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COMMISSION DELEGATED REGULATION (EU) .../...

of 2.2.2016

supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to the circumstances and conditions under which the payment of extraordinary *ex-post* contributions may be partially or entirely deferred, and on the criteria for the determination of the activities, services and operations with regard to critical functions, and for the determination of the business lines and associated services with regard to core business lines

(Text with EEA relevance)

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE DELEGATED REGULATION

Pursuant to Article 104(1) of the Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms ('BRRD'), extraordinary *ex-post* contributions shall be raised where the available financial means are not sufficient to cover the losses, costs or other expenses incurred by the use of a Member State's financing arrangement. The allocation of the extraordinary *ex-post* contributions shall follow the rules for the *ex-ante* contributions and shall not exceed three times the annual amount of contributions determined in accordance with Article 103 of the BRRD.

Pursuant to Article 104(3) of the BRRD, the resolution authority may defer, in whole or in part, for a period of up to six months (with the option of renewal) an institution's payment of extraordinary *ex-post* contributions to the resolution financing arrangement if the payment of those contributions would jeopardise the liquidity or solvency of the institution. The contributions deferred pursuant to this paragraph shall be paid when the payment no longer jeopardises the institution's liquidity or solvency.

Under Article 104(4) of Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms ('BRRD'), the European Commission is empowered to adopt delegated acts to specify the circumstances and conditions under which the payment of extraordinary *ex-post* contributions by an institution may be partially or entirely deferred in accordance with Article 104(3) of that Directive.

Article 104 of Directive 2014/59/EU uses the term 'jeopardise solvency or liquidity' and therefore requires an assessment of whether the hypothetical payment of the *ex-post* contribution represents a risk to the solvency or liquidity of the institution, i.e. whether it is likely that the institution would become illiquid or insolvent. The Delegated Regulation aims to further specify the likelihood that a payment of extraordinary *ex-post* contributions would jeopardise the solvency and liquidity position of the institution. In a group of institutions, the payment of extraordinary *ex-post* contributions may jeopardise the financial position of one group entity and thereby destabilise the group as a whole. However, the assessment of the capital and liquidity of the whole group may lead to the conclusion that there are sufficient means to avert the financial distress of the group entity in question. Both elements would have to limit the deferred period to what is necessary to avoid the risk to the solvency or liquidity of the institution. Resolution authorities would have to take into account that a potential deferral must not be granted for a period longer than six months and may also be deferred for a period of less than six months. Directive 2014/59/EU does not restrict the number of renewals. However, it emphasises that the deferred contributions must be paid when the payment no longer jeopardises the institution's financial position.

The specification of the circumstances and conditions according to which the payment of *ex-post* contributions can be deferred helps avoiding unnecessary financial burden on institutions, and the subsequent negative impacts on their ability to provide credit to the real economy, at times when their financial position limit their contributory capacity. This Delegated Regulation ensures a level playing field among all institutions in the internal market and provides legal and financial certainty.

Moreover, pursuant to Article 2(2) of Directive 2014/59/EU, the Commission is empowered to adopt delegated acts to specify the criteria for the determination of the "critical functions" and "core business lines" relating to a possible resolution.

It should be recalled that the continuity of critical functions of the institution under resolution is one of the main resolution objectives. It aims at safeguarding financial stability and the real economy and therefore plays a key role in the recovery and resolution planning process. Core business lines play also an important role in recovery and resolution planning. Moreover, identification of critical functions is key in the context of application of bail-in since, pursuant to Article 44(3) of Directive 2014/59/EU, resolution authorities may exclude certain liabilities from bail in, and pass the losses on to other creditors, if the exclusion is strictly necessary and proportionate to achieve the continuity of critical functions.

This Delegated Regulation defines a critical function in essence as (i) being provided by an institution to third parties; (ii) whose failure would give rise to contagion or undermine the general confidence of market participants due to the systemic relevance of the function for the third parties and the systemic relevance of the institution or group in providing the function. A function is only likely to have a material impact on third parties if it cannot be substituted on comparable terms and within a reasonable timeframe. Core business lines are defined as business lines and associated services which represent material sources of revenue, profit or franchise value for an institution or for a group of which an institution forms part.

2. CONSULTATIONS PRIOR TO THE ADOPTION OF THE ACT

On 28 July 2014, the Commission requested the European Banking Authority (EBA) for technical advice on the empowerments under Articles 2(2) and 104(4) of Directive 2014/59/EU, based on Article 1(5) of Regulation (EU) No 1093/2010, under the EBA's task to provide opinions to the Union institutions.

