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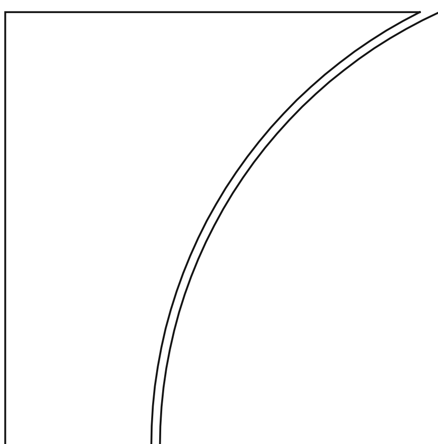

Early intervention regimes for weak banks

By Jean-Philippe Svoronos

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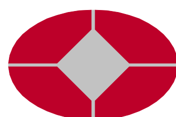

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Early intervention regimes for weak banks[1]

Executive summary

Prudential authorities conduct early interventions with the aim of prompting banks to address their weaknesses in a timely way. Early supervisory interventions are normally authorised under regular supervisory powers, which generally allow for a significant amount of discretion and scope for supervisory judgment. Some jurisdictions have set up more formal early intervention regimes that help supervisors directly address banks' weaknesses and trigger effective action when specific conditions are met. As they limit the degree of discretion allowed to supervisors, these regimes also reduce the risk of supervisory forbearance. The first formal early intervention regime was Prompt Corrective Action (PCA) introduced by the United States in 1991. The most recent is the European Union's Early Intervention Measures (EIM), introduced in 2014.

Formal early intervention regimes differ across jurisdictions. The main differences relate to the indicators used to trigger early interventions, any categories or steps within the formal early intervention regime, and the range of powers and the degree of discretion allowed to supervisors when deciding to activate the early intervention regime. For instance, PCA relies solely on capital triggers whereas the EIM regime considers composite indicators, such as supervisory ratings and events deemed significant by the supervisory authority. PCA mandates intervention once the triggers are breached and prescribes the measures to be taken, whereas the EIM only obliges supervisors to take an explicit decision on whether to intervene and gives them considerable flexibility in selecting intervention tools. Regimes in India, Japan, Peru, the Philippines and other countries have features that lie somewhere between these two examples.

There are trade-offs to consider when setting the triggers for a formal intervention framework. Capital-based triggers are based on relatively simple, transparent and harmonised bank solvency indicators. Such triggers are explicit and make for an internally consistent framework. However, capital is often a backward-looking indicator of bank weaknesses. Other, more forward looking, indicators may lead to more timely action but are less transparent and objective, potentially raising consistency issues and litigation risks. Nevertheless, more recent formal early intervention regimes and most recently revised regimes tend to make more use of composite "early warning" indicators including supervisory ratings.

Similar trade-offs apply to supervisory action when triggers are hit. The obligation to take specified measures may reduce the risk of forbearance and ensure a timely response. But, by reducing or removing supervisory discretion, such a requirement can limit supervisors' scope for adjusting their intervention to avoid putting unnecessary stress on the institution and for selecting the most appropriate measures. When formal early interventions are disclosed to market participants and customers, this lack of flexibility can have unintended consequences.

While formal intervention regimes cannot replace discretionary interventions based on regular supervisory powers, they provide useful backstops. They can be particularly effective when measures are required – such as the replacement of a whole management team or board of directors –

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that may not be enforceable under regular supervisory powers. At a minimum, the obligation to activate one of these formal regimes constitutes a credible threat for weak institutions, thus bolstering the effectiveness of regular supervisory measures.

Section 1: Introduction

1. **Early supervisory interventions prompt banks to address their weaknesses in a timely fashion.** The purpose is either to put banks back on a sound footing or to mitigate the consequences of a failure. This can mean reducing the cost to the deposit insurance scheme and to public finances, or limiting the spill over effects to the wider economy through a timely and orderly resolution. Authorities need to intervene forcefully and early enough for the problem bank to take the necessary corrective measures. Conceptually, three levels of intervention are possible, depending on their timing.

2. **Interventions at or before the point of bank failure aim to close distressed or insolvent institutions with as little disruption as possible.** In practice, as a bank starts to fail, deposits run, its franchise value crumbles, and its market value falls to zero or below. Intervention at this stage may often be too late to restore trust in the institution and to find a buyer. Typically, such a bank has little if any capital left to absorb losses. It may have to be closed, with losses being absorbed by subordinated debt holders, senior debt holders and, ultimately, the deposit insurance scheme if the failed bank's assets are insufficient.

3. **Interventions when the bank's minimum capital requirements are breached have two purposes.** The first is to limit losses, should the bank ultimately fail, by taking action at an earlier stage, when the bank may still have some capital left. The second is to increase the chance of restoring the bank to health. However, successful recovery plans often require radical surgery, because they typically include the need to bring in a new management team and/or a new board of directors, devise a new business plan and restructure activities. In practice, these measures may prove to be unfeasible or insufficient to restore customer and investor confidence.

4. **Supervisors can also take action before the bank's minimum capital requirements are breached.** By acting pre-emptively, after identifying and assessing the troubled institution's vulnerabilities, the supervisor requires it to take appropriate remedial action. The importance of intervention at this earlier stage has grown over time, as customers and investors become increasingly sensitive to any sign of bank vulnerability. This is due largely to the perception that banks have strong incentives to delay loss recognition in their financial statements. Such distrust feeds on banks' vulnerabilities and may potentially destabilise them.

5. **Supervisory authorities generally have ample discretionary powers.** Supervisors are expected to use judgment when imposing measures aimed at strengthening a bank. This is achieved by requiring the bank to take specific remedial action and/or by limiting the scope for management decisions that might lead to further deterioration. However, supervisory forbearance can arise when interventions based on discretion do not take place or, more frequently, when they are untimely or ineffective in addressing a bank's vulnerabilities.

6. **Some formal early intervention regimes mandate and define supervisory actions.**[2] One of the main rationales is to help supervisors enforce corrective measures. In doing so, such regimes also reduce the risk of supervisory forbearance. They provide authorities with both the triggers for intervention and intervention measures that are transparent and disclosed in advance to market participants, therefore mitigating moral hazard and reducing market uncertainty. These formal regimes require a series of specific supervisory measures to be at least considered or even imposed on banks when these meet certain prescribed conditions. Formal supervisory intervention regimes differ across jurisdictions in several respects. These include the definition of the triggers for intervention, the suite of measures envisaged and the degree of discretion left to the supervisor to decide when and how to intervene after triggers are hit.

7. **This paper analyses a range of early intervention regimes.** In particular it assesses how regular supervisory activity interacts with formal early intervention. It also analyses formal regimes in the European Union, India, Japan, Peru, the Philippines and the United States. In particular, the paper compares the triggers used and their consequences for the activation of formal intervention regimes and the supervisory powers available under the respective regimes.

8. **The paper is based on publicly available information supplemented by interviews.** The underlying information includes banking acts, regulations and statements from authorities on how they use their powers. The reports used are those published after the Great Financial Crisis (GFC) that relate to the Prompt Corrective Action (PCA) framework in the United States and the Early Intervention Measures (EIM) regime in the European Union. Feedback from representatives of the respective agencies has helped to clarify practices.

9. **The remainder of the paper is structured as follows.** Section 2 presents the general framework for supervisory interventions and introduces the two main forms that it may take: regular intervention regimes, which exist everywhere, and the formal intervention regimes introduced in some jurisdictions following banking crises. Section 3 compares the indicators used to trigger formal intervention regimes. Section 4 reviews the intervention powers associated with these regimes and the degrees of supervisory discretion. Section 5 concludes. An annex provides an overview of the six formal intervention regimes analysed in the paper.

Section 2: General framework for supervisory intervention

Types of supervisory intervention

10. **Conceptually, supervisory interventions can take place under either regular supervisory frameworks or formal intervention regimes.** In the first case, supervisors make use of their regular powers to take action based on their own judgment and following high-level principles as stated in their mandates.[3] In the second case, possible actions by the supervisor are derived from specific legal or

[2] For the purpose of this study, early supervisory interventions based on judgment and discretionary powers will be termed "regular supervisory intervention" while discretionary powers will also be termed "regular supervisory powers". Exceptional or mandatory intervention regimes and the mandatory powers and triggers associated with them will be termed "formal early intervention regimes", "formal supervisory powers" (or "formal powers") and "formal triggers", respectively. However, and as further developed in the paper, all mandatory regimes, even the most prescriptive ones, include some degree of flexibility and discretion that allows supervisory authorities to tailor their interventions.

[3] BCBS (2018) describes the range of practices and presents frameworks for early supervisory intervention using regular powers.

regulatory frameworks that specify the triggers for intervention and the set of measures to be used when such triggers are hit. The US Prompt Correction Action regime and the EIM in the European Union are two examples of formal regimes. This section compares the main characteristics of these two types of supervisory intervention. In practice, all jurisdictions combine rules and discretion, although in varying proportions.

Regular supervisory interventions

11. **Regular supervisory measures are an essential part of prudential oversight.** These measures are decided on the basis of regular on- and off-site supervision assessments, which are integrated through supervisory risk assessment systems. They imply the activation of regular supervisory powers on a discretionary basis when the supervisory authority determines that a bank's soundness[4] is at risk.

12. **Supervisory authorities have developed assessment systems that comprehensively classify banks according to multiple components.** Although these systems vary across jurisdictions, commonly assessed components include the bank's capital adequacy, exposure to credit, market, operational and liquidity risk, governance, risk management criteria and procedures and profitability.[5] Each component is rated separately, for instance on a scale from 1 (best) to 5 (worst). The combination of individual component ratings determines the bank's composite rating. The ratings are revised at least once a year.

13. **In practice, regular supervisory interventions begin with informal action (or "moral suasion").** Informal action aims at convincing the problem bank's management and/or its board of directors to correct deficiencies. These measures are often enough to address issues in a timely and efficient way. They are also discreet, as informal interventions are typically not disclosed.

14. **There is a wide range of practice regarding informal action.** These include recommendations, following up on-site examinations or off-site assessments that are addressed to a bank's board to prompt action that will meet supervisory expectations. A number of jurisdictions also use undisclosed memorandums of understanding (MoUs) signed between a bank's board and a supervisory agency. Nevertheless, in some cases, persuasion and informal measures are not enough.

15. **When its assessment determines that certain practices are "unsafe and unsound", the supervisory authority is expected to respond using its regular powers.** The legal basis for these powers is generally the respective banking act and the authority's mandate to ensure the safety and soundness of its banking system.

