



Brussels, 8 July 2014

Terms of Reference
Applicable rules on addressing capital shortfalls and burden sharing in the context of the Asset Quality Reviews and Stress Tests

As agreed between the Representatives of the Governments of the Member States, meeting in the margins of the Ecofin Council on 8th July 2014.

1. Building on the November 2013 Ecofin statement, the current Terms of Reference aim at setting out a common understanding on process, principles on addressing capital shortfalls and **applicable rules for burden sharing** in the light of the outcome of the European Central Bank's comprehensive assessment and the EBA EU wide stress test, the results of which are to be published in the autumn of this year.
2. In accordance with the November Ecofin statement, the first port of call to address capital shortfalls is **private sources**. There is broad agreement that supervisors should encourage banks that may need capital to benefit from the current benign climate and tap the market before the results of the comprehensive assessment are released. Several banks have already done so and an appropriate communication to encourage further capital-raising or other capital-generating measures will be undertaken in advance of the publication of the stress test results.

3. If the bank meets any of the early intervention triggers¹, it will be up to the competent **supervisory authorities** to require the banks to take the initial steps to address any negative results of the AQR/stress test (which may include early intervention). The authorities have a wide range of powers under the Capital Requirements Regulation and Directive (CRR/CRD IV)² as well as under the Bank Recovery and Resolution Directive (BRRD), which must be implemented in national law by December 2014 and will apply from January 2015.
4. It will also be up to the competent authorities³ or, where applicable, resolution authorities⁴, to determine whether an institution is failing or is likely to fail, when the pre-conditions required by the law are met. The determination by resolution authorities⁵ that there is no reasonable prospect that any alternative private sector or supervisory action would prevent its failure within a reasonable time-frame will be made in close cooperation with competent authorities.
5. The publication of the Asset Quality Review (AQR) and the stress test (ST) results is planned for October 2014. Capital shortfalls identified in the AQR/ST will need to be covered within 6-9 months, starting from the release of the results in October 2014. It is thus most likely that by the time any initial recapitalisation plans have been prepared and analysed, the **BRRD**⁶ will be applicable. The BRRD will form the regulatory framework governing the preparation of recovery and resolution plans, as well as early intervention powers for supervisors, which are to complement those already provided under CRR/CRD IV, and contain powers to write-down and convert capital instruments once the necessary triggering conditions, as set out in the BRRD, are met.

1 Article 27(1). These triggers may, for instance, include breach or likely breach of the institution's own funds requirement plus 1,5 percentage points, and once met, may require the management body of the institution to take action, including for instance by changing the business strategy or by implementing one or more of the arrangements or measures set out in the recovery plan.

2 Articles 102 and 104 together with Article 97

3 In the case of the SSM, the ECB or the NCAs depending on the cases.

4 In the case of the SRM, the SRB from 1 January 2016.

5 In the case of the SRM, the SRB.

6 Initially without and, from January 2016 at the latest, with the bail-in tool.

6. If at any moment - independently from the communication of the results of the AQR/stress test exercise to the banks and their disclosure - there were to be an assessment by the supervisor that a bank is not respecting minimum capital requirements under CRR, early remedial actions by the supervisors could restore the bank to viability using intervention powers already available under the CRR/CRD IV. In case remedial action in the form of private recapitalisation does not remedy the capital shortfall, and the conditions for resolution are met, the relevant authority in accordance with national law can decide to put the bank in resolution should Member States already have national resolution regimes in place in advance of the BRRD implementation deadline. If the supervisor concludes that material changes in asset valuations are needed, due to accounting irregularities or where the bank is not respecting minimum capital requirements, this needs to be promptly communicated to the bank. Under these circumstances, the bank will be under the obligation to disclose the findings and possibly restate the accounts.
7. Should any public capital injection be considered at that point in time, it would always be subject to the **State aid rules** as set out in the **2013 Banking Communication** which, as a general rule, requires burden sharing from shareholders and junior debt holders before any public support in the form of recapitalisation or asset protection is given to an entity. Burden sharing rules as required under State aid rules and under the BRRD have been designed in line with fundamental rights, including the NCWO⁷ principle, and with financial stability concerns in mind. They will be implemented accordingly under State Aid rules. Exceptions will be possible only when the implementation of writing down or conversion of junior debt holders would lead to disproportionate results or would endanger financial stability⁸. The decision in this regard will be taken by the Commission on a case-by-case basis.

⁷ No creditor worse off principle, i.e. subordinated creditors should not receive less in economic terms than what their instrument would have been worth if no State aid were to be granted.

⁸ Paragraphs 45 of the 2013 Banking Communication.

8. **Public recapitalisations** should be the exception rather than the norm and be used only when strictly necessary to remedy a serious disturbance in the economy of a Member State and preserve financial stability. From January 2015 the use of public funds would imply that an institution is deemed to be failing or likely to fail and would lead to resolution, except for precautionary public recapitalisations that meet all the conditions of the BRRD⁹. These precautionary recapitalisations will not trigger resolution and will be conditional on the final approval under State aid rules, including the presentation of a restructuring plan and burden sharing, thus ensuring a level playing field¹⁰. In summary, competent supervisors or, where applicable, resolution authorities will be responsible for determining whether an institution is failing or likely to fail, within the framework set by the BRRD. In case of State aid, its compatibility with the State Aid Framework as well as its compatibility with primary and secondary EU law will be assessed by the European Commission.
9. In accordance with the **November Ecofin statement**, all Member States will ensure that the necessary tools will be in place, including changes to national legislation, as appropriate, enabling them to proceed with required burden sharing under State aid rules and under the BRRD as soon as possible.
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⁹ BRRD, Art. 32 (4)(d).

¹⁰ BRRD, Art. 32(4)(d) provides that in each of the cases mentioned in points (i), (ii) and (iii) of said Article the guarantee or equivalent measures referred to therein shall be confined to solvent institutions and shall be conditional on final approval under State aid rules. Art. 32(4)(d)(iii) BRRD further provides that these measures shall be of a precautionary and temporary nature and shall be proportionate to remedy the consequences of the serious disturbance and shall not be used to offset losses that the institution has incurred or is likely to incur in the near future. Support measures under point (iii) shall be limited to injections necessary to address capital shortfalls established in the national, Union or SSM-wide stress tests, asset quality reviews or equivalent exercises conducted by the ECB, EBA or national authorities, where applicable, confirmed by the competent authority