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NOTE

from:	General Secretariat of the Council
to:	Delegations
Subject:	Summary record of the meeting of the European Parliament **Committee on Economic and Monetary Affairs (ECON)**, held in Brussels on 18 and 19 February 2013

The meeting was chaired by Ms Bowles (ALDE, UK) and by Mr Zalba Bidegain (EPP, ES).

1. Adoption of the agenda

The agenda was adopted

2. Monetary dialogue with Mario Draghi, President of the European Central Bank

ECON/7/00032

In his initial address, Mr Draghi delivered the speech in Annex I. He underlined the positive effects of concerted reforms by governments and national parliaments and the decisive actions of European institutions. He reiterated the need for further efforts for Europe to re-emerge from the crisis, to generate confidence among investors and citizens and to promote growth. He noted that economic weaknesses in the early part of 2013 should be followed by a very gradual recovery later in the year.

Mr Draghi expected inflation to decline below 2% in the short term and acknowledged that the underlying pace of monetary expansion and loan dynamics remained subdued. He explained that the exchange rate was not a policy target despite its importance for growth and price stability and feared that slow implementation of structural reforms in the euro area, geopolitical issues and imbalances in major industrialised countries could dampen the ongoing improvement in confidence and delay the recovery. He noted that national authorities had the appropriate tax and supervisory instruments to avoid the build-up of excessive risks in the financial system and housing market. He also favoured the establishment of a Single Resolution Mechanism centred on a Single Resolution Authority with a European Resolution Fund at its disposal and called for the Single Resolution Authority to have the appropriate institutional set-up to ensure its independence, a robust resolution framework and access to resolution financing.

The chair, Ms Bowles (ALDE, UK), pointed out that the European Parliament (EP) was still waiting for the Commission proposal on the Single Resolution Mechanism and warned that it would be impossible to deal with it during the current parliamentary term if it it had not been received by the summer recess.

In the subsequent exchange of views, Members of the European Parliament (MEPs) in general urged the European Central Bank (ECB) to improve lending to the real economy and to curtail market fragmentation as regards access to credit by SMEs (Mr Gauzès -EPP, FR- Mr Mauro -S&D, IT- Mr Zalba Bidegain -EPP, ES). Some advocated a lighter austerity regime in those Member States (MS) hardest hit by the crisis (Ms Ferreira -S&D, PT- Ms Matias -GUE/NGL, PT-); and others feared the weakening of the single market with the creation of a banking supervisory mechanism that could be detrimental to non-euro area banks (Mr Zīle -ECR, LT- Mr Saryusz-Wolski -EPP, PL-). MEPs also questioned the President of the ECB on Cyprus' ongoing memorandum of understanding negotiations, (Mr Klinz -ALDE, DE-), on Ireland's assistance programme (Mr Lamberts -Greens/EFA, BE- Mr Mitchell EPP, IE-), on Latvia's accession to the euro (Mr Balz -EPP, DE-), on the ECB's profits (Mr Hoang Ngoc -S&D, FR-), and on the attractiveness of the euro area (Mr Schmidt -ALDE, SE-).

In response, Mr Draghi acknowledged the importance of re-establishing credit flows to the real economy and underlined the ECB's commitment to achieve that. He noted that the ECB had provided extensive funding to banks, but that it was unable to address the banks' lack of capital, risk aversion and the lack of credit demand.

Mr Draghi further explained that access to credit depended to a certain extent on the balance sheet of the borrower. He admitted that risk premiums on sovereign debt affected the cost of credit in the EU. He warned against imposing conditionality on loans to banks since it would make the ECB responsible for bad loans. Mr Draghi pointed out that MSs were responsible for boosting the capital of their banks and that it was vital to avoid a disorderly deleveraging.

He said that fiscal consolidation was unavoidable despite short term negative effects and suggested to mitigate the effects of fiscal consolidation by focusing on spending instead of tax revenues. He favoured the swift implementation of structural reforms to boost exports and offset the contraction of domestic consumption. Mr Draghi also recommended that governments focus on the credibility of their fiscal consolidation plans by providing detailed information on their medium-term objectives to reassure the markets and to ensure lower spreads and interest rates. He thought fiscal consolidation ought to be tailor-made and underlined that MSs under assistance could redesign their programmes within the limits of the assigned envelope. In his opinion the pace of fiscal consolidation of a MS depended on its level of indebtedness.

Mr Draghi acknowledged the complexity of implementing the Single Supervisory Mechanism (SSM) and assured the committee that there was no intention to disrupt the single market through the creation of a single banking supervisory system. He stressed that the legal act on the SSM had not yet been approved and explained that the ECB viewed the SSM as a complement to the European Banking Authority (EBA). He called for the swift establishment of common rules to resolve banking crises and noted that non-euro area countries could also join the European Stability Mechanism (ESM). Mr Draghi said that the President of the European Council would be in the lead regarding the deepening of Economic and Monetary Union (EMU) and that the ECB would cooperate when necessary and issue a quarterly assessment on the implementation of the SSM once the regulation was approved.