16. **Regular supervisory powers are typically discretionary.** Supervisory discretion can apply to: (i) a decision to adopt measures that will correct or constrain banks' management activity; (ii) the timing of the intervention; and (iii) the choice of the appropriate intervention tools. Regular powers include the ability to require banks to take specific action to address weaknesses or to prevent banks from taking decisions that may aggravate these weaknesses. These powers may include requesting additional information and reporting obligations (see box 1). As institutions have different risk profiles and supervision should be risk-based, supervisory interventions should be tailored to fit a bank's specific circumstances. The exercise of these powers reflects a trade-off. They provide supervisory authorities with

[4] The Basel *Core principles for effective banking supervision*, as revised in 2012, states that "the primary objective of banking supervision is to promote the safety and soundness of banks and of the banking system" (Principle 1, essential criterion 2).

[5] While this paragraph summarises features of the CAMELS rating system as used in the United States, the main components that are assessed for supervisory purposes are broadly comparable across jurisdictions. Specifically, the acronym CAMELS stands for Capital adequacy, Assets, Management capability, Earnings, Liquidity and Sensitivity to market risk.

more flexibility in tailoring interventions, but the measures that can be taken are generally less intrusive than those taken under a formal intervention regime.

17. **Reliance on professional judgment and discretion raises the risk of supervisory forbearance.** Supervisors may have incentives to delay the adoption of forceful measures, including the triggering of resolution procedures where banks are deemed unviable. Supervisory forbearance arises when authorities fear that more intrusive measures regarding a weak bank could contribute to further destabilising it. It may also be driven by attempts to deny that prudential policy is failing. Moreover, supervisors may be tempted to defer taking strong supervisory measures until any deterioration in banks' soundness can be used as evidence. In practice, supervisory forbearance is difficult to prevent in all cases as it often becomes apparent only in hindsight. Given the potential for extreme supervisory measures to generate stress in the affected institutions, and because of possible knock-on effects on other banks, some degree of gradualism may at times be justified.

Box 1

The toolkit: regular/discretionary supervisory powers[6]

The list below includes discretionary powers to require banks to take, or refrain from taking, certain measures to address weaknesses. The types of power are classified according to their impact on the bank's governance, its cash availability, its shareholders' rights and its operations and expansion.

Powers with an impact on governance:

- Requiring the bank to enhance governance, internal controls and risk management
- Require the replacement of individual managers or board members
- Requiring the bank to submit a plan to restore compliance with supervisory requirements
- Restricting compensation (including management fees and bonuses) to directors and senior executive officers or limiting it to a percentage of net revenues including consideration of possible claw-backs
- Requiring prior supervisory approval for major capital expenditure, material commitment or contingent liability

Powers with an impact on cash availability:

- Require the bank to hold capital and/or liquidity in excess of minimum requirements
- Requiring new borrowing/bond issuance and/or rollover of liabilities/secure line of credit (in particular to address liquidity and maturity transformation issues)
- Powers with an impact on shareholders' rights
- Prohibiting the distribution of dividends/payment of interest or other withdrawals to shareholders (including share buybacks) and/or requiring the use of net profits to strengthen capital
- Approving/rejecting (or recommending the approval or rejection to the responsible authority) and imposing prudential conditions on major acquisitions or investments of a bank against prescribed criteria (applying Core Principle 7)

Powers with an impact on bank operations and expansion:

- Requiring the bank to enhance/change capital and/or liquidity and strategic planning
- Imposing specific liquidity requirements (such as restrictions on mismatches)
- Imposing additional/more frequent reporting requirements
- Imposing additional disclosures
- Requiring the bank to restrict or limit any (or all) activities
- Requiring downsizing of operations and/or asset sales, including closure of domestic/foreign branches
- Requiring immediate/enhanced provisioning for assets of doubtful quality and for those not carried at fair value

[6] This classification is derived from the Basel Committee's *Guidelines for identifying and dealing with weak banks*, July 2015. The list of powers above includes only discretionary/regular powers including the power to approve/reject and submit to conditions major acquisitions (which comes from Core Principle 7 in the *Core principles for effective banking supervision*).

Formal early intervention regimes

18. **Enhancing supervisors' ability to address issues posed by weak banks is the main rationale for developing formal intervention regimes.** These early intervention regimes generally specify triggers for supervisory action. They also include a range of powers to be used and measures that the bank needs to implement once the triggers are hit. Key parts of these measures are capital restoration and/or recovery plans approved by the supervisory authority, often with prescribed measures, and deadlines for completing and reporting them. By limiting the scope for judgment and discretion in supervisory decisions, such regimes reduce the risk of forbearance.

19. **Formal intervention powers generally go beyond those available under the regular regime.** They may be more intrusive and far-reaching. For example, they may empower supervisors to remove and replace senior managers and/or board members. While discretionary powers generally allow for the removal of individuals based on "fit and proper" considerations, the ability to remove the entire senior management and/or the entire board of directors of a weak bank is generally only available under formal intervention powers, subject to specific conditions.

20. **The adoption of formal intervention regimes has typically followed banking crises characterised by the multiple failures of banks, many of which remained in business despite breaching regulatory requirements.** One of the first of these frameworks was the PCA regime introduced in the United States in 1991 after the savings and loans crisis. Since then, other formal intervention regimes have been introduced in Asia (eg in Chinese Taipei, India, Indonesia, Japan, Korea, the Philippines and Thailand), and in Latin America (eg in Chile, Mexico and Peru). In 2014, the European Union introduced its own formal framework for early intervention, as part of the Bank Resolution and Recovery Directive (BRRD).

21. **Such regimes increase the scope for bank recoveries by subjecting troubled banks that breach triggers to corrective action.** The general idea is to require the supervisor – once a trigger is hit – to take or, at least, to consider taking, pre-defined intervention measures that will improve the bank's management and profitability and/or constrain its activities and prevent its financial condition from worsening. Such measures include preventing asset growth, requiring reductions of exposures or seeking to reduce fixed costs and improve risk selection.

22. **The second aim of most formal early intervention regimes is to reduce any losses arising from bank failures.** This includes the need to prevent problem banks from "gambling for resurrection" through excessive risk-taking or too costly funding. Some of the powers under certain formal intervention regimes, such as the ability to prohibit a bank from paying interest that significantly exceeds market rates, specifically address these concerns.[7]

23. **Existing regimes vary considerably across jurisdictions.** The differences relate to the definition of the triggers used to activate intervention, the range of measures foreseen and the degree of discretion in choosing measures to apply to banks in the formal early intervention regime.

[7] This is the case under the US PCA framework, which empowers supervisors to prevent weak banks from compromising their profitability by obtaining funding regardless of cost in order to remain in business. The powers are exercised as soon as a bank enters PCA at the "adequately capitalised" level.

24. **Some of the oldest formal intervention regimes use minimum capital triggers.**[8] This is still the case in the United States, but also in Japan, where capital ratios are the only type of indicator used to trigger the formal intervention. Over time, some regimes have refined and/or added intervention triggers. Several regimes which still rely on capital triggers have updated and completed their suite of capital triggers. The PCA regime in the United States, for instance, currently uses three leverage ratios[9] among its triggers. The leverage ratio and PCA threshold depends upon the bank's size and complexity. Some regimes that originally used only capital triggers have introduced additional triggers related to asset quality. This was the case in a number of Asian jurisdictions following the Asian crisis. In more recently adopted or recently revised regimes, triggers may also include "early warning" indicators such as supervisory ratings. This is, for instance, the case in the Philippines and in the European Union's EIM regime. Different practices in relation to early intervention triggers are further reviewed in Section 3.

25. **There appears to be a relationship between the types of trigger and the level of discretion allowed in an intervention regime.** Regimes that focus solely on capital triggers, as in the United States or Japan, classify banks according to capital thresholds. Each level reflects a further deterioration in the bank's condition, and specifies increasingly harsh corrective measures. In regimes using a wider set of triggers, or which include both quantitative and qualitative variables, as in the European Union, the scope for supervisory discretion when determining early intervention measures tends to be greater.

26. **No formal intervention regime reviewed is entirely automatic.** At a minimum, supervisors have the discretion to select measures from a list of options provided in addition to the measures prescribed by each regime. This is particularly the case under the US PCA regime once a bank becomes significantly undercapitalised. It is also true under India's PCA framework where, in all cases, measures drawn from a "common menu" can be selected in addition to "mandatory actions". The issue of automaticity is further analysed in Section 4.

Formal versus regular intervention regimes

27. **In most cases, there is substantial overlap between powers available under regular supervision and those used under formal intervention regimes.** For instance, in the United States (and in a number of other regimes), a bank may be deemed unsafe and unsound by the supervisory authority because it operates with inadequate capital for the type and quality of assets it holds prior to becoming undercapitalised and subject to PCA measures. It may therefore be already subject to discretionary supervisory intervention and required to recapitalise and/or subject to restrictions to its activities. In the European Union, many of the powers available as EIM measures can also be used as part of a discretionary intervention, for example, in requiring a capital restoration or restricting a bank's activities.

28. **Most formal intervention regimes provide supervisory authorities with powers to remove the entire bank management and/or boards subject to specific conditions.** These harsher interventions are both explained and justified by the bank's more parlous financial position and dysfunctional governance. For instance, under the PCA framework, such removals can be decided by the supervisory authority once the PCA bank has become significantly undercapitalised. In other frameworks,

[8] However, some frameworks, for instance in Peru, also include triggers related to absolute levels of capital, with these deemed more pertinent for the smallest institutions. One trigger relates to the minimum capital amount that an applicant firm must comply with in order to acquire a banking license. Another trigger is the loss of more than a pre-determined percentage of the bank's total capital.

[9] These are the Tier 1 Leverage Ratio, the Supplementary Leverage Ratio (SLR) and the Enhanced Supplementary Leverage Ratio (eSLR). See also Table 4 in the Annex, which shows how the three ratios are set out.

such removals are subject to tests. These can be cumulative, as under the European Union's EIM framework, where removals require both: (i) a significant deterioration in the bank's financial condition or serious breaches in law or regulation; and (ii) a determination that other early intervention measures were not, and would not be, sufficient to address the bank's problems.

Removing/replacing management and/or board under formal intervention regimes — Table 1

Countries	United States	Peru	Japan	Philippines	India	European Union
Power to remove management and/or board	Yes, optional when bank significantly undercapitalised	Yes, and powers to suspend voting rights/require shareholding meeting	Yes, for violations in law, reg, bylaws, JFSA decisions or public interest harmed	Yes, as may be warranted	Yes, as part of common menu of measures	Yes, if: (a) significant deterioration in financial condition (b) breaches of law/regulations and EIM insufficient
Power to appoint administrator	Conservator or receiver if critically undercapitalised		Yes, PM order transferring management to financial reorganisation administrator (one-year mandate)	Yes, if grounds for conservator ship or receivership exist	Yes, power to supersede board under Section 36ACA of BR Act, 1949	Yes, if board or management removal insufficient (one-year maximum)

29. **All of the formal intervention regimes reviewed empower supervisory authorities to appoint a temporary (or provisional) administrator.** The usual goal of appointing a temporary administrator (or conservator) is generally not to close the bank and liquidate its assets, so as to pay off its liabilities. Rather, the aim is either to return the bank to normal operating conditions or to prepare it for a sale or a merger. To this effect, the temporary administrator typically replaces the bank's senior management and takes over the bank's day-to-day operations but the bank's ownership remains unchanged.