The EBA Banking Stakeholder Group had the opportunity to comment on the advice. The EBA adopted the advice on the empowerment on 26 February 2015 (EBA/Op/2015/05¹ and EBA/Op/2015/06²).

The Commission drew closely from the EBA's technical advice in order to draft this Delegated Regulation. As regards the empowerment under Article 104(4) of Directive 2014/59/EU, the Commission did not follow the technical advice of EBA in one specific circumstance. In particular, EBA recommended taking into account macro-prudential indicators as well. However, Directive 2014/59/EU requires that decisions on the deferral of *ex-post* contributions are taken for individual institutions. Therefore, a methodology that uses indicators which reflect individual institutions' situations should be preferred, in order to measure the possible absolute impact of a due payment for each bank. As regards the empowerment under Article 2(2) of Directive 2014/59/EU, the Commission closely followed the technical advice of EBA.

On top of the participative nature of the EBA's process for the formulation of the technical advice, for the preparation of this Delegated Regulation the Commission also consulted experts in the 28th meeting of its Expert Group on Banking, Payments and Insurance on 24 June 2015. The Expert Group generally welcomed the preparatory work of the Commission for this Delegated Regulation and provided feedback to clarify the practical functioning of its forthcoming provisions and to ensure their effective applicability.

This Delegated Regulation does not involve new policy considerations beyond those of Directive 2014/59/EU.

¹ <http://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-05+Technical+Advice+on+critical+functions+and+core+business++++.pdf>

² <http://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-06+Technical+Advice+on+deferral+of+ex+post+contributions.pdf>

3. LEGAL ELEMENTS OF THE DELEGATED REGULATION

This Delegated Regulation covers in particular the following areas:

Chapter 1 contains the Common provisions.

Article 1 lays down the subject matter of this Delegated Regulation.

Article 2 lays down the applicable definitions.

Chapter 2 contains specific provisions on the Deferral of *ex-post* contributions.

Article 3 defines the circumstances and criteria according to which the extraordinary *ex-post* contributions can be partially or totally deferred by the resolution authority upon an institution's request.

Article 4 specifies the assessment to be conducted by the resolution authority of the impact of the deferral of the extraordinary *ex-post* contributions on the solvency of the requesting institution.

Article 5 specifies the assessment to be conducted by the resolution authority of the impact of the deferral of the extraordinary *ex-post* contributions on the liquidity of the requesting institution.

Chapter 3 contains specific provisions on the Criteria relating to the determination of critical functions and core business lines.

Article 6 specifies the criteria relating to the determination of critical functions.

Article 7 specifies the criteria relating to the determination of core business lines.

Chapter 4 contains the Final provisions.

Article 8 determines the date of entry into application of this Delegated Regulation.

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supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to the circumstances and conditions under which the payment of extraordinary *ex-post* contributions may be partially or entirely deferred, and on the criteria for the determination of the activities, services and operations with regard to critical functions, and for the determination of the business lines and associated services with regard to core business lines

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012 of the European Parliament and of the Council³, and in particular Article 2 (2), and Article 104 (4) thereof,

Whereas:

- (1) The deferral of extraordinary *ex-post* contributions, referred to in Article 104 of Directive 2014/59/EU, should be granted by the resolution authority upon an institution's request in order to facilitate the assessment by the resolution authority that that institution meets the conditions for the deferral set out in Article 104(3) of Directive 2014/59/EU. The concerned institution should provide any information deemed necessary by the resolution authority to conduct such assessment. The resolution authority should take into account all information available to the national competent authorities to avoid any duplication of notification requirements.
- (2) When assessing the impact of the payment of extraordinary *ex-post* contributions on the solvency or liquidity of the institution, the resolution authority should analyse the impact of the payment on the institution's capital and liquidity position. The analysis should assume a loss on the institution's balance sheet equal to the amount payable at the point in time when it is due and make a projection of the institution's capital ratios following this loss for an appropriate timeframe. Moreover, it should assume an outflow of funds equal to the amount payable at the point in time when it is due and should assess the liquidity risk.
- (3) Recovery and resolution plans require institutions and resolution authorities to be able to identify and ensure the continuance of critical functions of institutions or groups.
- (4) The continuity of critical functions of the institution under resolution is one of the main resolution objectives. It aims at safeguarding financial stability and the real economy and therefore plays a key role in the recovery and resolution planning

³ OJ L 173, 12.6.2014, p. 190.

process. Critical functions can include deposit taking, lending and loan services, payment, clearing, custody and settlement services, wholesale funding markets activities, and capital markets and investments activities.