He said that it was essential to secure national ownership of the assistance programme after the Presidential elections in Cyprus and to secure debt sustainability without creating financial instability. Mr Draghi agreed that the governance, transparency and supervision of the financial sector had to be strengthened and pointed out that the final version of the adjustment programme should provide for the close monitoring and implementation of anti-money laundering and tax transparency frameworks.

Regarding Ireland, Mr Draghi explained that the governing council of the ECB would assess the latest arrangements between the Irish government and the Irish central bank on the Anglo Irish Bank during its yearly evaluation of the financial situation of banks in the euro area.

Mr Draghi stressed Ireland's positive performance on most parts of the adjustment programme but mentioned that further action was needed on the financial sector.
He explained that the ECB would assess Latvia's convergence towards the criteria for joining the euro and its sustainability in due time.
He also explained that the ECB's net profit was distributed to all national central banks of the euro area according to their shares in the ECB's capital key; that the profits of the national central banks were distributed among their shareholders; and that it was up to MSs' governments to decide how to use the profits they were entitled to. He informed the committee that the ECB's financial results for 2012 as well as a press release on the Securities Markets Programme's holdings would be published on 21 February 2013. Finally, he highlighted some of the benefits of the euro such as the creation of a considerable financial market, price stability and low interest rates.

3. Public Hearing with Mario Draghi, Chairman of the European Systemic Risk Board

ECON/7/05173

In his initial address, Mr Draghi read out the speech in Annex II in which he presented the European Systemic Risk Board's (ESRB) current assessment of systemic risk, outlined the 2 new recommendations on bank funding and money market funds and proposed addressing in the immediate future the interconnectedness in the European financial system and the soundness of the European macro-prudential framework.

In the subsequent exchange of views, Ms Bowles (ALDE, UK) told Mr Draghi that the European Parliament (EP) had been trying to include asset encumbrance and to improve the proposals on covered bonds in the Credit Requirement Directive and Regulation (CRDIV) and called for the ESRB's support. She warned that the macro-prudential framework risked being too restrictive and could prohibit the use of the indicative list of instruments envisaged by the ESRB. She suggested that the ESRB ought to contact the Commission.
Mr Hökmark (EPP, SE) asked Mr Draghi how he viewed the balance between home and host countries regarding recovery and resolution plans and possible systemic risks regarding bank resolution due to the existence of euro and non-euro countries. Mr Draghi noted that an *ex ante* agreement was required on loss sharing. He saw no systemic risks stemming from different resolution authorities for resolving failing banks. He noted that the conception of the resolution framework should take into account the current reality (one single market and different currencies), in order to disrupt the single market as little as possible.

Ms Ferreira (S&D, PT) queried the effectiveness of the Outright Monetary Transactions (OMT) in the long run to deal with the problem of sovereign debt and on the value of the Liikanen Report recommendations to deal with systemic risks in the banking sector. Mr Draghi explained that OMTs had reduced the tail risk for the euro area but that it had to be accompanied by consistent action at government level in terms of fiscal consolidation, debt level reduction and structural reforms in order to foster competitiveness and growth which in turn would reduce the debt to Gross Domestic Product (GDP) ratio. He noted that the Liikanen report objectives consisted in designing a banking model where certain hazardous activities would be ring-fenced and providing a European common approach.

Ms Goulard (ALDE, FR) asked if Article 5 on the draft Single Supervisory Mechanism was clear enough regarding the ECB's and national supervisors' monitoring and intervention tasks. Mr Draghi considered the SSM a very important collective step taken by the EU towards a more genuine Economic and Monetary Union (EMU), adding that supervision ought to be strong to be effective and that an equilibrium between national and central supervision had to be struck. He explained that all supervisors would be part of the mechanism and would have to work together and share sovereignty to ensure its effectiveness.

Mr Bokros (ECR, HU) questioned the chairman of the ESRB on the rehabilitation, restructuring and recapitalisation of insolvent banks in Greece and Cyprus. Mr Draghi was unable to comment on Cyprus as there were ongoing discussions. As regards Greece, he mentioned that there was significant progress and that the total amount of emergency lending assistance had decreased significantly.

Mr Chountis (GUE/NGL, EL) challenged the validity of the adjustment programme in Greece and the ECB's know-how on the matter. Mr Draghi supported Commissioner Rehn and the International Monetary Fund (IMF) Managing Director, Ms Lagarde, and said that there were no reasons to review the assessment on Greece, adding that the agreed programme had to be fully implemented to ensure its success.

Mr Langen (EPP, DE) referred to the high indebtedness levels of the banking sector and asked how it could be reduced. He also enquired about international cooperation on money market funds and on zero value state bonds. Mr Draghi explained that the entry into force of Basel III was progressive in order to avoid a negative impact on the macro-economic situation. He noted that during the year the ESRB would assess the quality of the assets and the capital positions of the various banks. He added that so far banks had raised capital and that the European Banking Authority (EBA) had stated that banks had been raising capital ratios through capital increases instead of deleveraging.