30. **While the conditions for appointing temporary administrators may vary, all frameworks emphasise that they are "last ditch" attempts to address a bank's problems prior to resolution.** This final effort is generally reflected in the conditions for such appointments. For instance, the US PCA framework requires a bank to be critically undercapitalised (the lowest level under PCA) for such a measure to be applied. The frameworks in the European Union and the Philippines require, respectively, the failure of a bank to submit to or to comply with a PCA plan and the finding that the removal of a bank's management or board are insufficient to address its problems.

31. **Mandates of temporary administrators are typically short and generally expire within one year.** That is the time limit foreseen in the European Union's EIM framework (which is, however, exceptionally renewable) and in Japan. In the US PCA regime, mandates are significantly shorter (90 days) but can be renewed (once or twice). In Peru, the supervisory authority can nominate an official whose mandate is limited by the 90-day term of the surveillance period.

32. **Supervisors generally prefer discretionary to formal intervention measures.** This preference is largely based on the fact that measures under formal early intervention regimes may need to be disclosed. Such disclosures have the potential to destabilise the institution by undermining confidence and possibly causing a bank run, thus frustrating the aim of the intervention. Even in the United States, where the activation of PCA follows rather automatic procedures and has been used hundreds of times, formal intervention is applied mainly to smaller banks. In practice, large and medium-size institutions have been subject to intensive and discretionary supervisory measures before the automatic PCA triggers were hit.

33. **Some advantages of formal intervention regimes can also be achieved under discretionary regimes when supervisory expectations are disclosed in advance.** One of the main potential advantages of formal intervention regimes is their greater predictability for market participants, given that they reduce the scope for supervisory discretion and may promote consistency of treatment. However, these advantages can also be cultivated under regular supervisory frameworks through the disclosure of supervisory expectations. This is the case in Canada, where the Office of the Superintendent of Financial Institutions (OSFI) publicly discloses its early intervention framework, which consists of the four "stages" of intervention set out in its *Guide to Intervention*. The Australian Prudential Regulation Authority (APRA) also discloses its four supervisory response and oversight "stances". Both frameworks outline the conditions for the intervention measures that are likely to take place.

34. **More generally, regular interventions can be more flexible, discreet and timely.** Regular interventions based on discretion and judgment allow supervisors to choose if and when to act. They allow more flexibility in picking the most appropriate action and timing, according to each institution's circumstances.

35. **Formal early intervention regimes serve as backstops to regular supervisory action in practice.** Formal intervention regimes, by somewhat constraining supervisory forbearance, complement regular supervisory measures and contribute to their effectiveness by constituting a credible threat. Their existence suggests that supervisors may resort to potentially more stringent measures – including the dismissal of senior management or of the board of directors – if regular measures do not restore a bank's soundness.

36. **Under both types of regime, there is a need to ensure the early involvement of resolution authorities when supervisors address weak banks.** This is because it conditions the timeliness of a bank's resolution. In particular, it needs to take place before all of the weak bank's equity is wiped out. For resolution powers to be exercised promptly and effectively, the resolution authority needs to be fully informed of the ailing bank's situation and of the supervisory authority's measures and intentions. This is typically achieved through regular exchanges of information and meetings. Early involvement is also critical for the deposit insurance fund – particularly when liquidation is the chosen strategy – so that it can conduct a preparatory examination of the bank's books and deposit liabilities before the resolution, and when it believes that a deposit insurance payment may be imminent.

37. **A number of supervisory regimes explicitly coordinate the interactions between supervisors and other financial authorities.** In Canada, OSFI's *Guide to Intervention* specifies the interactions and exchanges of information between OSFI and the Canada Deposit Insurance Corporation (CDIC). The European Union's BRRD includes similar provisions, with the supervisory authority required to notify the resolution authority when it determines that a credit institution has breached or is likely to breach a prudential requirement, or when it considers that the conditions for the application of EIM are met. The supervisor must then provide resolution authorities with all necessary information to update the resolution plan and to value the bank's assets and liabilities.

Section 3: Triggers for action in formal early intervention regimes

38. **The first set of components of a formal early intervention regime are the triggers that activate the regime.** These are indicators reflecting a bank's financial condition and/or its future prospects. When hit, the triggers activate procedures that lead to specified supervisory measures as envisaged under the formal early intervention regime. Traditionally, triggers have been based on standard solvency indicators although, more recently, composite triggers and more forward-looking approaches have been adopted in a number of jurisdictions.

Triggers for intervention: Features of selected formal intervention regimes[10] Table 2

Countries	United States	Peru	Japan	Philippines	India	European Union
Date (last revisions)	1991 (2013)	1996 (2009)	1998 (2012)	1998 (2006)	2002 (2017)	2014
Capital triggers	TCAR, Tier 1 R, CET1 R, Lev ratio, tangible equity ratio, SLR	Total capital ratio, < min cap amount, loss>40% of regulatory capital	TCAR, Tier 1 R, CET1 R	Minimum capital requirements TCAR, Tier 1 R, CET1 R, Lev Ratio	TCAR and CET1 R	Yes through anomalies in indicators and breach of thresholds
Asset quality-based triggers	No	No	No	No	Yes, net non-performing advances ratios (NNPA)	No
Ratings-based	No	No	No	Yes, composite CAMELS less than 3 or management component less than 3	No	Yes, composite SREP = 4 or combinations (composite 3, component 4)
Other triggers	No	Breaches violations of law, non-cooperative or fraudulent practices	No	Serious supervisory concern (higher than normal risk of failure)	Tier 1 leverage ratio and negative return on assets for two, three or four consecutive years	Material changes, anomalies in indicators, significant events

Capital triggers

39. **Several types of capital-based metrics are used as triggers in formal early intervention frameworks.** Mexico, the Philippines and the United States all use the three risk-based Basel III capital

[10] TCAR stands for total capital adequacy ratio, Tier 1 R for Tier 1 ratio, CET1 R for common equity Tier 1 ratio and Lev Ratio for leverage ratio. Min Cap amount refers to regulations establishing an absolute minimum capital amount for a firm to obtain and maintain a bank license. SREP stands for supervisory review and evaluation process.

ratios (CET1 ratio, Tier 1 ratio and total capital ratio). Some PCA frameworks – in Peru for instance – have yet to include the Basel III definition of capital, although they use total risk-based capital adequacy ratios as triggers. Mexico's capital trigger ratios include the capital conservation buffer, the countercyclical buffer and, where relevant, the surcharge applicable to systemically important banks (SIBs).[11] Most PCA frameworks also include minimum leverage ratio levels as triggers. The use and levels of leverage ratio triggers vary between regimes. For instance, India and the United States use several thresholds and assign each to a specific PCA category, while the Philippines uses a single threshold of 5%. Since January 2018 and the introduction of the SLR in the United States, the PCA framework takes into consideration the size and complexity of banks' operations. While smaller institutions remain subject to the original Tier 1 ratio, banks with balance sheets exceeding USD 250 billion are subject to the harsher SLR and Global Systemically Important Banks are subject to the eSLR, which better captures their derivative activities.

40. **Capital-based triggers directly link supervisory interventions to weak bank solvency.** Since capital is traditionally a bank's last line of defence, failure to meet certain capital thresholds raises concerns about the bank's viability, justifying supervisory intervention. Moreover, using a set of (relatively) simple, harmonised and internationally accepted risk-based and leveraged ratios is advantageous in terms of transparency, comparability and consistency of treatment. To the extent that capital-based triggers provide less scope for interpretation than qualitative assessments, they may deliver more certainty to all stakeholders. In addition, the obligation for the financial authorities to take action once triggers are hit also protects them from pressures to delay and from litigation.

41. **In practice, however, capital-based indicators are lagging indicators of banks' vulnerabilities.** Capital is a residual value representing the difference between the accounting values of assets and liabilities. The amount of capital held by a bank takes account only of already incurred losses as reflected in the bank's financial statements. In terms of current accounting standards, capital cannot fully reflect expected (and therefore future) loan losses on assets that are currently classified as performing, even when their underwriting is known to have been defective.

42. **Capital-based triggers may reinforce weak banks' incentives to inflate reported solvency.** In particular, problem banks have the strongest incentives to minimise loss recognition because of their condition. In addition, capital-based triggers may not fully reflect a bank's actual degree of solvency especially when regulatory capital may include elements that fail to absorb losses immediately and unconditionally, as seen during the GFC. At the time, high capital ratio levels at large international banks were misleading. Undercapitalisation at larger or medium-sized institutions was largely masked, went un-reflected in supervisory reports and thus did not trigger prompt corrective action.[12] For smaller institutions, a post-crisis official report in the United States concluded that "between 2008 and November 2010, 43% of 4-rated and 50% of 5-rated institutions supervised by the Federal Deposit Insurance Corporation (FDIC) required material amendments to their Call Reports" (the periodic – generally quarterly – financial and supervisory reporting to the relevant supervisory agency), illustrating to what extent reported regulatory ratios could be inflated.[13]

[11] One feature of Mexico's PCA regime is that the inclusion of the capital surcharge for D-SIBs as a part of the capital triggers essentially means that each D-SIB has specific PCA levels to comply with. In addition, these levels are publicly disclosed.

[12] For the purpose of this section, and by the US definition, smaller institutions are those with up to USD 10 billion in assets, medium-sized ones have assets of between USD 10 billion and USD 50 billion, and large institutions are those with assets of more than USD 50 billion.

[13] Office of Inspector General (2011), p 27.

43. **By the time a bank becomes undercapitalised, it may be too late for it to recover.** The same OIG (2011) report shows that from January 2006 to March 2010, some 489 banks and thrifts triggered PCA and became undercapitalised. Nearly 60% of these (291) had failed by March 2010 with these PCA banks representing about 90% of all failures (325) over the period. The report concludes that "once a bank's capital has deteriorated to the undercapitalised level, it may be too late for the bank to recover".[14]

44. **One way to mitigate the drawbacks of capital-based triggers may be to set them at levels that are significantly higher than the respective minimum capital requirements.** Most PCA frameworks have introduced such higher limits. For instance, the US PCA framework has done so since its inception and the revised triggers adopted following the introduction of Basel III in 2013 are even more conservative.[15] The PCA framework in the Philippines also set PCA triggers for the Tier 1 ratio (7.5%) and the CET1 ratio (6%) that are higher than international minimum capital requirements. However, while these higher thresholds do provide extra buffers, they do nothing to prevent banks from inflating their reported regulatory capital. They also fail to address all types of bank weakness.

