conditions for resolution-failing or likely to fail	GL on the interpretation of failing or likely to fail	EBA/GL/2015/07	26/05/15	R.P.
17	36 (14)	Indepent valuers	RTS on Indepent valuers	EBA/RTS/2015/07	06/07/15	V.R.
18	36 (15)	Valuation	RTS on valuation*	EBA/CP/2014/38	Pending	V.R.
19	39 (4)	Sale of Busines tool	GL on the effectiveness of the sale of business tool	EBA/GL/2015/04	20/05/15	R.T.
20	42 (14)	Asset separation tool	GL on the asset separation tool	EBA/GL/2015/05	20/05/15	R.T.
21	44 (11)	Exclusions of bail-in	TA circumstances exclusion bail-in	EBA/Op/2015/07	06/03/15	R.T.I
22	45 (2)	MREL	RTS on Criteria for determining the MREL	EBA/RTS/2015/05	03/07/15	RPI
23	47 & 50	Treatment shareholders in bail-in	GL on treatments of shareholders in bail-in*	EBA/CP/2014/40	Pending	R.T.
24	48 (6)	Sequence of write-down & conversion in bail-in	GL on write down- conversion*	EBA/CP/2014/29	Pending	R.T.
25	49 (4)	Valuation derivatives	TS Valuation of derivatives*	EBA/CP/2015/10	Pending	V.R.
26	50 (4)	Conversion debt to equity	GL on the rate of conversion of debt to equity in bail-in*	EBA/CP/2014/39	Pending	R.T.
27	52 (13)	Business reorganization plan	RTS and GL on business reorganization plan*	EBA/CP/2015/05	Pending	R.T.
28	55 (3)	Contractual recognition of bail-in	RTS on the contractual recognition of bail-in	EBA/RTS/2015/06	03/07/15	R.T.
29	65 (5)	Critical Services	GL on the minimum list of services and facilities to operate a business transferred	EBA/GL/2015/06	20/05/15	R.T.
30	71 (8)	Stay on termination	RTS Financial contracts records*	EBA/CP/2015/04	Pending	R.PI.
31	76 (4)	Partial transfers	TA on on classes of arrangements to be protected in a partial property transfer	EBA/Op/2015/15	14/08/15	R.P.
32	81 y 83	Procedural obligations	TS on procedures and contents of resolution notifications	EBA/RTS/2015/04	03/07/15	R.P.
33	88 (7)	Resolution Colleges	RTS on Resolution Colleges	EBA/RTS/2015/03	03/07/15	I.F.
34	104	Expost contributions	TA on deferral of ex post contributions to financial arrangements	EBA/Op/2015/06	06/03/15	R.P.

* Papers pending of final publications;

Abbreviations: ITS: Implementing Technical Standards; GL: Guidelines; RTS: Regulatory Technical Standards; TS: Technical Standards; TA: Technical Advice. R.P.: Resolution Process; R.PI.: Resolution Plan; RC.PI.: Recovery Plan; VR: Valuation of resolution; R.T: Resolution Tools; I.F.: Institutional framework.

Source: BBVA Research

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