Council of the
European Union

Brussels, 23 November 2020
(OR. en)

13091/20

LIMITE

EF 296
ECOFIN 1067
CCG 48
DRS 35
CODEC 1177
JAI 991
JUSTCIV 127
COMPET 569
EMPL 518
SOC 720

Interinstitutional Files:
2010/0207(COD)
2011/0295(COD)
2015/0270(COD)
2016/0360(COD)
2016/0361(COD)
2016/0362(COD)
2016/0363(COD)
2016/0364(COD)
2018/0060(COD)
2018/0063(COD)
2020/0066(COD)

PUBLIC

REPORT

From:	Presidency
To:	Permanent Representatives Committee
Subject:	Presidency progress report on the strengthening of the Banking Union

Presidency Progress Report on the Strengthening of the Banking Union

I. Introduction

Pursuant to the Council conclusions on the **Roadmap to complete the Banking Union**, as adopted by the Council on 17 June 2016 (10460/16, "June 2016 Roadmap"), the Council has continued to work during the German Presidency towards the strengthening of the Banking Union and has also continued monitoring progress on risk reduction.

The discussions that took place in December 2019 in the **Eurogroup and the Euro Summit** (meeting in inclusive format) highlighted the need to continue to work on all elements of the further strengthening of the Banking Union on a consensual basis, with the aim of returning to these issues in June 2020.

Bearing in mind that the Banking Union was created as a response to the financial crisis, any further work should take into account the core guiding principles of the Banking Union, i.e. to break the bank-sovereign negative feedback loop that was at the heart of the crisis ensuring that the banking sector in the euro area and the wider EU is safe and reliable, and that non-viable banks are resolved without there being recourse to taxpayers' money and with minimal impact on the real economy while safeguarding financial stability at the EU and Member State levels.

In June 2020, in the midst of the COVID-19 pandemic, the Eurogroup meeting in inclusive format recognised that the creation of the Banking Union had significantly contributed to ensuring a more resilient banking sector, and agreed that the crisis strengthened the case for completing the Banking Union. It invited their deputies to resume the work on the **further strengthening of the Banking Union in a holistic manner**, as soon as possible.

Following this holistic approach, the German Presidency devised the work programme of the **Ad Hoc Working Party on the Strengthening of the Banking Union** (AHWP, 5006/16), which discussed at technical level, over the course of **four informal meetings during the German Presidency**, the elements considered essential in order to strengthen the Banking Union, namely:

- measures designed to improve crisis management,
- greater integration of the EU banking sector and the question of home-host balance,
- the regulatory treatment of sovereign exposures, and
- technical discussions on design features of a European deposit insurance (EDIS) on the basis of the so-called hybrid model.

These discussions were without prejudice to the outcome of political negotiations on the further strengthening of the Banking Union.

The work programme of the AHWP was closely coordinated with those of the High-Level Working Group on EDIS (HLWG) and the Commission Expert Group on Banking, Payments and Insurance (EGBPI).

This progress report summarises the state of play as discussed at the four meetings mentioned above and has been prepared under the responsibility of the German Presidency, taking into account the views expressed by AHWP members. It is intended to provide continuity and to facilitate the task of the incoming Presidency, and should not be considered binding on the delegations, as it constitutes the Presidency's assessment of the outcome of discussions held[1].

The report is divided into three parts: Section II is the most extensive part of the report covering the above-mentioned elements essential to strengthen the Banking Union. Section III deals with the review of the bank crisis management and deposit insurance framework and section IV deals with the monitoring of risk reduction, notably action to tackle non-performing loans.

II. Elements considered essential to strengthen the Banking Union

II.1 Crisis management framework

The Presidency has dedicated two working sessions to discussions on strengthening the crisis management framework for banks. At a **first meeting on 13 July**, discussions focused on:

- **the interaction between supervisory powers under the Capital Requirements Directive (CRD) and early intervention powers under the Bank Recovery and Resolution Directive (BRRD)**, and

[1] Progress achieved previously was presented in progress reports prepared by the Dutch (10036/16), Slovak (14841/16), Maltese (9484/17), Estonian (14808/17), Bulgarian (9819/18), Austrian (14452/18), Romanian (9729/19 ADD1), Finnish (14354/19 REV1) and Croatian (8335/20 ADD1) Presidencies.