Other triggers

45. **PCA triggers have been debated since the 1980s among academics and regulators**. Asset quality, asset growth and liquidity indicators have been often proposed as alternatives or as complements to capital-based ones. In the United States,[16] PCA's capital-based triggers have attracted criticism for not taking full advantage of early warning signs of bank distress because the triggers "lag behind other indicators of bank health".

46. **Asset quality indicators can provide useful complementary information.** This category includes measures for non-performing assets or for the coverage of distressed assets by provisions and/or collateral. Some jurisdictions (India and Indonesia, in particular) use both capital metrics and asset quality measures as intervention triggers, with the former also combining the non-performing asset measure with a return on asset measure. However, how accurately these measures are reported essentially depends upon the thoroughness and rigour of the problem bank's asset classifications, valuations and provisioning practices. As mentioned above, troubled banks have incentives to use "aggressive" valuations based on optimistic assumptions.

47. **Some jurisdictions have introduced broader sets of indicators to trigger intervention**. In Peru, chronic breaches of regulatory large exposure limits can trigger PCA, as can violations of law and of the bank's own statutes. Peru has also introduced a set of PCA triggers designed to address bank practices that can obstruct the efficiency of bank supervision or central bank operations. In the Philippines, the identification of a "serious supervisory concern" constitutes a trigger for intervention. In the European Union's EIM, "significant events", as defined and documented by the supervisory authority, indicate "that the conditions for early supervisory intervention are met".

[14] This quotation and the previous one are drawn from the Government Accountability Office (GAO) report to Congressional Committees, "Bank Regulation: Modified Prompt corrective Action Framework Would Improve Effectiveness", June 2011, p 23.

[15] The higher risk-based ratios thresholds for a bank to be deemed well capitalised under PCA in the United States were initially a Tier 1 ratio of 6% and a total capital ratio of 10%, where minimum requirements were respectively, of 4% and 8%.

[16] See for instance Jones and King (1995) and Peek and Rosengren (1996).

48. **Several jurisdictions use indicators derived from supervisory ratings as triggers of early intervention.** In particular, the European Banking Authority's (EBA) guidance on EIM[17] recommends using the overall SREP score as one of the triggers to formally consider the adoption of early intervention measures. That trigger is an overall score of 4 on a scale of 1 to 5 (fail). In addition, overall scores of 3 combined with a score of 4 for specific SREP components are also triggers.[18] The Philippines also uses overall and composite ratings as intervention triggers (see Table 3).

49. **While rapid asset growth is an early warning indicator in regular supervision, no formal supervisory regime uses it as a trigger.** In practice, high-growth strategies are generally early warning indicators of future bank vulnerabilities. One reason is that such a strategy often means growing assets faster than the market through less rigorous underwriting practices, thus accepting higher risk or less remuneration for a given risk. Exposures may increase without a commensurate expansion in risk management and control. But the resulting deterioration in asset quality only appears in the bank's financial statements with a significant time lag, when potential losses are recognised. It is difficult in practice to determine precisely at what stage a growth strategy becomes "excessive".

50. **Liquidity indicators can also help improve the specification of triggers.** The most recent financial crisis showed that low asset liquidity and excessive reliance on volatile sources of funding were indicators of a bank's vulnerability. While these vulnerabilities may often be symptomatic of a more fundamental weakness, their persistence increases the risk of the bank failing by becoming unable to fund its obligations. In response, two international liquidity standards were introduced as part of the Basel III framework. Some jurisdictions that emphasise discretionary supervisory interventions (such as Canada) also include a clear liquidity provision (inability to fund obligations) when defining non-viability or when characterising a business plan as unviable because funding is inadequate.

51. **The use of forward-looking indicators seems a natural way to make triggers more effective in formal early intervention regimes.** Those indicators can potentially detect vulnerabilities that would likely lead to a significant deterioration in a bank's financial situation. Such "early warning" signals could trigger a more timely supervisory intervention than capital-based triggers. Triggers could also include the quality of a bank's risk control function, underwriting practices, corporate governance framework and other indicators relating to credit, market, liquidity or operational risk. The main drawback of this type of indicator is that they are typically more subject to interpretation, and thus harder to enforce and potentially more subject to litigation.

Section 4: Powers in formal interventions: rules versus discretion

52. **How to strike a balance between compulsory and discretionary supervisory action is much debated, with jurisdictions following different practices as shown in Section 2.**

[17] The EBA issued its "Guidelines on triggers for use of early intervention measures pursuant to Article 27(4) of Directive 2014/59/EU" on 8 May 2015.

[18] The predefined score combinations are an overall score of 3 and score of 4 on any of the following individual components: internal governance and institution-wide controls, the bank's business model and strategy, capital adequacy and liquidity adequacy.

53. **A core feature of the US PCA regime is the obligation to impose specific measures on a bank once triggers are hit.** Restrictions start to apply when banks are classified as "adequately capitalised",[19] becoming increasingly stringent as the bank becomes "undercapitalised" and then "significantly undercapitalised". Measures taken can be either conservative or corrective.

54. **Conservative measures are constraints on the bank's management and/or activities to prevent any further deterioration.** The common purpose of these supervisory measures and of the restrictions imposed when a bank is undercapitalised is to ensure that its financial condition does not further deteriorate. Growth possibilities, whether through existing or new business lines, new branches or acquisitions, are typically constrained and must typically be approved by the supervisory authority.

55. **Corrective measures, including restoration plans, are meant to address the bank's weaknesses.** Under the US PCA framework, an "undercapitalised" bank must submit a capital restoration plan (CRP) within 45 days of hitting the corresponding trigger. Many other formal early intervention frameworks also require banks to produce similar plans within a pre-determined and short period. Other CRP provisions common to many jurisdictions include close monitoring of the capital restoration plan, with prescribed improvements in capital levels to be attained periodically (often on a quarterly basis) during the plan.

56. **Under the US PCA regime, additional restrictions combining mandatory and optional supervisory measures apply once the bank becomes significantly undercapitalised.** The mandatory measures come in addition to those applied to an undercapitalised bank. They include a prohibition on discretionary distributions – in particular, payments of executive bonuses or salary increases – unless these receive regulatory approval. In addition, federal agencies must use one or several additional powers selected from a pre-established list. Those supplementary powers include the ability to dismiss any director or executive officer in place at least six months before the bank became "significantly undercapitalised" or to require the election of a new board of directors.

57. **Other PCA regimes also combine mandatory and discretionary powers.** One example is the Reserve Bank of India's PCA Framework for banks. Specific mandatory measures are associated with each risk threshold. However, the discretionary measures are not specified but are part of a "common menu", with any given action potentially applicable to any of the thresholds. In the Philippines, depending upon circumstances, the Bangko Sentral ng Pilipinas (BSP) can direct the board of directors to design and implement up to three types of plan, with the ability to add business improvements and corporate governance reforms to its requirement to raise additional capital as soon as a bank enters PCA, and to require that the appropriate plans contain "actions to be taken immediately".

58. **While still a formal intervention regime, the EIM framework provides for significantly higher levels of discretion regarding the exercise of early intervention measures.** Unlike in other regimes, hitting a trigger does not necessarily lead to intervention. A second difference is that there is no obligation to use a specific measure.

[19] In particular, under US PCA, adequately capitalised banks can only accept brokered deposits subject to an FDIC waiver. They are not allowed to pay interest rates that significantly exceed the normal market rate.

Discretionary and rules-based powers in formal interventions						Table 3
Countries	United States	Peru	Japan	Philippines	India	European Union
Classifications (based on triggers)	Yes, 5 levels	No	Yes, 5 levels	Classification based on risk profiles (upper medium, moderately high, high, very high)	Yes, 3 thresholds	No
Activation if trigger hit	Automatic	Automatic	Automatic	Consider activating	Consider activating based on financial results and supervisory assessment	Obligation to formally consider if conditions are met to activate
Prescribed measures	Yes, for all undercapitalised levels depending upon classifications	Yes, related to determining bank's needs & raising fresh capital	Yes, business improvement and/or recap. plans	Yes, for capital restoration plans (CRPs); selection of appropriate enforcement action	Yes, mandatory measures based on risk thresholds	No, selection from listed EIM
Discretionary measures	Yes, for significantly undercapitalised	Yes, related to CRP	Yes, for and within each category	Yes, selection of appropriate enforcement action	Yes, measures drawn from menu common to all thresholds	Yes, selection from list of EIM

59. **When a trigger is hit, the EBA guidance on the EIM framework obliges supervisors to investigate and determine whether an early intervention is warranted.** Specifically, the supervisory authority must investigate and identify the cause of any breaches, or when these are unknown, determine whether early intervention is needed and, if so, take an explicit decision to use one or several early intervention measures. The supervisory authority must notify the resolution authority without delay if it decides that conditions for early intervention measures are met. Contrary to other PCA frameworks, where hitting thresholds triggers the enforcement of the framework, the EIM regime does not require specific measures to be taken to address specific breaches. However, breaches, outcomes of investigations and decisions to act (or not to do so) must be documented.

60. **The supervisor has the discretion to decide which measures to apply within the powers available under the EIM regime.** There is no bank classification according to intervention triggers. Moreover, early intervention measures listed under the EIM regime are not allocated to specific categories or types of problem bank. As a result, the EIM regime provides more flexibility and higher levels of discretion than most other formal intervention regimes.

61. **There are clear trade-offs when determining how much discretion should be included in an early intervention regime.** In principle, excessive discretion may lead to supervisory forbearance. However, too many or too stringent constraints, combined with a very high level of automaticity, may unduly constrain the supervisor's ability to tailor measures to banks' circumstances.

Section 5: Concluding remarks

62. **How to reach an appropriate balance between rules and supervisory discretion to address bank weaknesses is much debated.** The discussion resurfaces after each significant banking crisis. After the GFC, there was rapid agreement on the fact that more stringent rules were required to ensure the resilience of systemic banks. The new set of rules, once implemented, should also facilitate a level playing field. However, there is a wide consensus that, to be fully effective, rules need to be accompanied by effective risk-based supervision. In practice, the effectiveness of policy measures requires supervisors to have significant discretionary powers so that they can tailor their actions to the specificities of vulnerable institutions.

63. **Discretionary measures are seen by many authorities as advantageous in terms of early supervisory intervention.** They are often the most efficient way of getting a bank's management to comprehensively and promptly address problems. Moreover, they can normally be adopted discreetly as they are typically not subject to market disclosure obligations. This reduces the risk that supervisory measures may further destabilise the affected institution. In practice, their effectiveness depends on the supervisor's ability either to convince the bank's management or board to take the necessary corrective measures or to enforce such measures through the use of discretionary powers.