- (5) Critical functions of an institution or group are set out in its recovery plan. The recovery plan should be assessed by the resolution authority and form the basis of the resolution plan. The resolution authority should conduct its own assessment of critical functions when establishing the resolution plan and should demonstrate how critical functions and core business lines could be legally and economically separated from other functions so as to ensure continuity upon the failure of the institution.
- (6) When assessing the resolvability of an institution, resolution authorities should take into account whether the chosen strategy ensures the continuity of critical functions, and whether the power to address or remove impediments to resolvability relates to critical functions. Similarly, in a bail-in scenario, liabilities could be exempted from the scope of the bail-in where the exclusion is strictly necessary and proportionate to achieve the continuity of critical functions. Critical functions also become relevant in the operation of a bridge bank tool since a bridge bank institution should maintain critical functions.
- (7) Critical functions should be identified in a two-step procedure: first, the institutions perform a self-assessment when establishing their recovery plans. Secondly, the resolution authorities critically review the recovery plans of the individual institutions to ensure consistency and coherence in the approaches used by banks. Since the resolution authorities benefit from the overarching view as to which functions are essential to maintain financial stability as a whole, they should take the final decision as regards the designation of critical functions for the purpose of resolution planning and execution.
- (8) Critical services should be the underlying operations, activities and services performed for one (dedicated services) or more business units or legal entities (shared services) within the group which are needed to provide one or more critical functions. Critical services can be performed by one or more entities (such as a separate legal entity or an internal unit) within the group (internal service) or be outsourced to an external provider (external service). A service should be considered critical where its disruption can present a serious impediment to, or completely prevent, the performance of critical functions as they are intrinsically linked to the critical functions that an institution performs for third parties. Their identification follows the identification of a critical function.
- (9) Institutions and resolution authorities should also identify the critical services in the recovery and resolution plans. To the extent that critical services are outsourced to third parties, the resolution authority should be able to limit its assessment to that which is necessary to verify whether the institution has an appropriate business continuity plan in place.
- (10) The determination of a service as critical should enable institutions to ensure the continued availability of those services by providing them through entities or units that are resilient in a failure, or establishing appropriate arrangements where they are supplied by an external provider.
- (11) The main difference between a critical function and a core business line lies in the impact of the activities concerned. While critical functions should be assessed from a perspective of their importance for the functioning of the real economy and financial

markets and therefore for financial stability as a whole, core business lines should be assessed on the basis of the importance for the institution itself such as the level of their contributions to revenues and profits of the institution.

- (12) Insofar as the recovery plan should contain a detailed description of the processes for determining the value and marketability of the core business lines, operations and assets of the institution, also the resolution plan should contain a mapping of the institution's critical operations and core business lines and a demonstration of how critical functions and core business lines could be legally and economically separated from other functions so as to ensure continuity upon the failure of the institution. In resolution, the continuity of critical functions and core business lines may justify an exemption of certain liabilities from the application of the bail-in tool and may also justify its transference to a bridge bank.
- (13) While core business lines are often linked to how much they contribute to the financial results of the institution, such an approach may not completely capture all core business lines because an institution may provide a service which is not directly profitable (or may even generate losses) but creates significant franchise value and is therefore important to its business as a whole,

HAS ADOPTED THIS REGULATION:

CHAPTER I

Common provisions

Article 1 *Subject matter*

This Regulation lays down rules specifying:

- (a) the circumstances and conditions under which the payment of extraordinary *ex-post* contributions may be partially or entirely deferred pursuant to Article 104(3) of Directive 2014/59/EU;
- (b) the criteria for the determination of the activities, services and operations referred to in point (35) of Article 2(1) of Directive 2014/59/EU;
- (c) the criteria for the determination of the business lines and associated services referred to in point (36) of Article 2(1) of Directive 2014/59/EU.

Those rules shall be applied by a resolution authority designated by a Member State in accordance with Article 3 of Directive 2014/59/EU.

Article 2 *Definitions*

For the purposes of this Regulation, the following definitions shall apply:

- (1) 'deferral period' means a period of up to six months;
- (2) 'function' means a structured set of activities, services or operations that are delivered by the institution or group to third parties irrespective from the internal organisation of the institution;
- (3) 'business line' means as a structured set of activities, processes or operations that are developed by the institution or group for third parties to achieve the organisation's goals.

