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NOTE

From:	Presidency
To:	Council
Subject:	Banking package *- General approach*

I. INTRODUCTION

1. On 17 June 2016, the Council adopted Conclusions on the Roadmap to complete the Banking Union, in which it stressed the importance of pursuing risk reduction and risk sharing measures in an appropriate sequence.

2. Pursuant to the Council's 2016 Roadmap, the Commission adopted on 23 November 2016 a package of legislative proposals (the "Banking Package") with amendments to various legislative instruments currently in force dealing with banking prudential requirements, specifically the Capital Requirements Regulation and Directive (the CRR and the CRD), the Bank Recovery and Resolution Directive (the BRRD) and the Single Resolution Mechanism Regulation (the "SRMR").

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3. The Financial Services' Working Party met 37 times under the Slovak, Maltese, Estonian and Bulgarian Presidencies to scrutinise the Banking Package proposals.

4. The 7 March Coreper discussed the Presidency compromises for the legal texts on the CRR, CRD, BRRD and SRMR as set out in documents 6614/18, 6615/18, 6616/18 and 6617/18, respectively, on the basis of a Presidency note setting out the three political issues that remain outstanding before a general approach can be reached.

5. The three outstanding issues are: the way to implement the fundamental review of the trading book, MREL subordination and the scope of the CRR/CRD.

6. Taking into account the discussion at Coreper and while maintaining the overall balance of the package, the Presidency suggests the approach outlined below in order to address the three outstanding issues.

II. OUTSTANDING ISSUES

A. IMPLEMENTATION OF THE FUNDAMENTAL REVIEW OF THE TRADING BOOK

The **Fundamental Review of the Trading Book (the "FRTB")** sets out the new international standards on bank regulatory capital for market risks as agreed by the Basel Committee in 2016. Market risk capital standards can be defined as the amount of capital that banks must put aside as protection for potential losses resulting from their trading business, thus covering the risks of changes in the value of traded instruments (i.e. shares, bonds), foreign exchange risk, interest rate risk, etc. The Banking Package as initially adopted by the Commission was intended to implement the FRTB in EU law consistent with the 2016 Basel standards, taking into account a number of EU specificities.

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7. In December 2017, the Basel Committee published a statement announcing a three year delay in the implementation of the FRTB. The Committee now regards some of the capital calculations set out in the 2016 standards as inadequate and wishes to perform a thorough review by December 2018.

8. In light of these developments, the Presidency took the view that it is not appropriate to implement the FRTB as initially proposed in the Banking Package because it would oblige institutions to meet requirements subject to change in the short term.

9. The Presidency therefore puts forward the present compromise to implement the FRTB in a manner that takes account of the delay announced by the Basel Committee in December 2017, gives institutions enough time to prepare for the new market risk capital requirements and sends a strong message to international players that the EU remains committed to full FRTB implementation when the standards are ready. The Presidency's proposal, which is duly reflected in the compromise CRR text, is as follows:

   a) frontload the FRTB as a reporting requirement only while the review in Basel is ongoing. During this initial stage, institutions will be required to make the capital calculations and report the figures to their supervisors, but will not be under an obligation to hold the amount of capital resulting from such calculations or to disclose them to the market;

   b) remove from the draft CRR amending regulation those parts of the FRTB currently subject to review and give a mandate for the Commission to add them back in the CRR through a delegated act in 2019. Reporting will only start after the delegated act comes into force;

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c) <u>invite</u> the Commission to <u>submit a report</u> by end 2020, together with a legislative proposal, where appropriate, to amend the CRR for the purpose of converting this reporting requirements into a fully-fledged capital requirement. Institutions will only be required to meet the FRTB on the basis of the new legislation; and

d) until that time, keep the existing market risk framework as currently in force under the CRR for institutions to continue to comply with.

10. In Coreper, Member States agreed with the principle that institutions should only be required to meet FRTB as a capital requirement after Basel has completed its review and, accordingly, the FRTB should be frontloaded as a reporting requirement only and the CRR amended at a later stage via a level 1 amending proposal. Several Member States agreed with the Presidency's proposal.

11. Other Member States did not agree due to concerns about the use of a delegated act to supplement what they regard as a substantial part of the reporting requirement. These Member States suggested, instead, retaining the entire FRTB text in level 1 as agreed under the EE Presidency with all the regulatory capital calculations therein and require institutions to report on those calculations until they are introduced as a capital requirement by a level 1 amendment to the CRR. The Member States supporting this approach are concerned that the use of a delegated act would risk undoing the progress made on the FRTB under the Estonian Presidency. Other delegations, however, could not accept this approach as it would result in reporting on outdated figures.

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B. MINIMUM REQUIREMENT FOR OWN FUNDS AND ELIGIBLE LIABILITIES (MREL) SUBORDINATION

In November 2015, the Financial Stability Board (FSB) adopted the **Total Loss Absorption Capacity (the "TLAC")** standard for Global Systemically Important Banks (G-SIBs). It aims at providing for adequate loss-absorbing capacity when banks fail.

12. The TLAC standard should be implemented on 1 January 2019. The Commission has proposed that TLAC be transposed as minimum mandatory capital and subordinated debt requirements in CRR. The existing MREL framework also needs to be aligned with TLAC. Resolution authorities should have the discretion to require additional MREL for G-SIIs, and also for other banks, to be met with MREL eligible instruments that can be both subordinated and non-subordinated.

13. The overall amount (quantity) of MREL and the level of subordination of eligible debt should provide for an appropriate loss absorption capacity and for recapitalisation of a bank.