64. **Formal intervention regimes can provide useful backstops for the regular supervisory tools.** They may prove effective when measures are required – such as replacing a bank's management – that are difficult or impossible to impose under the supervisor's regular powers, or when the required measures can only be properly enforced if the bank is put under a special regime that acts as a strong signal to managers.

65. **For these regimes to be fully effective, the triggers for interventions should facilitate timely action by supervisors.** In particular, when triggers are capital-based, they should be calibrated to give ample room for timely corrective action. The use of additional triggers, such as supervisory ratings, may also help to address weaknesses promptly, and to reinforce the linkages between regular and formal intervention regimes.

66. **Supervisors need to retain some flexibility, in particular to select appropriate corrective measures.** This is justified by the need to tailor measures to the specific circumstances of a weak bank. This seems to be recognised in the most recent, or recently revised, formal intervention regimes.

67. **There is also a need to ensure the timely and effective involvement of resolution authorities.** Here again, a balance must be found between the need for resolution authorities to have full access to all necessary information at an early stage to ensure that their own interventions are effective, and the need to ensure a clear separation of roles and responsibilities between supervisory and resolution authorities. Regular and formal frameworks that provide for early supervisory interventions generally contain elements that help ensure timely and effective involvement. However, some frameworks do not systematically organise the resolution authority's involvement and the coordination of its measures with those of the supervisory authority as soon as a "problem bank" is identified.

Annex: Formal early intervention regimes – summary descriptions

PCA in the United States

Following the savings and loans crisis, in the late 1980s to early 1990s, federal supervisory agencies were criticised for failing to take sufficient and timely action to address the causes of bank failures and prevent losses to the deposit insurance fund (DIF) and taxpayers.[20] In response, Congress passed the Federal Deposit Insurance Corporation Improvement Act (FDICIA) in 1991. The Act contains a number of provisions to improve the supervision of federally insured deposit-taking institutions such as mandating annual bank examinations and audits and the adoption of a risk-based insurance assessment system. However, the most widely known provisions are those that introduced a PCA framework for bank supervision.

The overall objective was to resolve problems arising at insured deposit-taking institutions with the least possible long-term loss for the DIF. This implies timely (or prompt) and forceful (or corrective) supervisory intervention to prevent banks' problems from becoming deposit insurer or taxpayer liabilities. This leads to addressing problems early enough, when troubled institutions still have capital to absorb their losses. To limit supervisory forbearance, many PCA provisions are mandatory. Specifically, Section 38 of the FDICIA obliges all regulators to classify supervised banks into one of five capital categories according to capital-based triggers and to take specific action when these are breached.

For each bank, the classification takes place according to five capital metrics.[21] The five categories are well capitalised, adequately capitalised, undercapitalised, significantly undercapitalised and critically undercapitalised. Inclusion into one of the first four categories is subject to the bank failing to meet, meeting or exceeding four (or, for the largest institutions, five) pre-determined capital ratio levels. The metrics are the total risk-based capital ratio (Total ratio), the Tier 1 risk-based capital ratio (Tier 1 ratio), the Common Equity Tier 1 capital ratio (CET1 ratio), the Tier 1 leverage ratio (Tier 1 leverage ratio) and, for the largest institutions, the SLR or the eSLR.[22] A bank is critically undercapitalised when its tangible equity ratio[23] is 2% or less. The risk-based capital ratios and the SLR are calculated according to Basel standards, while the tangible equity ratio and the Tier 1 leverage ratio, which have been required in the United States since the early 1990s, do not have a corresponding Basel standard. The capital categories and the trigger

[20] The FDIC has published two studies on this crisis: a detailed analysis of the multiple bank failures is found in the FDIC's The History of the Eighties – Lessons for the Future, December 1997. How the FDIC and the Resolution Trust Corporation (RTC) managed the crisis is outlined in the FDIC's report, "Managing the Crisis: the FDIC and RTC Experience 1980-1994," August 1998.

[21] The number of capital measures increased from four to five with the introduction of the Basel III standards and CET1. While the names of the other ratios are unchanged, their modified composition makes them more demanding, with banks having to hold significantly more capital in excess of the PCA minimum levels as a result.

[22] Beginning in 2018, the SLR and the eSLR come into effect in the PCA framework. The SLR applies only to large or to internationally active banks. The eSLR is a higher quantitative requirement (with regard to derivative exposures in particular) that applies to US Global Systemically Important Banking Organisations (G-SIBs) only. See Table 2 for further detail.

[23] Also termed the Tangible Common Equity Ratio to total assets. Tangible (common) equity is the bank's total equity plus qualifying minority interests in subsidiaries plus the sum of unrealised gains (losses) on available-for-sale securities, the accumulated net gains (losses) less all elements that are not immediately and unconditionally available to absorb losses. These include intangible assets and goodwill, non-qualifying perpetual preferred shares and disallowed servicing assets and deferred tax assets. The denominator is the bank's total assets.

levels are presented in Table 4. The ratios and their respective levels are those incorporated in the Basel III capital rule as implemented in 2013.

Restrictions start to apply once an institution becomes "adequately capitalised". At this stage, it can only accept brokered deposits with an FDIC waiver. It cannot pay interest that significantly exceeds the market rate in the relevant market area and its risk-based deposit premium may be higher than that applicable to a "well-capitalised" institution.[24] Harsher restrictions start to apply to a bank when it becomes "undercapitalised". The restrictions become increasingly stringent as the bank's condition deteriorates. They are also cumulative.

A major component of PCA is the obligation for the undercapitalised bank to adopt a capital restoration plan (CRP) that is subject to supervisory approval and contains specific provisions. Mandatory CRP provisions include deadlines for submitting the plan (45 days after becoming undercapitalised), requirements related to contents and criteria that the regulatory agency must comply with when accepting such a plan. These criteria include the need to assess and determine whether the plan is based on realistic assumptions and whether it is likely to succeed in restoring the institution's capital.[25] Failure for an undercapitalised bank to present a plan within the prescribed delay or to comply with an approved plan leads to reclassifying the bank as "significantly undercapitalised", and therefore subject to additional and harsher restrictions. Table 5 summarises the restrictions applicable at each level of undercapitalisation.

Banks that become critically undercapitalised must be placed in conservatorship or receivership within 90 days of such a determination unless the FDIC and the appropriate regulator grant a 90-day extension that can be renewed once. The level set by the appropriate federal banking agency for tangible equity must be no less than 2%, regardless of other capital ratios, below which the bank would be deemed critically undercapitalised. The Federal Deposit Insurance Act provides that, subject to the aforementioned time limits, the appropriate federal regulator must appoint a conservator[26] or a receiver.[27] Once a failed bank has been placed in FDIC receivership, the FDIC is subject to the "least-cost resolution" principle, whereby it must choose the resolution alternative in which the total expected expenditure is the least costly to the deposit insurance fund.[28]

PCA includes safeguards to ensure that forbearance or conservatorships remain temporary and conditional. The first set of safeguards for banks critically undercapitalised for 270 days is that a receiver must ultimately be appointed unless a number of statutorily prescribed conditions are fulfilled. In particular, the bank must have positive net worth, be profitable (or have an upward, sustainable, trend in earnings), have substantially complied with its capital restoration plan, and be reducing its ratio of non-performing loans to total loans, and the head of both the FDIC and the appropriate (federal or state)

[24] While banks used to pay premiums on their domestic deposits, they currently pay premiums based on their assets minus capital.

[25] In addition to the FDICIA, federal agencies, through their own guidelines, specify how they interpret PCA provisions and add their own clarifications and/or requirements.

[26] A conservator is appointed to preserve the going-concern value of the institution, returning it to health or ultimately winding it up, resulting in a receivership. The conservator can be considered a temporary administrator with the power to operate the troubled bank in order to rehabilitate it as an alternative to receivership. The decision to appoint a conservator requires the concurrence of the FDIC.

[27] A receiver is appointed to take over the assets and liabilities of a failed bank (including one that has lost its charter or license) in order to quickly and efficiently dispose of that institution's assets; pay insured depositors; administer a claims process for other creditors; and wind up the affairs of the institution.

[28] There is, however, an exception to the least-cost requirement that covers circumstances in which a systemic risk exception has been made, as described under 12 U.S.C. § 1823(c) (4)(G).

regulator must certify that the bank is viable. The second set of limits is that all transactions which may significantly increase the bank's risk profile are subject to the FDIC's approval, with these including acquisitions, entering into highly leveraged transactions and amending the bank's bylaws (or paying excessive compensation).

PCA capital categories in the United States

Table 4

	Total Capital Ratio	Tier 1 Capital Ratio	CET1 Ratio	Tier 1 Leverage Ratio	SLR*	eSLR**
Well capitalised	10% or more and	8% or more and	6.5% or more and	5% or more	-	6% or more
Adequately capitalised	8% or more and	6% or more and	4.5% or more and	4% or more	3% or more	-
Undercapitalised	Less than 8% or	Less than 6% or	Less than 4.5% or	Less than 4%	Less than 3%	-
Significantly undercapitalised	Less than 6% or	Less than 4% or	Less than 3% or	Less than 3%	-	-
Critically undercapitalised	Tangible equity ratio of 2% or less, regardless of its other capital ratios					

* The SLR applies to advanced approaches banks, which are generally banks that have more than USD 250 billion in total assets or more than USD 10 billion in foreign exposure.

** The eSLR applies to bank subsidiaries of bank holding companies that have more than USD 700 billion in total assets or more than USD 10 trillion in assets under custody.

Summary of restrictions for "undercapitalised" institutions

Table 5

Undercapitalised	Significantly undercapitalised	Critically undercapitalised
Regulator must: – Closely monitor the bank's condition – Require and approve a capital restoration plan – Limit growth – Limit access to the Federal Reserve's discount window – Approve acquisitions, new branches or entering into new lines of business	– Prohibition of executive bonuses or raises without regulatory approval – Prohibition of payments on subordinated debt Regulator must require the bank to undertake one or more of the following: – Sales of voting stock securities – Eliminate sister bank exemption to Section 23A and further restrict transactions with affiliates – Limit interest rates paid – Require the bank to limit/terminate excessively risky activities – Obtain improvements to management by (a) requiring a new board to be elected, (b) dismissing any director or executive officer in place at least 180 days before the bank became significantly undercapitalised or (c) require the bank to hire executive officers – Prohibit deposits from correspondent banks – Require divestitures (by the bank) of any subsidiary, of any non-depositary affiliate (by the bank's parent) or of the bank itself (by the bank's parent) – Require any other actions	The bank must be placed in conservatorship or receivership within 90 days of such a determination unless FDIC and appropriate regulators determine that other action would better protect the deposit fund. Redetermination is required every 90 days. If the bank is on average critically undercapitalised for 270 days, a receiver must be appointed unless the bank: – Has positive net worth – Is in substantial compliance with the approved capital restoration plan – Is profitable – Is reducing its ratio of non-performing loans to total loans and The FDIC and the appropriate regulator certify that the bank is viable and not expected to fail. The FDIC must prohibit the institution, without approval, from: – Entering into any material transaction not part of its ordinary course of business (eg acquisitions, new business) – Extending credit for any highly leveraged transaction – Amending its articles or bylaws – Materially changing its accounting methods – Engaging in a "covered transaction" as defined in Section 23A – Paying "excessive compensation" – Paying interest on deposits in excess of prevailing rates

PCA in Peru

Through its Banking Act, Peru introduced in 1996 a "surveillance system", which is a formal supervisory intervention regime. While some of its characteristics are similar to the PCA regime in the United States, it has significant differences.[29] The objective is also to correct capital deficiencies. However, the surveillance system puts greater emphasis on promptly ending uncooperative or fraudulent bank practices. The intervention triggers include capital indicators but also repeated breaches of large exposure limits, of laws, of supervisory or central bank requirements and obstructive bank practices.

