



Brussels, 30 November 2018
(OR. en)

14448/18

Interinstitutional Files:

2016/0364(COD)
2016/0360(COD)
2016/0361(COD)
2016/0362(COD)

EF 296
ECOFIN 1078
DRS 52
CCG 39
CODEC 2050

NOTE

From: Permanent Representatives Committee (Part 2)
To: Council
Subject: Banking package (CRR/CRD/BRRD/SRMR)
- General endorsement of the results of the trilogues

I. INTRODUCTION

1. The Commission presented the Banking Package in November 2016 to implement, inter alia, the reforms agreed at international level following the 2007-08 financial crisis. The Package includes prudential standards adopted by Basel Committee on Banking Supervision and by the Financial Stability Board (FSB). The Banking Package's main objective is to reduce risk in the EU banking industry.
2. The Banking Package comprises two regulations and two directives relating to:
 - a) bank capital and liquidity requirements (amendments to regulation 575/2013 ("CRR") and directive 2013/36/EU ("CRD"));
 - b) recovery and resolution of banks (amendments to directive 2014/59/EU ("BRRD") and regulation 806/2014 ("SRMR").

3. On 25 May 2018, the Council agreed its mandate to start negotiations with the European Parliament. The European Parliament confirmed its position on the Banking Package at the June 2018 plenary. Since then, 13 trilogues have taken place (seven on CRR/CRD and six on BRRD/SRMR).
4. At the 21 and 22 November trilogues, the Austrian Presidency and the European Parliament agreed "ad referendum" to settle a number of key issues, without prejudice to technical finalisation of the legal text as a whole at a later stage.
5. On 30 November Coreper met to prepare the ECOFIN Council on 4 December.
6. Agreement on the key issues of the Banking Package would be a major step forward in the process of reducing risk in the EU banking sector. Risk reduction is, in turn, a pre-condition for further steps on risk sharing in the EU's Banking Union as per Council conclusions of June 2016.
7. The European Council is due to review the progress achieved so far in reducing risk in the EU banking industry in December 2018 and could decide on specific steps to be taken, specifically as regards the early implementation of a backstop for the European Stability Mechanism.

II. RESULT OF THE 21 AND 22 NOVEMBER TRILOGUES: KEY ISSUES

8. As a result of the 21 and 22 November trilogues, the Presidency agreed "ad referendum" with the European Parliament to settle the following key issues of the package as set out below:
 - a) **MREL calibration and subordination benchmark:** the European Parliament accepted the Council's general approach provided that:

- i. subject to an assessment of the resolution authority, for Top Tier banks the total risk exposure amount (TREA) metric shall be applied when certain criteria are met and taking into account the risk of disproportionate impacts on business models, without going below 27% TREA, where 8% of total liabilities and own funds (TLOF) leads to a higher Pillar 1 subordination requirement than 27% TREA; such limitation of the Pillar 1 requirement at 27% TREA, subject to an assessment of the resolution authority, would be without prejudice to the possibility of requiring additional subordination through Pillar 2;
 - ii. the conditions for resolution authorities to require Pillar 2 subordination are reordered, by moving the first condition concerning the 20% riskiest institutions to the end of the list;
 - iii. "the resolution authority may permit liabilities to qualify as eligible" within the context of the senior debt allowance.
- b) Moratorium:** the European Parliament accepted the Council's approach to disallow a combination of stays. Council accepted additional preconditions to impose the moratorium.
- c) Maximum Distributable Amounts (MDA):** the European Parliament accepted the Council's general approach, provided that:
- i. As regards BRRD (MREL related MDAs) the Council's approach is kept, including on flexibility (no automaticity), except the grace period which is extended from six months to nine months.
 - ii. As regards CRR the Council's approach is also kept on leverage and risk based MDAs.