Subordinated instruments are those designed to be bailed in before senior liabilities. Due to the increased risk of potential losses, such subordinated instruments are more costly for banks to issue.

14. The Commission proposed to split MREL into "requirement" and "guidance". The concept of MREL guidance was proposed by the Commission in order to establish a proportionate ladder of intervention measures available to resolution authorities at the time of an MREL breach. Thus, restrictions to discretionary distributions (e.g. dividends and variable remuneration) would be applied at a later stage when the breach of MREL reaches a certain level.

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15. In this context, three questions were debated at Coreper: flexibility in setting the level of subordination, scope of the mandatory subordination and transitional periods.

i. Flexibility in setting the level of subordination

16. The Commission proposed that resolution authorities have the discretion to require subordination for MREL where and to the level that this is necessary to ensure that creditors do not receive worse treatment in resolution than in insolvency proceedings. This is known as no creditor worse off principle (NCWO).

17. The Bulgarian Presidency has proposed to remove the concept of guidance and move the Market Confidence Buffer (MCB) from the guidance to the MREL requirement, in order to take into account the concerns of the Member States who asked for stricter requirements and further flexibility for the resolution authorities. In addition, in view of the risk reduction nature of this package, the Bulgarian Presidency has proposed to increase the flexibility for resolution authorities as regards setting the level of the MCB.

The **Market Confidence Buffer** is the part of the MREL requirement designed to allow the institution to continue to operate and sustain sufficient market confidence after resolution.

18. When setting the MREL requirement the authority should also be required to take into account the 8% of Total Liabilities and Own Funds (TLOF) rule for access to the Resolution Fund. To compensate for these higher requirements, framed flexibility has been afforded to Resolution Authorities in terms of imposing restrictions on discretionary distributions when MREL levels are breached.

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ii. Mandatory subordination for Top Tier banks and GSIIs

19. The Bulgarian Presidency has introduced a new minimum mandatory subordination requirement for Top Tier Banks (with consolidated balance sheet at resolution group level above EUR 75 bn). This floor ensures that such institutions have a minimum level of subordination based on recommendations by the European Banking Authority (EBA). One Member State, supported by several other Member States, proposed that Resolution Authorities should be able to impose the stricter conditions provided for top tier banks to other banks based on certain conditions outline in the level 1 text.

20. The Presidency's amendments to the subordination framework aim at accommodating both Member States who would like resolution authorities to be able to have broad discretion to require additional subordination for GSIIs and Top Tier banks, as well as Member States who asked for some safeguards and backstops regarding how much subordinated MREL resolution authorities can require from institutions.

21. The Presidency believes that the appropriate balance would imply discretion for resolution authorities to require additional subordination of up to the higher of 8% TLOF or an amount based on the risk profile of the institutions. For G-SIIs and Top Tier Banks, the discretion is broader. For all other banks, the discretion is based on assessment of the potential breach of the NCWO principle and up to the same levels (higher of 8% TLOF or the formula). Furthermore, higher levels of subordination can be required for the riskiest banks or where substantive impediments to resolvability have been identified (so called outlier banks).

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iii. Transitional periods

22. The Presidency believes that institutions should be granted sufficient time to address potential shortfalls for MREL eligible instruments. The Presidency compromise also provides flexibility for authorities to require compliance earlier than the end of the transitional periods, when justified.

23. The final decisions on the transitionals, however, should be dependent on the outcome of the political decisions regarding MREL calibration and subordination.

C. EXEMPTIONS FROM THE CRR/CRD SCOPE

24. Under current Article 2(5) of the CRD there are a number of legal entities explicitly exempted from both the CRD and the CRR, and as a result also from the resolution framework. These legal entities are for the most part credit unions and promotional and development banks. In the absence of an exemption, they would qualify as "credit institutions" thus requiring licensing and supervision under the CRR/CRD.

25. Three Member States requested adding their national development banks to the list of exemptions, which was supported by a large majority of Member States. There was also large support to exempt the credit unions from two Member States for consistency with other currently exempted credit unions.

26. Another Member State had requested to exempt 14 promotional banks (one national and 13 regional). This Member State already has a national promotional bank exempted from the CRR/CRD. The Working Party failed to agree on this request. Member States' views at Coreper were split between granting the exemption in full or not granting new exemption at all to that Member State.

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III. CONCLUSION

27. Council is invited to:

A. FRTB IMPLEMENTATION

– decide on the approach to frontloading the FRTB reporting requirements, either:

i) through a delegated act based on the final Basel figures, as suggested by the Presidency; or
ii) based on the current calculations as set out in the Estonian Presidency's Progress Report, as suggested by some delegations.

B. MINIMUM REQUIREMENT FOR OWN FUNDS AND ELIGIBLE LIABILITIES (MREL) SUBORDINATION

– Agree on the compromise submitted, while taking a decision on the items in square brackets below:

a) Mandatory subordination for GSIIs with the TLAC standard [**14.5 RWA+3.5**%] allowance based on NCWO

b) Mandatory subordination for top tier banks (13.5% of RWA - EBA report)

c) Framed flexibility for Authorities to require higher level of subordination for all banks:

i) up to the higher of 8% TLOF or [**X**]% of RWA
ii) under clear conditions (NCWO assessment, [**e. g. avoid exposing public funds to losses**])

d) Flexibility of the Resolution Authorities to require higher levels of subordination **[up to a certain level]** for outlier banks defined according to their riskiness and the possibility to address impediments to resolvability.

C. EXEMPTIONS FROM THE CRR/CRD SCOPE

– Decide on whether to exempt the 14 promotional banks as per the request of a Member State referred to in paragraph 26

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