PCA Triggers in Peru

Table 6

Breach of total capital ratio (10%)	Breach of minimum capital amount	Loss exceeding 40% of bank's capital	Breaches, violations of laws or regulations	Uncooperative and/or fraudulent bank practices

As shown in Table 6, capital triggers are not limited to capital ratios. Repeated breaches of the 10% risk-based minimum total capital requirement[30] for three consecutive months (or five months within a year) is one of several capital triggers. Others include breaching the mandatory minimum capital amount and loss of more than 40% of the entity's regulatory capital. Triggers also include multiple types of breach – such as breaches of large exposure limits[31] – but also a wide range of violations of law, of the bank's statutes and of general or specific requirements from either the supervisory authority or the central bank.

Uncooperative and/or fraudulent bank practices that can compromise the efficiency of bank supervision can also be used as triggers. These include the intentional provision of false information to the supervisory authority or to the central bank, suspicion of fraud or the significant altering of the bank's reported financial position, refusal by the bank's management or staff to submit the bank's books to the supervisor or to provide requested information, and actions with intent to avoid complying with such obligations and requests. The extension of credit to shareholders so that they can subscribe to the bank's capital and help cover its capital requirements is also grounds for placing the entity within the surveillance system.

The conditions for exercising surveillance are designed to encourage prompt solutions. The surveillance system itself does not lead to resolution. The decision to place an institution under surveillance is notified to the central bank and communicated in writing to the bank. It includes a request to submit a financial recovery plan. The duration of surveillance cannot exceed 45 days, renewable once if the grounds persist. However, surveillance cannot be prolonged beyond 45 days where laws, statutes or regulatory requirements have been violated.

[29] One of these differences is that the surveillance system applies to both banks and to insurance companies.

[30] The minimum risk-based total capital ratio in Peru is 10%. Peru has yet to implement the Basel III definition of capital. It therefore does not use a CET1 ratio as an intervention trigger. It does not use a Tier 1 ratio because bank capital in Peruvian banks is mostly made up of common equity. The Basel III leverage ratio has not yet been introduced in Peru. Introducing a CET1 ratio and a leverage ratio would require changes to the existing Banking Act.

[31] Depending upon exposures, the nature of the collateral and whether the amount in excess of the large amount limit is collateralised, the limits when compared with the bank's total capital are 10% (no collateral) or 15%, 20% and 30%.

The recovery plan must include new capital and be developed, adopted and implemented quickly. The authority of the bank's governing bodies (board of directors and management) is maintained, with these having seven business days to submit a financial recovery plan after receiving the official letter placing the bank within the surveillance system. The supervisory authority then has a further seven business days to approve it. The bank must demonstrate improvements in its position with the frequency prescribed in the plan, with such improvements necessarily implying new capital contributions in cash.

Peru: Formal supervisory powers during the surveillance period — Table 7

Powers of the supervisory authority
Evaluate the bank's regulatory capital and carry out a viability study to establish the possibility of rehabilitation
Evaluate bank's regulatory capital and, if necessary, absorb losses using reserves
Require the bank to produce and implement a restructuration plan according to its recommendations
Require shareholders to make immediate capital contributions
Obtain third-party (new) shareholder contributions, if existing shareholders refuse new contributions
Appoint an official with the ability to: – Request any necessary information from the bank, in particular with respect to deposits and loans – Attend Board of directors and shareholder meetings as an observer
Suspension of voting rights with respect to any shareholder who may have acted as director or manager at the time the bank became subject to the surveillance procedure and/or during the two previous years and/or any shareholder related to them
Convene immediately a shareholder meeting to implement the agreements needed to overcome the causes that led to the surveillance procedure, in particular, the implementation of the capital contributions
Appoint directly a new board of directors in one of the four following cases: – Shareholders' meeting did not meet on one of the dates for which it was convened – Shareholders' meeting did not approve the removal and substitution of the board of directors – New Board of directors did not comply with the replacement of the general manager – No individual shareholder represented at least 4% of the capital and all attending shareholders made up less than 15% of the capital

Formal supervisory powers under the surveillance system are geared towards promptly determining the bank's capital needs and obtaining capital from shareholders. Powers to determine the bank's capital needs include the ability to evaluate the bank's assets on-site, to charge losses to its reserves and capital, to accordingly determine the problem bank's real capital and to assess its viability. The supervisory authority then requires existing shareholders to make capital contributions and is empowered to obtain such contributions from new shareholders if necessary.

Additional powers are designed to ensure that the recovery plan is adopted and implemented without obstruction. These include the ability to appoint an official at the bank and the power to request any necessary information. The supervisory authority also has the power to suspend the voting rights of any shareholder which may have acted as a director or a manager during the surveillance period and to immediately convene a general shareholder meeting to address the causes that led to applying the surveillance regime. At this meeting, the voting rights of board of directors' members or managers at the time when the surveillance procedure was introduced and/or during the two years prior to the beginning of the surveillance procedure and those of anyone related to them are suspended. Additional powers include the ability to require the shareholders' meeting to appoint a new board of

directors or to appoint a new board of directors directly when the shareholders fail to do so or fail to replace the general manager.

The superintendent has the authority to conclude the surveillance system at any time. While the procedure cannot last more than 90 days, the supervisory authority can close it either when it considers that its causes have been addressed or when it is convinced that the bank's problems cannot be overcome within the prescribed period or when the bank fulfils the conditions for being resolved (a procedure termed "Intervention" under the Banking Act). In the latter cases, the superintendent must begin resolution procedures and notify the central bank.

The 1996 Banking Act (as modified in 1998) also created another early intervention regime[32] that provides the supervisory authority with special powers to address banks that present financial instability or are subject to poor management. In such cases, the supervisory authority can determine the real assets value and, if necessary, require any capital adjustments that it deems appropriate and have them charged to reserves and share capital. Subsequently, it may also request immediate cash injections from shareholders. Likewise, for a period of six months (renewable once), the supervisory authority may prohibit such banks from carrying out one or more of the following operations:

– Taking additional risks of any nature through transactions with any natural or legal person, directly or indirectly linked to the ownership or management of the bank, with or without guarantees

– Renewing for more than 180 days any operation involving risks

– Carrying out operations that generate new market risks

– Purchase, sell or encumber any property that corresponds to its fixed assets or to its permanent financial investments

– Sell their credit portfolio

– Grant unsecured loans and granting powers for the execution of the operations previously mentioned

The regulation does not establish formal triggers to determine financial instability or poor management. Instead, such determinations are reached through supervisory assessments. In practice, the regime is applied when, based on the evaluation of the bank's risk profile (internal classification methodology), the supervisory authority determines the need to require harsher corrective measures than those used under discretionary interventions. It is therefore a regime that can be used by the supervisory authority as a follow up to discretionary interventions but before the bank triggers the above-mentioned surveillance system.

[32] Two discretionary intervention regimes were established by the Banking Act on the basis of paragraph 19 of Articles 349 and 355, respectively. The first article empowers the supervisory authority to take all necessary actions to safeguard the interests of the public (depositors). It therefore allows the authority to take discretionary measures without having to declare the surveillance regime. Article 355 establishes the early intervention applicable to banks that are deemed financially unstable or poorly managed. Although both regimes are established by law, the decision to use them and the action taken on this basis are at the supervisory authority's discretion.

PCA in Japan

Japan's PCA regime was introduced in April 1998 through the "Law to Ensure the Soundness of Financial Institutions". The framework was introduced when Japan was coping with a system-wide banking crisis during which it became apparent that all major banks and regional banks had significantly understated their non-performing loans and based their asset valuations on overly optimistic assumptions. Since the introduction of the Basel I framework, international minimum capital requirements apply to "internationally active banks" incorporated in Japan. These are banks that have branches and/or subsidiaries outside Japan. Purely domestic Japanese banks are exempt from international capital adequacy requirements but must maintain specific, but lower, minimum capital requirements.

Following the introduction of Basel III, Japan's PCA framework for internationally active banks uses three capital ratios (CET1 Ratio, Tier 1 ratio and Total CAR) as triggers to determine that a bank has become undercapitalised. Undercapitalised banks are classified into four categories according to their level of undercapitalisation, with corrective measures stipulated for each category. Table 8 presents the four categories, their associated trigger levels and the respective measures that the FSA may order the bank to take.

Main features of PCA regime for internationally active banks in Japan — Table 8

Categories of undercapitalised banks	Total capital ratio	Tier 1 ratio	CET1 ratio	FSA's powers
No action	8% or more and	6% or more and	4.5% or more	No PCA action
Category 1	From 4% to less than 8% or	From 3% to less than 6% or	From 2.25% to less than 4.5%	Submission of business improvement plan including measures for recapitalisation and order its implementation
Category 2	From 2% to less than 4% or	From 1.5% to less than 3% or	From 1.13% to less than 2.25%	Submission and execution of recapitalisation plan Prohibit or limit dividend distribution/bonus payments Restrict asset growth or order asset reduction Prohibit/limit acceptance of costly deposits Downsizing of specific operations Closure of operations (except head office) Other measures
Category 2.2	From zero to < 2% or	From zero to < 1.5% or	From zero to < 1.13%	Order measures for: strengthening of bank's capital, downsizing of operations, bank merger or withdrawal of license
Category 3	< zero	< zero	< zero	Suspension of all or part of bank's business operations

Moreover, the supervisory authority has the power to remove bank management and boards of directors through Prime Minister's orders. Additionally, under the resolution framework based on the Deposit Insurance Act, the Prime Minister has the power to appoint a financial reorganisation administrator. The former takes place in application of the Banking Act (Article 27) when a bank has

violated laws, regulations, its own bylaws or any Prime Minister's order. In addition to its powers to remove senior management and Board, the supervisory authority may suspend part or all of the activities and rescind the license. The administrator has all necessary powers to represent and operate the bank and manage its assets and is expected to end its duties within one year by transferring the bank's business to – or merging it with – another bank.