- d) SFD (settlement finality directive) amendments:** the European Parliament accepted the Council's general approach. A review clause is added, whereby the Commission will assess the existence of any gaps to be repaired 24 months after entry into force of the BRRD.
- e) Insolvency:** Council accepted the European Parliament's proposal. Institutions that are failing or likely to fail, but not subject to resolution, would be wound up in an orderly manner in accordance with the applicable national law. In Art. 48(6a) the insolvency hierarchy is harmonised.
- f) Retail:** the Council accepted the European Parliament's ambition to introduce safeguards for retail investors to subscribe newly issued subordinated TLAC/MREL instruments in the following manner:
- i. Member States would be given discretion to require either of the following:
 - Option A: retail investors with an investment capacity below EUR 500,000 may only invest a minimum initial amount of 10,000 EUR in those instruments representing not more than 10% of their investment capacity; or
 - Option B: a minimum denomination of EUR 50,000
 - ii. smaller Member States with a less liquid market for subordinated instruments may be allowed to implement a lower minimum initial investment amount (down to EUR 10,000).

- g) **Home-Host and G-SII Score:** the European Parliament accepted the Council's general approach on all home-host related provisions (including the G-SII score).

- h) **Credit Risk:** the Presidency agreed to some targeted amendments to the credit risk requirements on "massive disposals" and pensions and salary-backed loans.

As regards massive disposals, the new provisions would help banks with high level of non-performing loans (NPLs) to dispose of them with a limited impact on their capital requirements, subject to certain requirements and within a pre-determined timeframe. This should make it easier for banks to clean up their balance sheets from bad assets without unduly impairing their lending capacity.

As regards pension and salary-backed loans, it was agreed to provide for lower capital requirements for these loans taking into account their low default risk. Specifically, the capital charge for these loans would fall from 75% (as per the current CRR) to 35% under the standardised approach, but the Presidency agreed on a number of safeguards and risk mitigants for prudential reasons.

- i) **Proportionality:** both co-Legislators agree that prudential requirements should be proportionate to the size of the institution and, in particular, administrative burden on smaller institutions should be reduced in as much as possible. To that end, an explicit definition for "small, non complex institutions" would be provided for and accompanied by reduced reporting and disclosure requirements in order to lower compliance costs for those.

On regulatory reporting in particular, the EBA would be mandated to develop targeted reporting standards for small, non-complex institutions with the objective of lowering their reporting costs by at least 10% and, ideally, up to 20%. Furthermore, the EBA would conduct a study to assess the feasibility of an integrated reporting system for all EU banks which could lead to further developments if the results of the study were positive.

- j) The net stable funding ratio (NSFR):** as the NSFR is a key tenet of the Basel Committee reforms referred to above, both Co-Legislators agree to a large extent on the content of this new requirement. However, the Presidency would recommend taking on-board certain targeted amendments proposed by the European Parliament to prevent undue market disruption. Specifically, these amendments relate to the calibration of the so called "required stable funding" for certain market transactions (trade financing, factoring, repos and reverse repos). The EBA would be mandated to produce reports on holdings in securities to hedge derivatives and on the liquidity of precious metals for NSFR purposes, also for consistency with the European Parliament's proposals.
- k) Simplified net stable funding ratio (sNSFR):** as proposed by the European Parliament, small non-complex institutions would get the advantage of a simplified version of the NSFR to reduce their administrative burden. The simplification results from fewer data points to be collected for calculation and reporting purposes, but the Presidency has ensured through targeted amendments to the Parliament's text that the sNSFR would remain at least as conservative and safe as the fully-fledged metric.

- l) Supporting factors:** the Commission had proposed to reduce certain capital requirements to support lending to small and medium sized enterprises and infrastructure projects by extending the scope of the so called "supporting factors" for such entities or activities.

The Presidency recommends extending the existing supporting factor for loans to SMEs in an amount up to EUR 2.5 million (up from 1.5 million). For infrastructure financing, the scope of the supporting factor would be extended to cover additional types of infrastructure projects such as for those conducted by consortiums of firms. In both cases the Presidency has framed the initial EP proposals. A non-binding assessment of sustainability will be required for such projects on the request of the EP.