- questions related to the **triggers used to assess whether banks are failing or likely to fail (FOLTF)** and whether there would be merit in aligning these with the triggers for bankruptcy under national insolvency frameworks.

In addition, the Presidency provided a non-paper setting out the premises considered instrumental when discussing future amendments of the creditor hierarchy (e.g. transparency and predictability for creditors). The purpose of this non paper was to prepare the ground for a more detailed discussion on targeted amendments of the creditor hierarchy at the September meeting of the AHWP.

Interaction between supervisory powers under the CRD and early intervention powers under the BRRD

As concerns the interaction between supervisory powers under CRD and **early intervention powers** under BRRD, a majority of Member States saw merit in eliminating existing overlaps in the respective regulatory frameworks which might jeopardize the appropriate use of the tools. There were divergent views on whether labelling such measures as early intervention measures under the BRRD carried an exacerbating effect to their use, and whether such labelling might trigger public disclosure obligations under the Market Abuse Regulation (MAR). The Commission clarified at the meeting that there is no difference from the perspective of MAR obligations between supervisory and early intervention measures. Furthermore, Member States largely opposed the idea of defining quantitative triggers for early intervention powers or having a clear escalation ladder and were instead in favour of allowing supervisory authorities greater discretion. One Member State called for further clarity to understand different potential outcomes from the various applications of both EIMs and supervisory powers, by developing scenarios to identify areas of potential streamlining.

Nonetheless, there was general support for measures that would align the toolbox available to supervisory authorities. Merging supervisory measures and early intervention powers in the Single Supervisory Mechanism Regulation (SSMR) and the CRD was therefore deemed a reasonable way forward by a majority of Member States. Also, the importance of ensuring coordination between supervisors and resolution authorities was raised. The ECB and a few Member States supported removing the overlap between early intervention and supervisory measures by deleting from the BRRD those early intervention measures that are already available in the CRD and the SSMR, as this would imply limited changes, and clarity on the interaction with resolution authority.

Regarding the Single Supervisory Mechanism (SSM), there was general support for granting the European Central Bank (ECB) a directly applicable legal basis to apply supervisory and early intervention powers. In this context, the ECB pointed out that amending the SSMR might entail a delay compared to an amendment to the BRRD and the SRMR during which the ECB would still lack a directly applicable legal basis. Given the need to solve this issue swiftly, the ECB expressed the view that amending the Single Resolution Mechanism Regulation (SRMR) could be a more efficient solution, given that amendments to the SRMR can be adopted under the ordinary legislative procedure, for which unanimity is not required (unlike amendments to the SSMR).

The **Presidency** acknowledged the majority view of Member States that supervisory measures and early intervention powers **should be merged** under the SSMR/CRD. Technical work towards a legislative proposal in due time is conducted by the Commission.

Interaction between the determination of FOLTF and national insolvency triggers

The general view on the interaction between the determination of FOLTF and national insolvency triggers was that it would be necessary to align national insolvency triggers in order to avoid “limbo situations” where banks with a negative PIA are declared FOLTF but do not meet the insolvency criteria under national insolvency frameworks. However, for some Member states an alignment of national insolvency triggers would raise significant constitutional and practical issues and do not therefore consider an alignment as a feasible option.

Nonetheless, some Member States expressed the view that this issue might be resolved by implementation at national level of the new Article 32b BRRD2. This article requires banks that are declared FOLTF but whose resolution is not in the public interest to be "wound up in an orderly manner in accordance with the applicable national law".

In this respect, there was broad agreement that the reference in the provision to the concept of "winding up" would **ensure that failing banks would exit the market**, although views remained divided as to the procedures and timelines according to which market exit would need to be conducted. Notably, many Member States took the view that any kind of automaticity between the determination of FOLTF and the opening of a formal insolvency proceeding is not necessary, especially since FOLTF includes the situation when bank is only "likely" to fail, thus not insolvent, or the FOLFT does not concern the issue of insolvency at all. Most Member States, nonetheless, argued in favour of clarifying the legal concepts that are not precisely defined in Article 32b BRRD2, such as the meaning of "winding up". Some Member States also highlighted interactions between FOLTF and withdrawals of banking licences and held that a discretionary power for such a withdrawal could be considered as a useful addition in this regard. The ECB clarified that conditions for the withdrawal of licence are also not aligned with the FOLTF conditions. An amendment to the legal framework would be required to address this issue.

