"Early Intervention Measures under CRD IV, the SSM and SRM regulations (conditions for the application of both) and the early intervention phase under the SRM regulation"

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Presentation

- Purpose of Early Intervention (EI) Measures
- Enhanced Supervisory Measures and EI Measures: Triggers & Tools
- EBA Guidelines on Triggers for use of EI Measures
- Interference with Shareholders' Rights

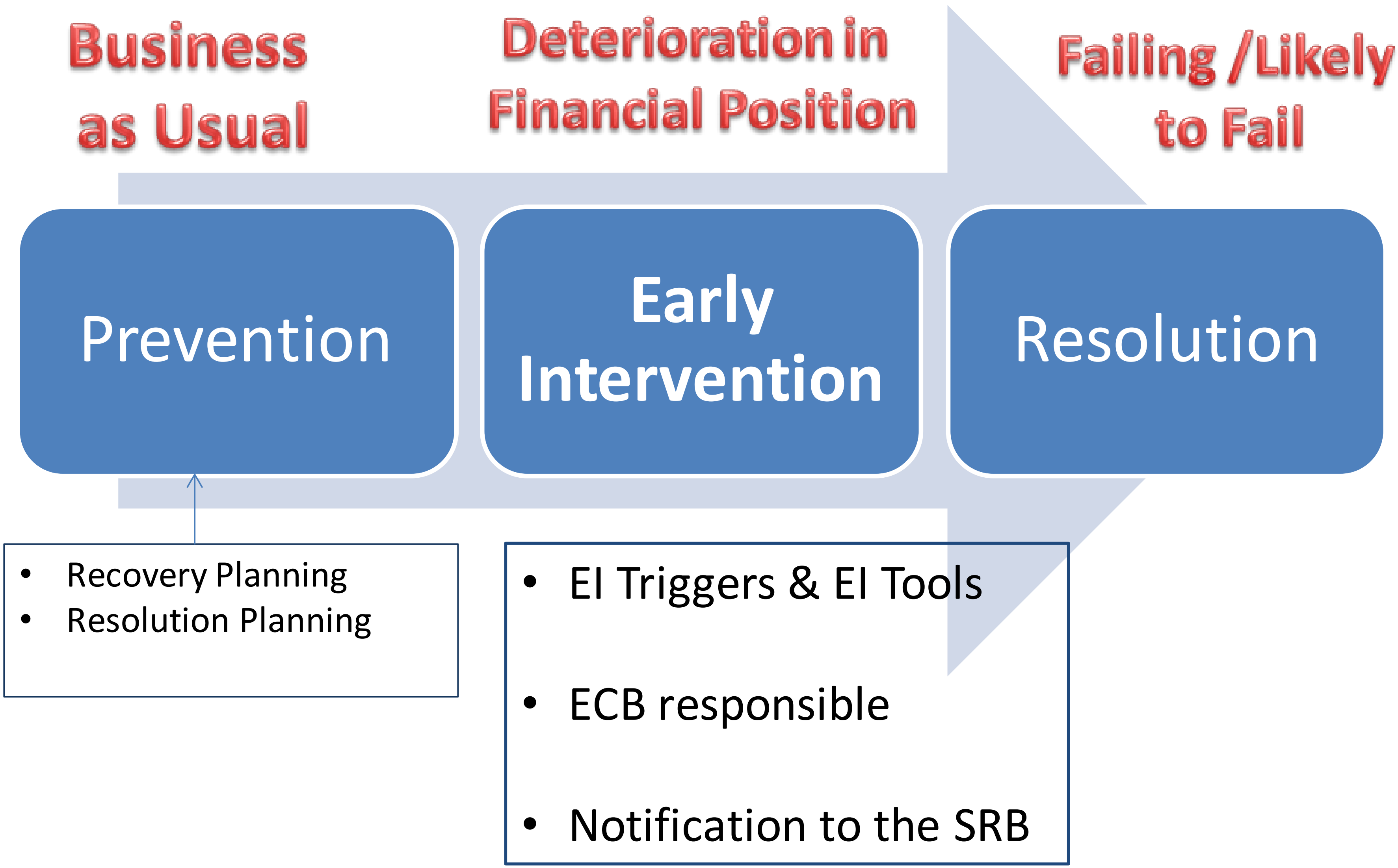
Early Intervention - Theory

- EI serves "to prevent an identified weakness from developing into a threat to safety and soundness" (Basel Committee on Banking Supervision, *Core Principles for Effective Banking Supervision)*
- Avoids hidden deterioration in conditions which could magnify the cost of eventual resolution
- Recognises economic agents operate under distorted incentives

- "The nature and size of the problems should be recognised early and intervention should follow quickly." (Borio, Vale and von Peter, 2010)
- "Policy makers need flexibility to head off systemic risk in time to avert disaster." (Tucker, Bank of England and Dombret, Bundesbank, 2012)