- m) Anti Money Laundering:** the Presidency recommends taking on the European Parliament's amendments to the CRD with the objective of enhancing the cooperation and exchange of information between prudential supervisors, financial intelligence units (FIUs) and competent authorities for Anti-money laundering and combatting the financing of terrorism (AML/CFT). Additional amendments would be made to strengthen the AML dimension in the relevant prudential tools on authorisation, fit and proper checks and supervisory review and evaluation process (SREP).
- n) Own funds:** as regards the composition of banks' own funds (eg capital), the following targeted and framed changes have been agreed by the Presidency at the proposal of the EP:

- i. **Holdings in insurance subsidiaries ("Danish Compromise"):** a transitional period is provided for that would allow institutions not to deduct certain types of insurance holdings until 31 Dec 2024;
- ii. **Profit and Loss Transfer Agreements:** such agreements would be recognised for own funds treatment purposes where they have been set-up for legitimate tax purposes, the subsidiary is located in the same Member State as the parent and it is at least 90% owned by the parent. Moreover the parent would have full discretion to reduce profits by allocating funds to common equity tier 1 (CET1) eligible items, but would be obliged to fully compensate the subsidiary for all losses and the contract may only be terminated with a 1 year notice period;
- iii. **Minimum Value Commitments (MVC)** will be assigned a credit conversion factor (CCF) of 20%;
- iv. **Additional distributable items (ADI):** the agreed text would allow the distribution of items that are restricted under national law, but eligible under the CRR/CRD;
- v. **Software:** an exemption from deductions of certain intangible software assets is granted from own funds items provided that its value is prudentially valued and loss absorbing also in a gone concern situation. The mechanics and details of the non-deduction will be set out in an EBA RTS.

- o) Pillar 2/Macroprudential framework:** the Co-Legislators disagreed with the Commission's objective to confine bank specific capital requirements or Pillar 2 to micro-prudential purposes, if not coupled with a more thorough reform of the macroprudential or systemic provisions in the CRR/CRD. Both Co-Legislators have, thus, made a large number of amendments to the Commission's proposal to offset the loss of flexibility in Pillar 2 to tackle macroprudential or systemic risks.

The Co-Legislators' amendments in connection with Pillar 2 and macroprudential risks are, largely consistent. However, the Co-Legislators had slightly diverging views on the appropriate interaction between the new micro-only Pillar 2 framework, the capital buffer provisions and the macroprudential requirements, in particular as regards the degree of flexibility that supervisory and macroprudential authorities should be given. As a compromise, it was agreed that narrower availability of Pillar 2 tools should be offset by more flexibility to resort to macroprudential tools implemented through not fully harmonised measures in a Member State. Furthermore, the Presidency suggests that the macroprudential framework be subject to a comprehensive report in the terms proposed by the European Parliament.

- p) Fundamental Review of the Trading Book:** The Commission proposal to introduce new capital requirements for bank's trading or derivative activities is based on the new standard regarding capital requirements for market risks introduced by the Basel Committee in January 2016. However, the final version of the Basel Committee is still pending due to certain irregularities found within the original standard and some recalibration work that is yet ongoing. Against this backdrop, the Council introduced reporting requirements for this new standard and agreed with the European Commission that the final standards should be implemented as soon as they are finalised at international level. The European Parliament could be convinced of the merits of such approach and accepted the Council's position.

The Presidency, however, accepted certain targeted amendments regarding qualitative requirements for institutions using the derogation for small trading book business, thus contributing to reducing administrative burden for those institutions.

- q) IPU:** large non-EU banking groups with two or more subsidiary institutions in the EU would be required to establish an intermediate parent company or IPU to consolidate all their activities in the Union under that IPU. The objective is to facilitate group supervision and enhance the resolvability of the firms in scope. Though the approach of both Co-Legislators on this was largely similar, the compromise text would include the following main items:
- i. Threshold to be set at € 40 billion balance sheet assets in the EU including those held by third country branches (both those of credit institutions and investment firms).
 - ii. Global Systemically Important Institutions (G-SIBs) are not automatically captured by the requirement if they do not meet the threshold;
 - iii. IPUs may be set up as investment firms as per the Council's text;
 - iv. a transitional period of 3 years would be provided;
 - v. EBA would issue a report on the treatment of third country branches under Member States' laws as per the European Parliament's text.
- r) Scope of CRR/CRD:** the scope of entities exempted from CRR and CRD would be as per the Council's general approach, that is, in Level 1 and not through a delegated act as in the European Parliament's text.