PCA in the Philippines

According to BSP, the PCA framework is intended to ensure that a troubled bank's board of directors institutes strong measures to restore the entity to a normal operating condition prior to the open outbreak of crisis, and within a reasonable period, ideally within one year.

The framework – initially focused on capital triggers – was updated in 2006[33] with the emphasis being placed upon the basis for PCA interventions, which is the existence of a "higher-than-normal" risk of failure at a bank. Accordingly, the three main sets of changes were made:

– Indicators of "higher-than-normal" risk of failure were introduced in addition to capital deficiency triggers. These indicators include "serious supervisory concerns", and criteria related to supervisory ratings;

– The Memorandum of Understanding (MoU), signed between the ailing bank and the BSP as part of the PCA process, includes three components: a capital restoration plan (CRP), a business improvement plan (BIP), and corporate governance reforms (CGR); and

– Existing formal intervention powers were broadened in order to better address bank deficiencies.

PCA triggers in the Philippines — Table 9

Capital triggers (Basel III)	Rating triggers	Discretionary supervisory triggers
Total capital adequacy ratio less than 10% Risk-based Tier 1 ratio less than 7.5% CET1 ratio less than 6% Minimum leverage ratio less than 5% Below-minimum capital requirements	CAMELS composite rating worse than 3 or Management component rating worse than 3	Identification of a serious supervisory concern placing the bank at a higher-than-normal risk of failure due to capital deficiency and concerns such as (but not limited to) the following: – Findings of unsafe and unsound activities that could affect the interests of depositors and/or creditors – Finding of repeated violations of law or continuing failure to comply with Monetary Board Directives – Significant reporting errors that materially misrepresent the bank's financial condition

Capital-based criteria are derived from – but higher than – the international Basel III minimum requirements.[34] These include the total capital adequacy ratio (10% of risk-weighted assets), a Tier 1 risk-based ratio of 7.5% and a Common Equity Tier 1 (CET1) of 6%. Also included is a minimum leverage ratio set at 5%. A total capital account falling below the prescribed minimum capitalisation based on bank category[35] is also a trigger.

33 Through the issuance of BSP Circular no 523 dated 23 March 2006, implementing Section 4 of Republic Act no 8791 (General Banking Law of 2000).

34 The Basel III risk-based ratios were introduced in 2013 whereas the leverage ratio was adopted in 2015 and became a Pillar 1 requirement in 2017.

35 BSP Circular no 854 dated 29 October 2014.

Triggers based on supervisory ratings include a composite CAMELS rating worse than 3 and a Management component rating worse than 3. Such rating triggers, which are indicators of serious supervisory concerns, should be combined with an actual or impending capital deficiency.

Cases where "a serious supervisory concern" is identified, placing the bank at "higher than normal risk of failure",[36] are also triggers for intervention. Three types of concern are explicitly included in the guidance but others may be invoked, allowing for the exercise of discretion. These may relate to unsafe and unsound activities that could adversely affect depositors or other creditors, repeat violations of law or repeated failures to comply with the supervisory authority's directives, or to significant reporting errors that materially misrepresent the bank's financial condition, for instance. Such supervisor triggers should be combined with an actual or impending capital deficiency.

Initiation into the PCA framework is subject to prior Monetary Board (MB) approval. The appropriate Supervision Department (SD) determines the need to initiate a bank into the PCA framework through either on-site examination or off-site monitoring. The initiation of PCA must be reported to the Philippine Deposit Insurance Corporation (PDIC). The BSP notifies the bank of the MB's approval to initiate PCA and of the requirement to execute a MoU committing the problem bank to implementing specific action plans as embodied in a PCA Plan (PCAP). This plan will address the supervisory concerns which caused it to be initiated into PCA. Compliance with the MoU commitments and PCAP is monitored through quarterly reporting and on-site validation.

Subject to MB approval, sanctions can also be applied against the board of directors or responsible officers or the bank where there is unreasonable delay to enter into a PCA plan or failure to comply with the plan. Where the bank's problems are too serious to be addressed through PCA, or when it is unwilling or unable to submit to PCA, or to comply with a PCA plan, the Bank may be declared "failure of PCA" and sanctions may be imposed against the bank and/or its directors and/or officers.

The three components of a MoU under PCA are CRP, a BIP and CGR. The CRP, at a minimum, includes a capital plan with specific measures allowing for the build-up and restoration of capital levels at least up to regulatory minimum requirements within a reasonable time period (ideally one year), with quarterly milestones. It should also provide a timetable for the implementation of the identified measures as well as specify sources of funds and other contingency plans. The BIP must contain a specific set of measures that the bank commits itself to implementing in order to bring about improvements in its operating condition. The CGR should contain a specific set of measures that the bank commits itself to taking immediately to improve the qualifications and/or independence of the board and to enhance the quality of its oversight over its management and operations.

The outcome of PCA is either the bank's return to regular supervision or the failure of PCA, leading to the bank's resolution. When the bank has substantially complied with its commitments as detailed in its MoU and there no longer exists grounds for it to remain under PCA, the Supervisory Department may recommend to the Monetary Board to lift its PCA status. When this is approved by the MB, the bank again becomes subject to regular supervision. However, the end of the PCA period (ideally one year) may also result in the MB declaring "failure of PCA", followed by resolution.

The Supervisory Department may recommend that the MB declares "failure of PCA" when any one of four conditions is fulfilled. These conditions are (a) the non-submission by the bank of an acceptable MoU; (b) the non-submission of an acceptable PCA plan coupled with a persisting capital

[36] Specifically, the more-than-normal risk of failure is determined by the director of the relevant examination department and confirmed by the Monetary Board (MB). The MB, which exercises the central bank's powers, is chaired by the Governor and has seven members, including a cabinet member.

deficiency and the absence of significant improvement in the bank's financial condition; (c) the bank's non-compliance with significant commitments/action plans in the MoU/PCAP; and (d) the bank's board of directors expresses its inability to comply with the commitments in the MoU/PCA plan. A bank that exhibits grounds for receivership may be prohibited from doing business in the Philippines and its assets may be liquidated.

Enforcement of PCA in the Philippines — Table 10

<table>
<tr><th>Approval by the MB to initiate bank into the PCA framework and directive to execute an MoU containing the following components</th><th>Sanctions/appointment of conservator or receiver</th></tr>
<tr><td>Capital restoration plan with the following components:
– financial projections showing CAR of at least 10% by the end of the CRP with quarterly milestones;
– capital build-up programme with top-up provision – deed of undertaking by stockholders to inject additional capital should the bank's capital fall below the required levels.
Corporate governance reforms including, but not limited to, any one, or combination of the following:
– changing the composition of the board of directors (BOD) or any of the mandatory committees;
– enhancing the frequency and/or depth of reporting to the BOD;
– developing a strong compliance programme;
– reducing exposures to and/or termination/reduction of business relationships with affiliates that pose excessive risk or are inherently disadvantageous to the financial institution;
– changing the external auditor.
Business Improvement Plan, including but not limited to any or combinations of the following:
– reducing risk exposures to manageable levels;
– strengthen risk management;
– curtail/limit the bank's scope of operations including those of its subsidiaries or affiliates where it exercises control;
– change or replace management officials;
– reduce expenses;
– other measures to improve quality of earnings.</td><td>When PCA initiation results from violations of existing laws and regulations, any or a combination of the following restrictions may be imposed, among other measures:
– curtailment of existing special authorities, licenses or privileges;
– restriction on operations and on grant of certain special authorities, licenses or privileges;
– denial of new applications for the grant of certain special authorities, licenses, and privileges;
– restriction or prohibition on the making of new investment of any sort;
– restrictions on declaration of dividends;
– restrictions on the payment of compensation, bonuses and benefits to its directors and officers.
Failure of PCA can arise when a bank's problems are deemed exceptionally serious from the outset, when it is unwilling to submit to PCA or when it is unable to comply with an agreed PCA. This leads to the bank being considered for resolution (see paragraph below).
As a consequence of such failure, in addition to the restrictions under PCA initiation, other sanctions may be imposed which shall include any or a combination of (but not limited to) the following:
– Fine or rotating suspension of the Board of directors;
– Recall of authorities, licenses or privileges granted by virtue of PCA initiation;
– Other restrictions on PCA initiation which were not imposed.</td></tr>
</table>

The PCA framework allows the PCA bank to be placed in conservatorship to restore its viability or in receivership to liquidate its assets. The decision, subject to meeting the grounds for such placement as provided for under the law,[37] is taken by the MB on the recommendation of the Deputy

[37] The relevant dispositions are Sections 29 and 30 of the Republic Act (RA) no 7653 (New Central Bank Act) and Section 53 of the Republic Act no 8791 (General Banking Law of 2000).

Governor in charge of supervision. The main difference between the two options is that an institution placed in conservatorship may not have adequate liquidity but is still deemed to be solvent, with this justifying the conservator's efforts to restore its viability, whereas a bank placed in receivership is one that is no longer able to pay its liabilities as they come due, because it has insufficient realisable assets.

PCA in India

Revised in April 2017, the Reserve Bank of India's (RBI) PCA framework is used to induce stressed banks to improve their condition. Its aim is to help banks take corrective measures, including those prescribed by RBI, in a timely manner, in order to restore their financial health.

In addition to capital ratios, triggers include leverage, asset quality and profitability indicators. Capital triggers include the total risk-based capital ratio, the CET1 ratio, but not the Tier 1 ratio, with the RBI setting minimum capital requirements that are higher than the Basel III minimum levels. The asset quality and profitability indicators are a non-performing asset ratio (net non-performing advances ratio or NNPA[38]) and a return-on-assets ratio. The Tier 1 leverage ratio is also monitored as part of the framework.

The 2017 revisions reset the indicators, making them more stringent and/or more granular. The risk-based capital triggers now include the CET1 ratio in addition to the total capital adequacy ratio.[39] The number of NNPA ratio thresholds has increased from two (10% and 15%) to three (6%, 9% and 12%) and their levels have been reduced. Negative return on assets (RoA) ratios have been introduced for all thresholds. The PCA framework is applicable to all banks operating in India including small banks and foreign banks operating through branches or subsidiaries based on breach of risk thresholds of identified indicators. A bank is placed under the PCA framework based on financial results and the RBI's supervisory assessment.