Mr Dragi noted that the ESRB was in contact with the US authorities and that a delegation would visit the US in March to present its work and recommendations. He informed the committee that the Federal Reserve (FED) supported the solutions proposed by the ESRB since these were the most advanced. He told Mr Langen that the ESRB was aware of the potential systemic implications of zero value state bonds and that this would soon be discussed in its general board meeting.
Ms Bowles (ALDE, UK) suggested the ESRB should look into the use of permanent partial exemptions under the Internal Ratings-based (IRB) approach under Article 145 of the Credit Requirement Regulation (CRR).
Mr Bullmann (S&D, DE) asked if negotiations regarding CRDIV should still be based on Basel requirements and if there should be more market regulation. Mr Draghi considered the latest Basel agreement on Liquidity Coverage Ratio (LCR) to be good as it took stock of the situation of the European banking sector and on how the liquidity regulation would reflect the business model of European banks. Consequently he did not think it should be reviewed. He explained that the ESRB had to coordinate macro-prudential policy and that it would have precise coordination tasks, together with the EBA, in CRDIV to support the Commission and the Council in their decisions on whether to consider the national macro-prudential policies in line with the single market. He also mentioned that the ESRB would host an on-going voluntary and flexible dialogue among national authorities based on a voluntary but demanding coordination process to assess the spillover effects of national measures.

4. Approval of minutes of meetings

The minutes of the meetings on 10 and 21-22 January 2013 were approved.

5. Chair's announcements

Mr Zalba Bidegain (EPP, ES) announced that political trilogues on Capital Requirements Directive and Regulation (CRDIV) had taken place on 5 and 7 February 2013 in Strasbourg and that the next trilogue meeting would take place on 19 February 2013. He added that updates were being prepared on the interplay between the Basel I floor and the prospective leverage ratio, the definition of investment firms, the calculation of credit value adjustments and exposures to central counterparties. He said that the European Parliament (EP) and the Council had yet to agree on how to incorporate additional input received on liquidity from the Basel committee on banking supervision in December.

Mr Zalba Bidegain also informed the committee that a first trilogue meeting on FISCALIS had been held on 13 January 2013 and that some progress had been made on the participation of tax experts and third countries, participation in joint actions and training activities, scope, budget, communication and budgetary ceilings. He said that a technical mandate had been granted and that the first meeting of the working group was scheduled for 21 February 2013. He explained that the next trilogue on FISCALIS was scheduled for 27 February 2013. Finally he told the committee that the sixth trilogue meeting on the Single Supervisory Mechanism (SSM) had taken place on 6 February 2013 in Strasbourg and that further progress had been made on technical issues and on a number of articles and recitals in the European Central Bank (ECB) file, and that most political issues had been identified. He noted that the next trilogue would take place on 21 February 2013 and would deal solely with the European Banking Authority (EBA) Regulation, adding that the negotiations on this file remained at the start-up phase.

6. Adoption of the 2013 revised draft calendar of ECON committee meetings

ECON/7/00338

The 2013 revised calendar was approved. Meetings scheduled for 9 and 10 October were cancelled and replaced with new meetings on 24 and 30 September and on 14 October.

7. Common system of value added tax, as regards the treatment of vouchers

ECON/7/09537 2012/0102(CNS)
Rapporteur: Ms Ildikó Gáll-Pelcz (EPP)
Consideration of amendments

In her initial address, Ms Gáll-Pellcz (EPP, HU) informed the committee that 23 amendments had been tabled. She reiterated the main points in her report, expressed during the considerationof the draft report on 16 January[1].

In the debate that followed, Ms Kleva Kekuš (S&D, SI) and Mr Gauzès (EPP, FR**)** welcomed the report and the Commission proposal

The Commission representative also thanked the rapporteur and considered the proposed amendments constructive, in particular regarding the implementation date. He said that the Irish Presidency had given priority to this file and intended to conclude the legislative process in 2013.

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1 See 5366/13 page 2.

The rapporteur said that compromise amendments would be discussed next week.

Vote in ECON: 26 February 2013. Vote in plenary: April 2013.

8. 2011 Discharge: EBA - European Banking Authority
9. 2011 Discharge: European Securities and Markets Authority - ESMA
10. 2011 Discharge: European Insurance and Occupational Pensions Authority - EIOPA

ECON/7/10612 2012/2207(DEC)
ECON/7/10616 2012/2209(DEC)
ECON/7/10856 2012/2208(DEC)
Rapporteur for the opinions: Mr Werner Langen (EPP)
Consideration of amendments

In his opening remarks, Mr Langen (EPP, DE) restated some of his earlier positions during the consideration of the draft opinions[2]. He announced that amendments were similar for the three authorities and concerned the need for increased resources and the review of the current mix financing agreement (40% from the then European Union budget and 60% from national competent authorities). Regarding the European Banking Authority (EBA), he expressed doubts regarding amendments 7 and 9 by Mr Martin (NI, AT) and opposed amendment 13 by Mr Giegold (Greens/EFA, DE).

In the ensuing exchange of views, all speakers supported the rapporteur (Ms Ferreira - S&D, PT- Mr Schmidt -ALDE, SE- Mr Strejček -ECR, CZ- Mr Mann -EPP, DE- and Ms Jensen - Greens/EFA, DK-).

Vote in the lead committee CONT: 19 March 2013. Vote in ECON: 25 February 2013. Vote in plenary: April/May 2013.