CHAPTER II

Deferral of *ex-post* contributions

Article 3

*Deferral of extraordinary *ex-post* contributions*

- (1) The deferral of *ex-post* contributions referred to in Article 104(3) of Directive 2014/59/EU may be granted by the resolution authority upon an institution's request. That institution shall provide any information deemed necessary by the resolution authority to conduct the assessment of the impact of the payment of extraordinary *ex-post* contributions on its financial position. The resolution authority shall take into account all information available to the national competent authorities to establish whether that institution meets the conditions for deferral referred to in paragraph 3.
- (2) When determining whether that institution meets the conditions for deferral, the resolution authority shall assess the impact a payment of extraordinary *ex-post* contributions would have on the solvency and liquidity position of that institution. Where that institution is part of a group, the assessment shall also include the impact of solvency and liquidity of the group as a whole.
- (3) The resolution authority may defer payment of extraordinary *ex-post* contributions where it concludes that the payment results in any of the following:
 - (a) a likely breach, within the following six months, of the institution's minimum own funds requirements set out in Article 92 of Regulation 575/2013;
 - (b) a likely breach, within the following six months, of the institution's minimum liquidity coverage requirement set out in Article 412(1) of Regulation (EU) No 575/2013 and specified in Article 4 of the Commission Delegated Regulation (EU) 2015/61.
 - (c) a likely breach, within the following six months, of the institution's specific liquidity requirement set out in Article 105 of Directive 2013/36/EU.
- (4) The resolution authority shall limit the deferral period to the extent it is necessary to avoid risks to the financial position of that institution or its group. The resolution authority shall regularly monitor whether the conditions for the deferral referred to in paragraph 3 continue to apply during the deferral period.
- (5) Upon request of that institution, the resolution authority may renew the deferral period, where it determines that the conditions for the deferral referred to in paragraph 3 continue to apply. This renewal shall not exceed 6 months.

Article 4

Assessment of the impact of the deferral on solvency

- (1) The resolution authority shall assess the impact of the payment of extraordinary *ex-post* contributions on the institution's regulatory capital position. That assessment shall include an analysis of the impact the payment of extraordinary *ex-post*

contributions would have on the institution's compliance with the minimum own funds requirements set out in Article 92 of Regulation (EU) No 575/2013⁴.

- (2) For the purpose of this assessment, the amount of *ex-post* contributions shall be deducted from the institution's own funds position.
- (3) The analysis referred to in paragraph 1 shall cover at least the period up to the next reporting remittance date for the own funds requirement set out in Article 3 of Commission Implementing Regulation (EU) No 680/2014⁵.

Article 5

Assessment of the impact of deferral on liquidity

- (1) The resolution authority shall assess the impact of the payment of extraordinary *ex-post* contributions on the institution's liquidity position. That assessment shall include an analysis of the impact a payment of extraordinary *ex-post* contributions would have on the institution's ability to meet the liquidity coverage requirement provided for in Article 412(1) of Regulation (EU) No 575/2013 and specified in Article 4 of Commission Delegated Regulation (EU) 2015/61⁶.
- (2) For the purposes of the analysis described in paragraph 1, the resolution authority shall add a liquidity outflow, equal to 100% of the amount payable at the point in time when the payment of extraordinary *ex-post* contributions is due, to the calculation of net liquidity outflows as set out in Article 20(1) of Commission Delegated Regulation (EU) 2015/61.
- (3) The resolution authority shall also assess the impact of such outflow established under paragraph 2 on the specific liquidity requirements set out in Article 105 of Directive (EU) No 2013/36⁷.
- (4) The analysis referred to in paragraph 1 shall cover at least the period up to the next reporting remittance date for the liquidity coverage requirement set out in Article 3 of Commission Implementing Regulation (EU) No 680/2014.

⁴ Regulation (EU) No 575/2013 of the European Parliament and the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, (OJ L 176, 27.6.2013, p. 1).

⁵ Commission Implementing Regulation (EU) No 680/2014 of 16 April 2014 laying down implementing technical standards with regard to supervisory reporting of institutions according to Regulation (EU) No 575/2013 of the European Parliament and of the Council, (OJ L 191, 28.6.2014, p. 1).

⁶ Commission Delegated Regulation (EU) 2015/61 of 10 October 2014 to supplement Regulation (EU) No 575/2013 of the European Parliament and the Council with regard to liquidity coverage requirement for Credit Institutions, (OJ L 11, 17.1.2015, p. 1).