The **Presidency** concluded that the extensive discussions on the topics of FOLTF and insolvency triggers should be acknowledged as part of a potential reform of the crisis management framework. Member States welcomed further technical work at the level of the Commission with a view to prepare a legislative proposal in due time.

At a **<u>second meeting on 18 September</u>**, the AHWP focused on:

- the **creditor hierarchy**, and
- the **crisis management framework for smaller banks**.

Targeted amendments to the creditor hierarchy

Most Member States agreed that it would be beneficial to adopt a **targeted approach** to the harmonisation of the **creditor hierarchy**. An approach of this type was proposed by the Presidency in its non-paper in order to avoid far-reaching changes to insolvency regimes, the scope of which may go beyond bank-related issues. It instead focused on harmonising those areas that would be relevant for bank resolution purposes, taking particular account of the “no creditor worse off” principle.

Member States had divergent views, however, as to which specific areas would require harmonisation and what a harmonised approach should look like, notably in terms of the ranking of deposits and liabilities excluded from bail-in.

As regards the **ranking of deposits**, most Member States were in favour of a “moderate” general depositor preference based on a tiered approach. Under a moderate general depositor preference, all depositor claims rank higher than the claims of ordinary unsecured creditors. In addition in a tiered depositor preference regime, covered deposits rank higher than eligible deposits for natural persons and SME above the DGS coverage level, but other deposits still rank higher than other senior liabilities[2]. In view of this, Member States underlined the importance of maintaining the super priority ranking of covered deposits, which safeguards sufficient funding to allow national Deposit Guarantee Schemes (DGS) to fulfil their core functions. With regard to “other deposits” (e.g. large corporate deposits and non-eligible deposits), most Member States have not commented on the question of whether these deposits should rank higher than senior liabilities, as the moderate general depositor preference suggests, or whether they should rank *pari passu* with other senior liabilities.

Few Member States, however, were opposed to the concept of a tiered depositor preference. They, instead, argued in favour of an approach where all covered and uncovered deposits rank equally (*pari passu* ranking) on the basis that this would increase the financial scope of DGSs to finance other measures in addition to payout as part of an EU orderly liquidation regime aimed at providing a tool to manage the crisis of banks that do not meet the public interest test.

[2] This approach was suggested by the ECB in its opinion of 8 March 2017 (CON/2017/6).

The discussion on the **ranking of liabilities excluded from bail-in** and their interaction with other liabilities such as deposits or secured liabilities turned out to be difficult. Member States indicated numerous problems that deserve further reflection. As regards tax liabilities, for example, some Member States expressed concerns if such liabilities would be paid off before covered deposits or DGS claims. Against this background, a significant number of Member States indicated that they would only prefer a harmonization of some but not all of these liabilities. There was support to group the excluded liabilities on the basis of reasons of exclusion. Other Member States asked for a group-wide perspective to support resolution based on the "Single Point of Entry" approach (SPE) when referring to the ranking of intragroup liabilities.

The **Presidency** acknowledged the view of most Member States that any follow-up work on the creditor hierarchy should be targeted, with a specific focus on analysing which liabilities excluded from bail-in should get a harmonised ranking. The Presidency believes that further technical work on the ranking of liabilities excluded from bail-in is needed, including on how the ranking could be applied in combination with a moderate general depositor preference based on a tiered approach, which is the preferred option of many Member States. The Commission confirmed its intention to continue technical work on that basis.

Crisis management framework for smaller banks

The discussion on the design of the crisis management framework for smaller banks was based on four contributions:

- a presentation from the SRB on its approach to the public interest assessment;
- a Presidency non-paper on a dedicated liquidation regime for banks that are FOLTF but that have a negative public interest assessment ("EU bank liquidation regime");
- a joint non-paper by FI, FR and NL, dealing with targeted measures on how to improve the crisis management framework for all banks, including the public interest assessment and State Aid control.;
- a presentation from the European Forum of Deposit Insurers (EFDI) on its practical experiences with the least-cost test.