11. Fight against Tax Fraud, Tax Evasion and Tax Havens

ECON/7/11580
Rapporteur: Ms Mojca Kleva Kekuš (S&D)
Consideration of draft report

In her initial address, Ms Kleva Kekuš (S&D, SI) pointed out that roughly EUR 1 trillion in public money was lost annually to tax fraud and tax evasion in the European Union (EU).

Ms Kleva Kekuš explained that this tax gap represented EUR 2000 per citizen per year and/or the entire annual budget for health care in all Member States (MS). In her opinion this constituted a threat to the single market, the European social model, and to the fairness and efficiency of tax systems and national budgets.
Ms Kleva Kekuš considered that this money could be used to foster investment, growth and employment. She proposed establishing a concrete and cohesive European tax strategy; enhancing coordination at national, European and international level; and halving the tax gap by 2020 in order for MSs to have new tax revenues without raising taxes to enhance fiscal consolidation, soften the blow of austerity and contribute to the stabilization of financial markets by reducing the liquidity available for speculation. She thought MSs should try to respect their commitments and conclude all related ongoing legislative proposals. She recommended fighting tax avoidance, revoking banking licences for financial institutions which assisted their clients in tax fraud, bringing in a compulsory Common Consolidated Corporate Tax Base (CCCTB), upgrading and extending the scope of the Savings Directive, introducing country-by-country reporting for cross-border companies, tackling tax fraud as a crime, addressing the complexities of electronic commerce and strengthening the regulation of company registries and registers of trust. She noted that the black list from the Organisation for Economic Co-operation and Development (OECD) on tax havens remained empty. She suggested new definitions and criteria based on international standards, a common European approach on tax havens and the creation of a European blacklist. She concluded by stating that the finance ministers of Germany, Great Britain and France, who had expressed their commitment to fight tax evasion and fraud during the last G20 summit, were blocking tax related negotiations in the Council.

In the debate that followed, all speakers welcomed the Commission initiative and the report by Ms Kleva Kekuš. Ms Pietikäinen (EPP, FI) agreed that there should be more cooperation and that the EU should play a more concrete role. She proposed addressing tax competition and aggressive tax planning. Mr Skylakakis (ALDE, EL) claimed that peripheral countries ought to have lower tax regimes to compete with core countries to foster growth and employment. He added that the EU should enable tax competition while tackling tax evasion.
Mr Eickhout (Greens/EFA, NL) feared tax competition would lead to lower tax revenues and consequently less public spending.

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[2] See 5742/12 pp. 3-4.

Mr Eickhout considered the right of veto in the Council on tax matters to be detrimental to the flow of the legislative process and proposed using the community method instead. He also recommend mentioning in the report the consequences of tax evasion in developing countries and properly addressing the definition of tax havens. He considered his own country to be a tax haven.
Mr Strejček (ECR, CZ) stood for entrepreneurship. He stressed that businesses avoided taxes because these were too high and too complex. He also opposed enhancing the role of the EU on tax matters as he feared that it would trigger capital outflows and lead to the creation of additional tax havens. Mr Händel (GUE/NGL, DE) favoured transparency and thought that institutions from non-cooperative states should have their privileges removed. He proposed addressing the issue of the tax burden across the population. Ms in 't Veld (ALDE, NL) noted that the sharing of information ought to be regulated and expressed concerns regarding the sharing of information between the EU and the US. Ms Gáll-Pellcz (EPP, HU) favoured a common approach on fiscal governance and adequate exchange of information. She recommended addressing the issue of double non-taxation and opposed unnecessary red tape. She told the rapporteur that she would table amendments on the rapid response mechanism on Value Added Tax (VAT) Fraud and the reverse charge mechanism. Ms McCarthy (S&D, UK) believed that the financial sector should contribute proportionally to the tax burden imposed upon society. She also agreed about mentioning tax avoidance by global companies in developing countries. Ms Goulard (ALDE, FR) agreed that SMEs shouldn't be overburdened and called for a swift agreement on the CCCTB to avoid excessive red tape. In her opinion, tax policies needed to be urgently addressed for the EU to regain the support of citizens. Mr Tehro (EFD, FI) proposed sharing best practices on tax havens. Mr Stolojan (EPP, RO) recommended banning companies in the EU from operating in tax havens that refused to share information with the EU.

The Commission representative explained that the resolution passed by the EP in April had influenced the Commission communication issued in June and the Action plan (34 measures) presented in December. He said that it was important to secure revenue for the MS and to promote fairness in the tax system. He also referred to the two recommendations launched by the Commission on tax havens and on aggressive tax planning and called for the EP's support to persuade MS to take common action on those issues.

The rapporteur explained that the Committee on Development (DEVE) was preparing a special document on developing countries and therefore considered unnecessary to mention it in the ECON report. She hoped her report would have an impact on the workings of the European Council.

Deadline for amendments: 26 February 2013. Consideration of amendments: 20 March 2013. Vote in ECON: 21 April 2013. Vote in plenary: May 2013.