- s) **Leverage Ratio:** as regards the introduction of a binding leverage ratio as a non-risk sensitive backstop capital requirement calibrated on the size of the banks' on- and off-balance sheet exposures, the Presidency and the European Parliament could agree to the following amendments:
- i. on capital composition, the Basel standards should not be gold-plated and, hence, the Council's text should be retained;
 - ii. further, some targeted exemptions from the Leverage Ratio would introduced for certain entities or business models (for Central Securities Depositories holding a banking license, building societies, central bank exposures, certain development banks that are structurally and organisationally an independent part of commercial bank or institutional protection schemes - IPSs).
 - iii. Above that, the issue of so called "window dressing" should be addressed by accepting the European Parliament's proposal but amending it to a reporting obligation complemented by Pillar 2 measures, where necessary.

t) **Environmental Social and Governance-Risks (ESG):** environmental, social and governance (ESG) criteria are a set of standards for a company's operations that could be used to screen potential investments from an environmental, social and governance perspective. The European Parliament proposed that the EBA report on the appropriateness of reflecting under the risk management processes financial risks that are related to Environmental Social and Governance (ESG) risks. Where banks are exposed to such risks, this should be adequately reflected by the banks' internal risk management systems and processes and supervised properly. Furthermore, the European Parliament proposed additional disclosure requirements for such risks and a mandate for the EBA to produce a report on the prudential treatment of "green" and "brown" assets (penalising factors for assets posing environmental risk). The Presidency would suggest that these amendments are taking on by the Council in the compromise text. The EBA report, in particular, should however be delivered within a sufficiently long timeframe to cater for legislative developments on sustainable finance.

III. OTHER ISSUES WHERE AGREEMENT HAS ALREADY BEEN REACHED

9. Without prejudice to the principle that nothing is agreed until everything is agreed, the Presidency and the European Parliament also agreed "ad referendum" to settle a number of other issues, as follows:

a) **TLAC deductions for O-SIIs:** an EBA report to assess whether such deductions are acceptable will be included in the legal text.

- b) Interest Rate in the Banking Book:** it was agreed to keep the simplified methodology proposed in the European Parliament text, but with fine-tuning to ensure the approach remains "conservatively calibrated" allowing no alleviation in capital requirements, that additional criteria and flexibility for supervisors are implemented as regards the scope of banks eligible for using the simpler methods and that both co-Legislators can agree on a mutually acceptable threshold, taking into account the concepts of proportionality (e.g. in the field of disclosure) elsewhere in the framework.
- c) Counterparty Credit Risk:** the Council text was agreed by the European Parliament.
- d) Transitional agreements for the Central Clearing Houses (CCPs):** the Council text was agreed.
- e) Leverage:** as regards the Leverage Ratio surcharge for globally systemic institutions (G-SIIs), both Co-Legislators agree on implementing the Basel standard on introducing a Leverage buffer add-on. With respect to other systemically important institutions (O-SIIs), there was agreement to mandate the COM to issue a report on the appropriateness of subjecting them to similar Leverage Ratio buffer requirements. Similarly as regards MDA restrictions for leverage purposes, there was agreement on the Council text including on the consequences of a breach of the leverage ratio.

f) **Large exposures:** the European Parliament accepted the Council's approach on:

- i. guarantees for export credit;
- ii. national discretion for reducing exposure values of immovable property;
- iii. substitution approach for repo transactions.

The Council agreed with the European Parliament's position on the exemptions from large exposures-limits for Settlement systems with common settlement infrastructure.

IV. OUTSTANDING ISSUES

10. There are still a number of outstanding issues, in particular, remuneration, off-balance sheet guarantees to CIUs (Collective Investment Undertakings), treatment of shadow-banking or market-based finance, which have to be addressed.

11. Furthermore, technical and lawyer-linguist revision still has to take place to make the legal text operationally-sound and complete.

V. CONCLUSION

12. In view of the above, COREPER invites the Council to endorse the results of the trilogues on the key issues of the Banking Package and on the other issues as set out in sections II and III above.