PCA triggers in India — Table 11

Triggers	Total capital ratio or CET1 ratio	Tier 1 Leverage Ratio	NNPA Ratio	RoA Ratio
Risk Threshold 1	TCR: up to 250 basis points (bps) below minimum requirement (10.25% as of 31 March 2017) At least 7.75% – less than 10.25% and/or CET1: up to 162.5 bps below minimum requirement (6.75% as of 31 March 2017) At least 5.125% but less than 6.75%	Less than 4% More than 3.5%	At least 6% Less than 9%	Negative RoA for two consecutive years
Risk Threshold 2	TCR: more than 250 bps below but not exceeding 400 bps below minimum requirement (10.25% as of 31 March 2017) At least 6.25% – less than 7.75% and/or CET1: more than 162.50 bps below but not exceeding 312.50 bps below minimum requirement (6.75% as of 31 March 2017). At least 3.625% but less than 5.125%	Less than 3.5%	At least 9% - Less than 12%	Negative RoA for three consecutive years
Risk Threshold 3	CET1: in excess of 312.50 bps below minimum requirement (6.75% as of 31 March 2017) Less than 3.625%	NA	12% and more	Negative RoA for four consecutive years

[38] The NNPA ratio is determined as the percentage of net non-performing assets to net advances.

[39] This corresponds to a minimum total capital ratio of 9% plus 1.25% of the capital conservation buffer (CCB) as of end-March 2017. The CCB will reach 2.5% by end-March 2019, when the total capital ratio plus the CCB will be 11.5%. The minimum CET1 ratio is 5.5% plus 1.25% of CCB as of end-March 2017. It will be 8% once the CCB is fully implemented in March 2019.

The introduction of a "common menu" allows for more flexible interventions. India's framework initially included a limited list of discretionary measures that could be taken in addition to "mandatory actions" as each risk threshold was breached. The revised framework includes a "common menu" of measures that can be taken in addition to specified "mandatory actions." Each heading of the "common menu" includes a wider range of possible measures, with an "any other" category added in for good measure. This essentially allows the RBI to select any measure or combination of measures that it deems to be the most appropriate.

With regard to the removal of management and/or board members, the common menu of discretionary measures include those whereby the RBI may recommend to owners (eg the government, private owners, or parent company of a foreign bank branch) to bring in a new management team and/or a new board of directors. Under the PCA and in conjunction with the powers vested with the RBI under the Banking Regulation Act (BR Act), 1949, the RBI may remove managerial persons (under Section 36AA) and supersede the board of directors for a maximum period of 12 months (under Section 36ACA). Under the same section of the BR Act, 1949, the RBI may also, when the board of directors is superseded, appoint in consultation with the government, an administrator to which it may issue directions. The tables below present, respectively, the mandatory actions associated with each of the risk thresholds and the indicative list of discretionary measures that can be taken under the main headings of the "common menu".

PCA powers in India: Mandatory actions — Table 12a

Specifications	Mandatory actions	Discretionary actions
Risk Threshold 1	Restriction on dividend distribution/remittance of profits Promoters/owners/parent of foreign banks to bring in capital	Special supervisory interactions Strategy-related
Risk Threshold 2 (in addition to mandatory actions of Threshold 1)	Restriction on branch expansion, domestic and/or overseas Higher provisions as part of the coverage regime	Governance-related Capital-related Credit risk-related
Risk Threshold 3 (in addition to mandatory actions of Threshold 1)	Restriction on branch expansion, domestic and/or overseas Restriction on management compensation and directors' fees	Market risk-related HR-related Profitability-related Operations-related Any other

PCA powers in India: Discretionary actions

Table 12b

Types of discretionary action	Examples of measures included
Special supervisory interactions	More intensive supervision: quarterly (or more frequent) Special supervisory monitoring meetings, special inspections and targeted scrutiny, special audit
Strategy-related	Activation of recovery plan, review of business model and/or business lines. Undertake business process reengineering/restructuration of operations
Governance-related	Recommend to owners to bring in new management and/or board, removal of managerial persons, supersede board, restrictions on directors' and managers' compensation etc
Capital-related	Review of capital planning, require submission of capital plan, increase reserves through retained earnings, restrictions on investments/expansion, restrictions/reductions of high risk activities/exposures
Credit risk-related	Require plan to reduce stock of NPAs, strengthening of credit risk management, reduce risk concentrations, risk assets, unsecured exposures etc
Market risk-related	Reduce interbank borrowings, restrictions on wholesale/costly deposits, derivative activities etc
HR-related	Restriction on staff expansion, review of specialised training needs of existing staff
Profitability-related	Restrictions on capital expenditure other than technological upgrades
Operations-related	Restrictions on branch expansion plans/reduce branches, restrictions on entering new lines of business, reduction in non-fund-based business etc

EIM in the European Union

The European Union's Bank Recovery and Resolution Directive (BRRD) put in place a formal early intervention regime. In May 2014, the BRRD established a common European recovery and resolution framework with three components: preparation, early intervention and resolution. The second component which includes EIM and their triggers and conditions constitutes the European Union's formal early intervention regime. A trigger event requires the competent authority to assess whether the early intervention conditions are met. These conditions require a breach or a likely breach of prudential requirements in the near future. Therefore, the occurrence of a trigger event by itself does not necessarily lead to early intervention. It only requires the competent authority to assess whether the conditions of a breach or likely breach are fulfilled. Once it has been determined that the conditions are met, the competent authority may then apply early intervention, if appropriate.

Early intervention triggers Table 13

Supervisory review and evaluation process (SREP) scores	Material changes, anomalies in SREP indicators (as defined by supervisory authority)	Significant events (as defined by supervisory authority)
Composite score of 4 Combinations of composite score of 3 and score of 4 for specific components: – business model and strategy – governance and institution-wide controls, – capital adequacy, – liquidity adequacy	Example of thresholds set for capital adequacy indicators equal to: – minimum capital requirements +1.5% or – additional capital requirements (Pillar 2) +1.5%	Examples: – Major operational risk event – Significant deterioration in capital levels – Signals of need to review asset quality and/or portfolio valuations – Significant outflow of funds – Unexpected loss of senior/key staff – Significant rating downgrade – Resolution authority consults to determine if FI is "failing or likely to fail"

The EIM are designed to "supplement rather than replace the existing SREP and the supervisory measures based on its outcomes", according to the EBA's Guideline. The intention is to provide a backstop for regular supervision and therefore limit the consequences of supervisory forbearance. The triggers link discretionary and formal interventions, with the EBA's guidelines[40] identifying three sets of triggers.

The first set of triggers is specifically derived from the SREP and include both the overall assessment and specific combinations of the overall assessment and of SREP components. The first trigger is an overall SREP score of 4. The pre-defined score combinations are internal governance and institution-wide controls, and the bank's business model and strategy, as well as its capital adequacy and liquidity adequacy. The supervisory authority needs to consider early intervention measures in these four cases when the SREP component is assigned a score of 4 even when an overall SREP score of 3 indicates that "there is no high risk to the viability of the institution". This is because each of these four elements is

[40] See EBA (2015).

a sign that the bank's performance will deteriorate in the near future if the identified vulnerabilities are not addressed.

The second set of triggers includes material changes/anomalies identified in the monitoring of financial/non-financial SREP indicators. While the choice of changes and/or breaches are mostly left to the discretion of supervisory authorities, the BRRD (in Art 27.1) and the EBA's Guidelines include a breach of the institution's capital requirements plus a margin of 1.5% as one of the possible triggers. The objective is to show that the bank "is likely in the near future to infringe the requirements". It also demonstrates that the purpose is to encourage using triggers as "tripwires" that can lead to an early intervention before the minimum requirements are breached.

The third category includes "significant events" that need investigating and may trigger the EIM. These are defined broadly. Illustrative examples are provided. "Significant events" include major operational risk events such as rogue trading, severe IT problems, significant fines imposed by public authorities, and signals of the need to review asset quality, including frequent and material adjustments to the bank's financial statements due to errors in valuation and frequent changes in accounting, or unexpected losses of senior management or key staff who have not been replaced.[41]

Cases where a resolution authority decides to consult with a supervisory authority regarding whether an institution is "failing or likely to fail" are also significant events. In this case, Articles 102.2 and 102.3 of the BRRD Directive determine the conditions for resolution. While the determination that a bank is "failing or likely to fail" usually belongs to the supervisory authority, Article 102.2 allows the resolution authority to reach such a determination subject to having the necessary tools, adequate access to the relevant information and to adequate consultation with the supervisory authority.

If a trigger event has occurred, the competent authority assesses whether the early intervention conditions are satisfied. If it determines that the credit institution has breached the prudential requirements of the Capital Requirements Directive (CRDIV), the Capital Requirements Regulation (CRR) and the Markets in Financial Instruments Directives (MiFID and MiFID II) or Regulation (MiFIR) or that it is likely to breach any of them in the near future, it may then decide on early intervention measures.

The EIM are provided as a menu of measures from which the supervisory authority can choose. Rather than requiring the application of specific powers and measures to specific trigger breaches, the BRRD obliges supervisory authorities to take a formal and documented decision on whether to intervene or not and what measures to use should an intervention take place. As part of this decision, they must identify the causes of breaches and notify the resolution authority when it has determined that the intervention conditions are met. Breaches, outcomes of investigations into their causes and decisions to act (or not to do so, as the case may be) must be explicitly documented. Accordingly, and contrary to other formal intervention frameworks, there is no bank classification according to intervention triggers.

The BRRD allows for the removal of senior management and/or of the bank's board in three specific cases where EIM measures are insufficient to reverse the deterioration. These are a significant deterioration in the bank's financial condition, serious infringements of laws, regulations or bylaws, or serious administrative irregularities. The nomination of a temporary administrator for one year (or exceptionally longer if the conditions for nomination remain valid) can take place when the removal of the bank's management and board are insufficient to address its problems.

[41] The full list of examples can be found in EBA (2015), paragraph 24, pp 12–13.

European Union's EIM Regime – powers and supervisory measures

Table 14

EIM	Measures
Require management body to: – Implement recovery plan measures within specific timeframe – Examine situation, identify corrective measures, draw up action programme and timetable – Convene (or convene directly) a shareholder meeting – Remove/replace board members/senior managers if found unfit to perform their duties – Draw up a debt restructuring plan	Supervisory procedure for activating EIM: – Investigate the situation if causes of breach unknown – Decide whether to apply early intervention measures – Document breaches, outcomes of investigations, decisions to act (or not) – Notify resolution authorities upon determining that conditions for EIM are met
Changes to the business strategy	Conditions for removal of management/board: – Significant financial deterioration – Infringements of law, regulations, statutes – Serious administrative irregularities – Measures of Art. 27 insufficient to reverse deterioration
Changes to the legal/operational structure of the bank	Appointment of temporary administrator (one year): If removal of senior management/board is insufficient
Acquire all necessary information to update the resolution plan, prepare for resolution, for valuation of assets and liabilities	
Provide all information above to resolution authority	

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