12. Constitutional problems of multitier governance in the European Union

ECON/7/09375 2012/2078(INI)
Rapporteur for the opinion: Ms Sylvie Goulard (ALDE)
Consideration of draft opinion

In her opening remarks, Ms Goulard (ALDE, FR) explained that she tried to defend the ECON committee's competences and not to encroach upon those of the Constitutional Affairs (AFCO) committee. She considered it essential to preserve the unity of the EU and to ensure that all members of the euro zone and all countries which had made the commitment to join the euro were well organized institutionally to facilitate democratic accountability. She said that the opinion praised efforts by Member States (MS) to consolidate the euro and concluded by saying that once a country had decided to adhere to the euro it had to respect its obligations and commitments, and to be accountable.

In the debate that followed all speakers welcomed the report. However, Mr Gauzès (EPP, FR) expressed some reservations on paragraph 5 since the Commission's 'Blueprint' had not yet been fully agreed and therefore his group could possibly differ on some elements. Mr Cutaş (S&D, RO) agreed with calls for the troika to be answerable. Mr Eickhout (Greens/EFA, NL), on behalf of Mr Besset (Greens/EFA, FR), supported calls to secure democratic accountability. Mr Cutaş opposed dividing the EP into euro and non-euro zone countries. He was backed by Mr Eppink (ECR, BE). Mr Gauzès noted that the euro was supposed to be the currency of the entire EU and if some MSs decided not to be part of it, then it should be reflected in the institutional organization of the European Union. Mr Eickhout proposed using the community method as regards the European Stability Mechanism (ESM). He though the Single Resolution Mechanism and Deposit Guarantee Scheme should be part of the banking union and that the own resources debate should also tackle the system for managing asymmetric shocks.

Mr Eppink noted that his group opposed debt mutualisation and pointed out that the six-pack concerned all MS, whereas Mr Cutaş suggested creating a European treasury. Mr Tremosa i Balcells (ALDE, ES) said that he would table amendments advocating fiscal federalism in EU centralized states like Spain to improve efficiency.

Deadline for amendments: 25 February 2013. Consideration of amendments: 11 March 2013. Vote in the lead committee (AFCO): 21 March 2013. Vote in ECON: 21 March 2013.

13. Date of next meeting

The next meeting will be held in Brussels on 26 February 2013.

ANNEX I

Speech by Mr Draghi, President of the European Central Bank

Madam Chair,

Honourable members of the Committee on Economic and Monetary Affairs,

It is a pleasure to be back here in Parliament and in front of your Committee for our regular exchange of views.

We enter 2013 in a more stable financial environment than in recent years. This has been achieved through concerted reforms by governments and parliaments and decisive actions by European institutions. But considerable further efforts are needed to ensure that Europe continues emerging from the crisis, re-creates confidence among investors and citizens, and re-establishes stability and growth.

This house has a key role to play in the reform agenda. I am thinking in particular of the adoption of the legislation for the Single Supervisory Mechanism. This is of crucial importance for progress towards financial union.

Today, I will first review economic and monetary developments in the euro area since December. I will then address the two topics that you have selected for our discussion: the impact of a low interest rate environment; and the establishment of a Single Resolution Mechanism.

1. Economic and monetary developments

Since our last meeting, the Governing Council has left key ECB rates unchanged: the main refinancing rate currently stands at 0.75%; the rate on the deposit facility stands at 0%; and the rate on the marginal lending facility stands at 1.50%.

Economic activity contracted for a third consecutive quarter in the fourth quarter of 2012. Available indicators signal further weakness at the beginning of 2013, with domestic demand remaining dampened. This is due to weak consumer and investor sentiment and to the necessary balance sheet adjustments in both the public and private sectors. Foreign demand also remains subdued.

Economic weakness in the early part of 2013 is expected to be followed by a very gradual recovery later in the year. Strengthening global demand, our accommodative monetary policy stance and the improvement in financial market confidence across euro area countries should all work their way through to spending and investment decisions and support the recovery.

Even though we have yet to see sustained improvement in the real economy, survey indicators have confirmed earlier evidence of a stabilisation of business and consumer confidence, albeit at low levels.

Taking a somewhat longer view, the improvement in financial market confidence since last summer has been significant. As regards the exchange rate, let me be clear that the exchange rate is not a policy target, but it is important for growth and price stability.

Another sign of improved confidence is the larger than expected early repayment by counterparties in the first of our two three-year longer-term refinancing operations settled in December 2011 and March 2012. This indicates that banks are less uncertain about their funding prospects than a year ago. We will closely monitor conditions in the money market and their potential impact on the stance of monetary policy, which will remain accommodative with the full allotment mode of liquidity provision.

The risks surrounding the economic outlook for the euro area continue to be on the downside. They relate to the possibility of weaker than expected domestic demand and exports, slow implementation of structural reforms in the euro area, as well as geopolitical issues and imbalances in major industrialised countries which could both have an impact on developments in global commodities and financial markets. These factors have the potential to dampen the ongoing improvement in confidence and thereby delay the recovery.

Annual inflation in the euro area has continued to moderate, falling from 2.5% in October to 2.2% in November and December and 2.0% in January, as we had foreseen. Inflation is expected to decline to below 2% in the near term.