Three Phases of Bank Crisis Management

for Significant Institutions



CRD IV (Directive 2013/36)

Triggers (Art.102(1))

- Not meeting requirements of CRDIV
- CA's have evidence of likely breach within 12 months

Supervisory Measures (Art.104)

- Increase own funds
- Reinforce internal capital strategies, internal governance arrangements and recovery and resolution plans
- Plan to restore compliance
- Apply a specific provisioning policy
- Restrict operations or divest risky activities
- Reduce risk in activities, products and systems
- Limit variable payment revenues
- Use net profits to strengthen own funds
- Restrict/prohibit distributions or interest payments
- Increase reporting requirements
- Impose liquidity requirements
- Require additional disclosure

SSM Regulation 1024/2013

Triggers (Art.16(1))

- Not meeting requirements of EU/National law
- ECB have evidence of likely breach within 12 months
- A Determination in the supervisory review framework that the bank's arrangements, strategies, processes and mechanisms and its own funds and liquidity do not ensure a sound management and coverage of its risks

Supervisory Powers (Art.16(2)

- Increase own funds
- Reinforce internal capital strategies, internal governance arrangements and recovery and resolution plans
- Plan to restore compliance
- Apply a specific provisioning policy
- Restrict operations or divest risky activities
- Reduce risk in activities, products and systems
- Limit variable payment revenues
- Use net profits to strengthen own funds
- Restrict/prohibit distributions or interest payments
- Increase reporting requirements
- Impose liquidity requirements
- Require additional disclosure
- <u>To remove at any time members from the bank's management body who do not fulfil their statutory requirements</u>

BRRD (2014/59)

Triggers (Art.27(1))

- Bank infringes requirements of CRDIV, MiFID II or MiFIR
- Is likely to do so in the near future (due inter alia to 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

BRRD (2014/59)

Early intervention Measures (Art 27(1))

- Require board to implement measures in the recovery plan / to update the recovery plan
- Require board to examine the situation, identify solutions to identified problems and draw up an action plan
- Require board to convene a shareholders' meeting, set agenda and require certain decisions to be considered by shareholders
- Require removal of board members / senior management if unfit per CRDIV/MiFID
- Require board to draw up a plan to negotiate debt restructuring according to the recovery plan
- Require changes to Bank's business strategy
- Require changes to bank's legal or operational structures
- Acquire and provide information to the resolution authority in order to update its resolution plan

- Removal of entire board or management (Art.28)
- Appointment of a temporary administrator (Art.29)

EBA Guidelines on BRRD EI Triggers

1. Overall SREP Score and combinations of overall SREP scores and score for individual elements
2. Material changes/anomalies in monitoring of key indicators under SREP
3. Significant events indicating EI conditions are met

- Focus is on consistent application of the triggers
- Mixture of Qualitative and Quantitative Frameworks
- Triggers do not create an automatic application of EI measures

Early-warning" Literature

- Seeking to predict banking failures eg Demyanyk and Hasan (2009), Haq and Heaney (2012) and Miles et al. (2013)
- Measuring optimal early-warning signals for policymakers eg Betz et al. (2013), Goodhart and Segoviano (2015) and Damian (2016)

EBA Guidelines (continued)

Stakeholder Concerns

- Ongoing dialogue is fundamental between the institution and the competent authority
- Clear governance procedures and communications between the supervisory authority and the resolution authority.
- Prime responsibility of bank management to ensure recovery from key events
- EI should be the last resort before taking any resolution action – produced not too early in the recovery process or too late such that it reduced to a pre-resolution phase.

Article 13 SRMR (Regulation 806/2014)

- ECB or NCA must inform SRB of any EI measure they require the bank or group to take or they take pursuant to SSM Regulation, BRRD or CRDIV.
- SRB may prepare for the resolution
- SRB can require the bank or parent to contact potential purchasers
- SRB can require national resolution authority to draft a preliminary resolution scheme for the bank or group
- Must ensure consistency between any additional early intervention measures by ECB or NCA and any action by SRB aimed at preparing for resolution