⁷ Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, (OJ L 176, 27.6.2013, p. 338.)

CHAPTER III

Criteria relating to the determination of critical functions and core business lines

Article 6

Criteria relating to the determination of critical functions

- (1) A function shall be considered critical, where it fulfils both of the following:
 - (a) the function is provided by an institution to third parties not affiliated to the institution or group; and
 - (b) the sudden disruption of that function would likely have a material negative impact on the third parties, give rise to contagion or undermine the general confidence of market participants due to the systemic relevance of the function for the third parties and the systemic relevance of the institution or group in providing the function.
- (2) When assessing the material negative impact on third parties, the systemic relevance of the function for third parties and the systemic relevance of the institution or group providing the function, the institution and the resolution authority shall take into account the size, market share, external and internal interconnectedness, complexity, and cross-border activities of the institution or group.

The assessment criteria for the impact on third parties shall include at least the following elements:

- (a) the nature and reach of the activity, the global, national or regional reach, volume and number of transactions; the number of customers and counterparties; the number of customers for which the institution is the only or principal banking partner.
 - (b) the relevance of the institution, on a local, regional, national or European level, as appropriate for the market concerned. The relevance of the institution may be assessed on the basis of the market share, the interconnectedness, the complexity and cross border activities.
 - (c) the nature of the customers and stakeholders affected by the function, such as but not limited to retail customers, corporate customers, interbank customers, central clearing houses and public entities.
 - (d) the potential disruption of the function on markets, infrastructures, customers and public services. In particular, the assessment may include the effect on the liquidity of markets concerned, the impact and extent of disruption to customer business, and short-term liquidity needs; the perceptibility to counterparties, customers and the public; the capacity and speed of customer reaction; the relevance to the functioning of other markets; the effect on the liquidity, operations, structure of another market; the effect on other counterparties related to the main customers and the interrelation of the function with other services.
- (3) A function that is essential to the real economy and financial markets shall be considered substitutable where it can be replaced in an acceptable manner and within

a reasonable timeframe thereby avoiding systemic problems for the real economy and the financial markets.

When assessing the substitutability of a function the following criteria shall be taken into account:

- (a) the structure of the market for that function and the availability of substitute providers;
 - (b) the ability of other providers in terms of capacity, the requirements for performing the function, and potential barriers to entry or expansion;
 - (c) the incentive of other providers to take on these activities;
 - (d) the time required by users of the service to move to the new service provider and costs of that move, the time required for other competitors to take over the functions and whether that time is sufficient to prevent significant disruption depending on the type of service.
- (4) A service is considered critical where its disruption can present a serious impediment to, or prevent the performance of, one or more critical functions. A service is not considered critical where it can be provided by another provider within a reasonable timeframe to a comparable extent as regards its object, quality and cost.
- (5) The disruption of functions or services shall consist in functions and services that are no longer provided to a comparable extent, under comparable conditions and of comparable quality, unless the change in providing the function or service concerned takes place in an orderly manner.

Article 7

Criteria relating to the determination of core business lines

- (1) Business lines and associated services which represent material sources of revenue, profit or franchise value for an institution or for a group of which an institution forms part shall be considered core business lines.
- (2) Core business lines shall be identified on the basis of an institution's internal organisation, its corporate strategy and how much those core business lines contribute to the financial results of the institution. Indicators of core business lines include, but are not limited to, the following:
 - (a) revenues generated by the core business line as percentage of overall revenues;
 - (b) profit generated by the core business line as percentage of overall profit;
 - (c) return on capital or assets;
 - (d) total assets, revenue and earnings;
 - (e) the customer base, geographic footprint, brand and operational synergies of the business with other group businesses;
 - (f) impact of ceasing the core business line on costs and earnings, where it is a source of funding or liquidity;
 - (g) the growth outlook of the core business line;
 - (h) the attractiveness of the business to competitors as a potential acquisition;
 - (i) market potential and franchise value.

Future expected revenues, growth outlooks and franchise value may be considered in the identification of a core business line where they are supported by plausible, evidenced projections setting out the assumptions on which they are based.

- (3) Core business lines may rely on activities which do not by themselves generate direct profit for the institution, but which support core business lines of the institution thereby contributing indirectly to the institution's profits.

CHAPTER IV

Final provisions

Article 8 *Entry into force*

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the Commission
The President
Jean-Claude JUNCKER