Risks to the outlook for price developments continue to be seen as broadly balanced over the medium term, with upside risks relating to higher administered prices and indirect taxes, as well as higher oil prices, and downside risks stemming from weaker economic activity and, more recently, the appreciation of the euro exchange rate. Inflation expectations for the euro area remain firmly in line with the Governing Council's aim of maintaining annual inflation rates below, but close to, 2%.

Our monetary analysis is consistent with price stability. The underlying pace of monetary expansion and loan dynamics remain subdued. The annual growth rate of loans to the private sector remains negative. To a large extent, subdued loan dynamics reflect the current stage of the business cycle, heightened credit risk and the continuing process of deleveraging.

Overall, inflationary pressures should remain contained over the policy-relevant horizon. Taking the evidence together, this allows our monetary policy stance to remain accommodative.

2. The impact of a low interest rate environment

Let me turn to the first topic that you have chosen for our meeting today, namely the implications of a low interest rate environment.

The impact of the global financial crisis on the economy and, potentially, on price developments has been unprecedented. We have taken unprecedented measures in response, aiming pre-emptively and forcefully to avert risks to price stability, in accordance with our primary mandate.
First, we have reduced our key interest rate to 0.75%, a level previously unseen in virtually all euro area countries. The interest rate in the overnight interbank market is now even lower, close to zero.
Second, we have acted to prevent an abrupt reduction in the supply of credit to the real economy. We have given banks unrestricted access to central bank funding in all our refinancing operations. We have extended significantly the average maturity of these operations. We have broadened the set of eligible collateral. This assurance of funding to banks has prevented disorderly deleveraging in the financial sector and averted a collapse in money and credit, with potentially severe implications for price stability, and thereby employment and growth.
All these decisions have ensured price stability and stabilised inflation expectations during an exceptional period.
Naturally, the ECB is aware of the challenges arising from a protracted period of low policy rates and ample liquidity. Let me elaborate on the three main challenges.
The first is that low interest rates may affect the ability of savers and investors to generate returns. This is especially the case for institutions targeting nominal returns, such as insurance companies and pension funds. Yet, by ensuring price stability throughout the crisis, monetary policy has contributed to more stable financial conditions. This is central to the interests of savers and investors: there can only be sustainable returns in a stable environment.
The second challenge relates to incentives. A protracted period of low interest rates and ample liquidity facilitates rolling-over loans at very low costs. Banks may therefore have less incentive to monitor credit risk properly and may provide too many loans to non-profitable business. Over time, such misallocation of financial resources would undermine overall productivity and depress growth and employment.
The third challenge is that protracted monetary accommodation may fuel bubbles in house prices and other asset markets. As the crisis has painfully demonstrated, the bursting of such bubbles inflicts large costs for the real economy.
In this context, a natural question is whether monetary policy should be used actively to contain asset price booms and bubbles – a response known as ‘leaning against the wind’. Thanks to our monetary policy strategy, implicitly we do this to some extent. We focus on the medium-term horizon and take account of monetary developments in assessing risks to price stability.
Having said that, let us be clear that changes in policy interest rates are normally not the first best instrument for addressing financial imbalances.

They should be considered only under very special circumstances, for example when a widespread rise in asset prices threatens price stability in the euro area as a whole. In the absence of such imbalances relevant from a euro area perspective, the appropriate tools to counter imbalances in the financial sector and possible asset price misalignments are at the country level.

To avoid the build-up of excessive risks in the financial system or housing markets, national authorities have appropriate tax and supervisory instruments at their disposal.

3. The establishment of a Single Resolution Mechanism

Let me turn to your second chosen topic, the establishment of a Single Resolution Mechanism.

The Single Resolution Mechanism should be centred in a Single Resolution Authority with a European Resolution Fund at its disposal. I welcome the European Council's December statement that during the course of 2013, the Commission will submit a proposal for such a mechanism for Member States that are participating in the Single Supervisory Mechanism.

The ECB shares the European Council's view on timing for the Single Resolution Mechanism, namely that it will be required once bank supervision is effectively moved to the Single Supervisory Mechanism. We therefore welcome the European Council urging the co-legislators to examine the proposal as a matter of priority with the intention of adopting it during the current parliamentary cycle.

There are four main reasons for a Single Resolution Mechanism, with a Single Resolution Authority at its centre.

The *first* reason is that only a Single Resolution Authority will ensure timely and impartial decision-making focused on the European dimension. In a situation where a cross-border resolution is required, the Single Resolution Authority would avoid national focus and pursue the optimal resolution strategy, thus mitigating coordination problems.

The *second* reason is that the Single Resolution Authority would credibly pursue the least cost resolution strategy, assessing possible cross-border spillover effects and systemic concerns, and ensuring that resolution costs are first and foremost borne by the private sector. It would thereby minimise resolution costs without recourse to taxpayer money.

The *third* reason is that the Single Resolution Authority is an essential complement to the Single Supervisory Mechanism. The Single Supervisory Mechanism will provide a timely and unbiased assessment of the need for resolution, while the Single Resolution Authority will ensure prompt and efficient action once the trigger is reached. This will avoid misaligned incentives that could arise with supervision moved to the European level while resolution responsibility remained national.