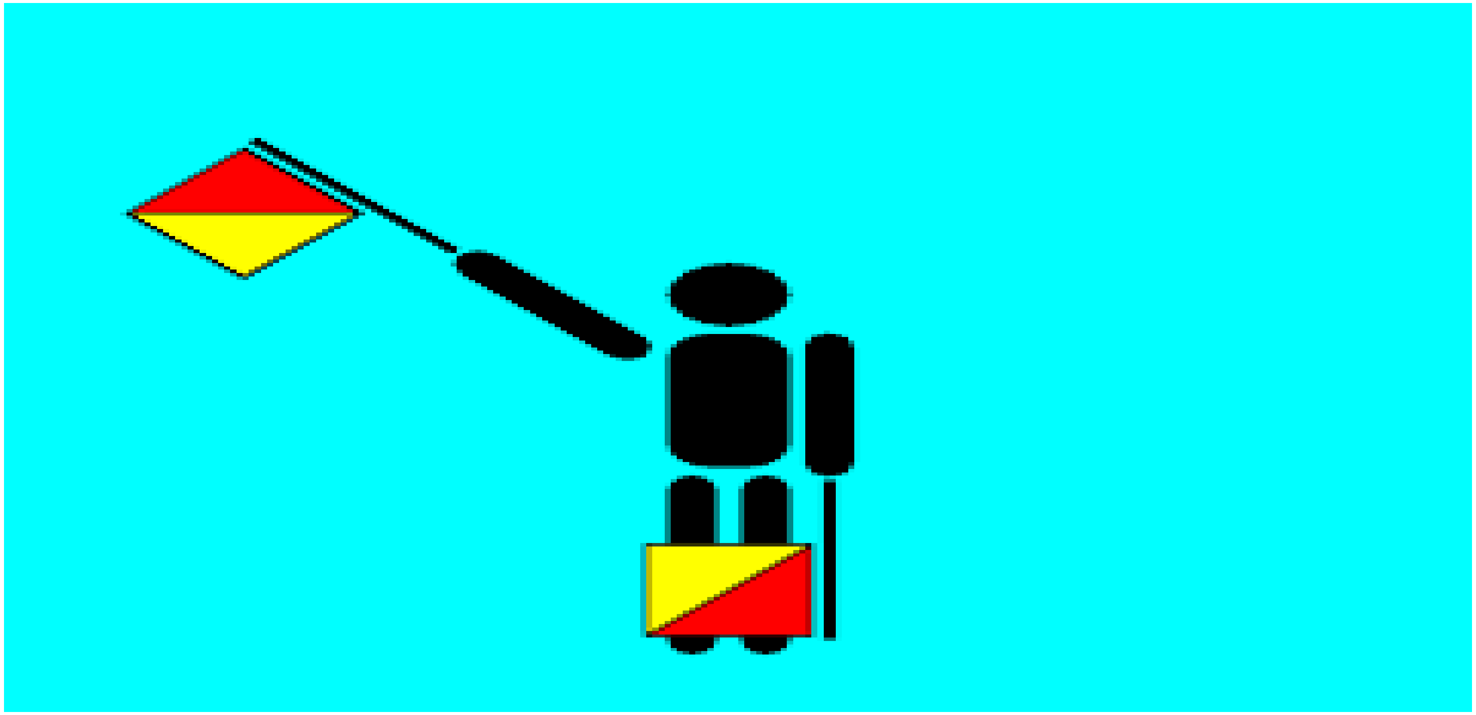
- SRB must notify the Commission

How can consistency between the EI measures as listed in Article 27 of the BRRD and those already envisaged in Article 104 of CRD IV be ensured, in particular taking into account that the triggers for these measures are partially different?

- There is no contradiction between the two sets of measures mentioned in Article 27 of BRRD and those already envisaged in Article 104 of CRD IV
- The powers available under Article 27 do not preclude the use of powers under Article 104 . Both can coexist, and give a wider range of power to the supervisory authorities, keeping in mind proportionality: therefore, once a measure is imposed, subsequent measures could complement, but not duplicate it.
- Regarding the triggers mentioned, Article 27 was aligned with the language in CRD IV so that the trigger is that the institution "infringes or […] is likely in the near future to infringe the requirements" of Regulation (EU) No 575/2013 (CRR) / Directive 2013/36/EU (CRD IV).

EBA, Single Rule Book Q&A

Early Intervention



Is Interference with Shareholders Rights Justified ?

- Separation of ownership and control
- Agency costs
- Monitoring by shareholders made harder due to complexity of business and the confidentiality and quantity of information
- Shareholder approval processes might make quick restructuring impossible and create uncertainty

- At prevention stage – shareholders retain their rights but their governance rights can be modified based on pre-defined contingency plans, by suspension/restriction or by appointment of an administrator

Dowling and others C-41/15 (December 2016)

- Irish Life and Permanent bank wholly owned subsidiary ILPGH
- Irish Central Bank following a PLAR and PCAR exercise of Irish banks ordered bank to raise €4bn
- High Court directed ILPGH under national legislation to issue new shares to the Ministry for Finance (heavily discounted) giving it 99% of share capital without shareholder approval
- ECJ said protection of shareholders and creditors enshrined in Second Company Law Directive does not apply to national measures adopted where there is a serious disturbance of the economy and the financial system of a MS derived from the capital shortfall that threatens EU financial stability

- Followed *Kotnik and Others* C-526/14
- Distinguished *Pafitis* C-441/93

Final Remarks

- EI measures demonstrate increasing intrusiveness of the supervisory authorities as risk exposures increase and bank approaches insolvency
- Gradual erosion of shareholders' rights at the same time
- Likely to lead to increased judicial and political scrutiny