The *fourth* reason is that a Single Resolution Authority would help to break the vicious bank-sovereign nexus.

The Single Resolution Authority naturally needs to be strong and effective to deliver what is needed. This requires three features to be fulfilled:

First, the Single Resolution Authority needs to dispose of a robust resolution framework, one that provides it with enforceable resolution tools and powers. In this respect, the proposed bank recovery and resolution directive is key. Adoption of the directive, ideally by June, is an urgently needed step towards a strong European resolution framework.

Second, the Single Resolution Authority needs access to resolution financing. It should therefore have a European Resolution Fund at its disposal, which should be financed by the private sector via risk-based ex ante levies. The European Resolution Fund should be backed by a public backstop mechanism, the support of which would need to be recouped via special ex post levies on the private sector. This means that it would be fiscally neutral over the medium term.

Third, the Single Resolution Authority should have an institutional set-up that allows for independence, sufficient operational capacity and a robust accountability framework with effective judicial protection against resolution decisions ex post.

The Commission is currently assessing the options for the institutional anchoring of the Single Resolution Authority. I am looking forward to its proposal, which will need to ensure these three essential features.

Thank you for your attention. I am now at your disposal for questions.

ANNEX II

Speech by Mr Draghi, Chairman of the European Systemic Risk Board

Dear Honourable Members,

I am very pleased to appear before this Committee today to inform you about the activities of the European Systemic Risk Board (ESRB).

As you know, the ESRB's task is to identify and monitor systemic risk, and to issue policy recommendations to mitigate such risks. Today, I am pleased to present two new ESRB recommendations, one on ways to mitigate some risks encountered by banks in their funding activities and another to strengthen the regulatory framework disciplining money market funds in the European Union (EU). But before that, I would like to elaborate on the current situation. I will then turn to the new recommendations. And I will conclude on some medium-term ESRB work on interconnectedness and on a sound macro-prudential framework in the EU.

1. Current situation – the ESRB's assessment of systemic risk

Let me start on a positive note with respect to the improvement in financial market conditions in recent months. Sovereign debt spreads vis-à-vis Germany have followed a downward path, some countries, such as Ireland and Portugal, have issued medium-term sovereign bonds for the first time since 2010, and general indicators of systemic risk have receded markedly. Furthermore, the geographical fragmentation of financial intermediation that has characterised much of the European debt crisis appears to be losing momentum, with deposit flows starting to stabilise and Target2 imbalances receding from their mid-2012 peaks. Finally, bank funding markets are also showing signs of improvement, as indicated by, among other things, the investors' rising appetite for euro area bank debt. However, a weak macroeconomic outlook in some EU member countries could affect banks' profitability and capital levels. Banks may delay necessary deleveraging and cleaning-up of their balance-sheets, exacerbating fragile macro-financial linkages and making more difficult to raise equity and provide credit to the real economy.

Where search for yield is driving investor choices, there is a vulnerability as a result of possible sudden risk re-pricing. Finally, there are several reasons for remaining cautious about the improvement in bank funding markets. In addition to the risks noted earlier, EU banks have high refinancing needs over the coming years and continue to be dependent on central bank funding. Addressing these challenges in a decisive and sustainable manner is a prerequisite for ensuring a more resilient financial system that is capable of supplying the financial services to support economic activity.

From a macro-prudential perspective, this includes: (i) supporting growth-enhancing reforms that help fuel virtuous macro-financial dynamics; (ii) continuing efforts to clean up banks' balance sheets, based on a transparent and consistently applied prudent valuation of banks' assets and reinforced by a coordinated asset quality review to ensure consistency across the EU, possibly under the lead of the European banking Authority (EBA); (iii) closely monitoring the potential build-up of fragilities in credit markets, with a view to strengthening the financial system's resilience in the event of a downturn, including through adequate shock-absorbing buffers; and (iv) intensifying the monitoring of bank funding risks.

To elaborate on this last point, let me now turn to the two ESRB recommendations that are being published today, as one of them deals directly with the strengthening of bank funding.

2. ESRB recommendations on bank funding and money market funds, as are being published today

(a) ESRB recommendations on bank funding

At my last hearing before this Committee, I announced that, upon my return, I would present the results of the ESRB's assessment of vulnerabilities related to bank funding and asset encumbrance. I am now in a position to present to you, first hand, an ESRB recommendation based on such assessments.

Let me mention the risks that we intend to address, and the responses we would like to provide.

First, the fragility of the "funding structure" of many of our credit institutions: the crisis showed that they were overly reliant on volatile and short-term funds, and excessively engaged in maturity transformation. For this reason, the ESRB recommends that credit institutions submit their individual funding plans to their national supervisors, as is already the case in a few EU Member States, and that the EBA co-ordinates assessment of those plans at Union level. The main goal is to ensure that supervisors have an aggregate view, at the national and EU level, of the banking sector's capacity to indeed reach its funding targets.

Second, the growth in asset encumbrance: asset encumbrance is the use by credit institutions of their assets to guarantee financial transactions. The implications thereof are twofold. On the one hand, encumbering a large proportion of their assets may make it more difficult to obtain unsecured funding and may pose more challenges for the effective management and oversight of liquidity and funding risks. On the other hand, creditors can take recourse to a smaller set of unencumbered assets in the event of an institution's default.

To mitigate these risks, the ESRB recommends that credit institutions monitor and assess their encumbered assets internally, also through appropriate governance mechanisms, while supervisors review them on a regular basis. Finally, credit institutions should disclose information on their encumbered and unencumbered assets.
Third, the need to extend best practices for covered bond regimes throughout the EU: covered bonds have been used increasingly to finance credit institutions, and they should be preserved as a high-quality financial instrument. While harmonisation is made difficult by underlying national legal regimes, the ESRB recommends that authorities foster convergence to the highest standards.

(b) ESRB recommendations on money market funds

The ESRB is also publishing recommendations on money market funds (MMFs) today. MMFs are a key component of the shadow banking sector. In Europe, such funds manage around €1 trillion in assets, concentrated on a few countries (mainly France, Ireland and Luxembourg). Following the financial crisis, there was international agreement on the need for structural reforms in this sector. The risk addressed by the ESRB is that a potentially destabilising run by investors on MMFs could lead to spillover effects for the wider financial system. The risk of an investor run may be higher for MMFs with a constant net asset value (so-called CNAV funds). The ESRB thus recommends that it be mandatory for CNAV funds to be transformed into funds with a variable net asset value (VNAV funds) over a sufficiently long transition period. Finally, the ESRB recommendations cover other areas that aim, in addition, to reduce the systemic risk related to MMFs, namely the introduction of explicit liquidity requirements, a better public disclosure and enhanced reporting and information sharing between authorities.
With its recommendations to the European Commission, the ESRB primarily provides input to the development of robust EU legislation in this area. At the same time, the recommendations intend to support global progress, as has recently also been advocated by the Financial Stability Board (FSB) and the International Organization of Securities Commissions (IOSCO), also in major partner economies. The Financial Stability Oversight Council, the US counterpart of the ESRB, has recently published a consultative paper with the same objective.

3. Looking ahead: ESRB activities over the medium term

(a) Interconnectedness in the EU financial system

Looking ahead, one of the key areas of work for the ESRB is to gain a better understanding of the role of interconnectedness (or networks) play with respect to the resilience of the financial system.

Interconnectedness is a core dimension of systemic risk. As the aftermath of the collapse of Lehman Brothers has revealed, linkages across institutions and markets – which contribute to diversification in a benign environment – can lead to sizeable contagion in adverse circumstances. This is of particular relevance for the ESRB as the process of financial integration has created a myriad of complex linkages within the EU financial system.

So far, the ESRB – together with the European Securities and Markets Association (ESMA) – has been examining this issue in relation to two specific market segments, namely interbank interconnectedness and contagion in the credit default swap (CDS) market. The ESRB and the ESMA are currently concluding their work in this important area. Final outcomes notwithstanding, one preliminary lesson learnt from this work is that a more holistic view of interlinkages in the financial system is needed to understand how shocks are transmitted across the system and how to mitigate them. Another lesson is likely to be that the assessment of systemic risk requires granular and timely data on bilateral exposures or "super-spreaders" (i.e. the hubs of the financial system or the most interconnected firms). Ultimately, this type of analysis could feed into the ESRB's Risk Dashboard and provide a basis for a system-wide stress-testing exercise.

(b) Macro-prudential policies in the EU

Let me now say a few words on the progress being made in ensuring a sound macro-prudential framework across the EU. At the hearing before this Committee one year ago, I presented the ESRB recommendation on the macro-prudential mandate of national authorities. Since then, noticeable progress has been made. Several countries have already taken action and set up committees with explicit remits to monitor and mitigate systemic risks. Some (Germany, Greece, Malta, the Netherlands and the United Kingdom) have brought new macro-prudential legislation into force. Others (Czech Republic, Denmark, France, Poland, and Slovenia) have presented legislative proposals to their Parliaments. I am aware that many other countries are preparing to take similar steps. Finally, other countries (Bulgaria, Estonia, Ireland, Italy and Spain) deem themselves to be already compliant with the recommendation. The ESRB is monitoring developments and will report to the Parliament later on.

The next step in developing the macro-prudential framework is to provide these national authorities with a flexible toolkit of macro-prudential instruments to ensure that, once in place, they are able to prevent the local build-up of systemic risks. The ESRB has made important headway, at a technical level, in identifying both the primary and the intermediate objectives of macro-prudential policy, as well as an indicative list of instruments that should be available in order to attain all the goals.

I am confident that I shall be able to report on this in greater detail at one of the forthcoming hearings.

As you are aware, some relevant pieces of EU legislation are being finalised. They include the CRD/CRR package, which requires direct ESRB involvement in the coordination of macro-prudential measures. Moreover, the draft SSM regulation also calls the SSM to cooperate closely with the ESRB. Finally, the two EU regulations underpinning the ESRB will be submitted for a review by the end of this year. With respect to all these new institutional developments, the ESRB will be at Parliament's disposal as needed.

Thank you very much for your attention. I am now available for questions.