The current crisis management framework follows a binary nature: the resolution authority acts only when the resolution of the respective bank is in the public interest while all other cases are subject to national insolvency proceedings, enabling divergent courses of action to be pursued along national lines. The choice between liquidation under national insolvency regimes and resolution under the resolution regime depends therefore on the result of the public interest assessment. In view of this, the **SRB** provided various clarifications on its approach to the **public interest assessment** under the SRM:

- First, the SRB is the resolution authority for 128 banks/banking groups, including the largest banks operating in the Banking Union, systemically relevant banks and certain cross-border groups. For these banks, the SRB generally expects and plans for the use of resolution tools not liquidation under the respective national insolvency regimes.

- Second, the public interest assessment takes into account the circumstances at the time when the bank is failing or likely to fail, i.e. the SRB also considers the economic environment and assesses the impact of resolution versus insolvency at that specific point in time, re-assessing the impact of the bank's failure on the resolution objectives.

- Third, differences in NIPs can lead to different outcomes for the public interest assessment. Therefore, the harmonisation of NIPs would be very helpful in this regard.

- Finally, the SRB explained that further work is planned on dedicated areas in cooperation with NRAs. The main focus will be on systemic-wide events, refinement of critical functions, analysis at regional level and protection of covered deposits.

The SRB explained that – given the large number of banks in the European Union, which stands at around 3 000 – liquidation under national insolvency regimes is the "baseline scenario" for a large number of banks in most Member States in the event of a crisis.

For these banks the Presidency suggested in its non-paper an **"EU bank liquidation regime"**, which contains special liquidation tools and would allow for the harmonised use of DGS interventions beyond payout ("P&A transactions") on the basis of a clearly defined least cost test methodology. Member States had diverging opinions on the key question of the introduction of an EU bank liquidation regime for banks with a negative public interest assessment: some Member States, the ECB and the SRB saw benefits in such an approach, as they considered the current rules under the BRRD inappropriate for smaller, deposit-taking banks. These Member States and the ECB argued, in particular, that it could be difficult to bring these banks within the scope of the resolution framework, as most of them may have no/or limited access to the capital markets to build up sufficient MREL for a resolution strategy. In their view, an EU bank liquidation regime would allow a proportional approach to be taken, which would at the same time ensure neutrality with regard to different business models.

Other Member States, however, recalled the founding objective of the Banking Union that "*all classes of institutions are resolvable irrespective of their size and interconnectedness"* (ECOFIN Conclusions, December 2010). These Member States considered that all the tools needed to facilitate the resolution of banks – including smaller ones – were already in place in the resolution toolbox (for instance the sale of business or bridge bank tools). To allow the application in practice of such tools to smaller banks, these Member States supported a **broader interpretation of the public interest assessment**, as suggested in the joint non-paper by FI, FR and NL, more coherent with the view expressed by some Member States that even the failure of small banks might carry risks for financial stability, continuity of critical functions, protection of and access to deposits. Subsequently, the remainder of banks with a negative public interest assessment should be subject to winding up according to national insolvency regimes without the possibility of using interventions other than a payout (i.e. P&A transactions) financed by the national DGS. The SRB as the resolution authority responsible for applying the PIA for the largest and most systemic banks and certain cross-border groups operating in the Banking Union has clarified that the resolution strategy for almost all banks under its remit is resolution, not insolvency under national regimes. Furthermore, it clarified that the current regime provides sufficient flexibility to adequately address all situations.

With regard to the **least-cost test**, almost all Member States agreed that a more detailed methodology was needed to more effectively ensure a level playing field in the EU, as suggested in the Presidency non-paper. Some Member States, however, expressed concerns about the inclusion of indirect costs, even if these costs would be subject to caps and objective criteria laid down as part of a comprehensive methodology. In their view, including indirect costs would increase the complexity of the methodology. They also argued that including cost elements of this type is in fact driven with an objective of enabling expanded use of DGS funds for protecting claims beyond covered deposits, and would likely have a negative impact on DGS funds. In addition, some Member States were in favour of the introduction of a *pari passu* ranking of all deposits (covered and uncovered), as this would extend the scope for DGSs to finance P&A transactions. Many Member States, however, considered that this would be detrimental to the purpose of protecting DGS funds. They argued that a preferential ranking of DGS is a precondition for appropriate and reliable DGS refinancing, thereby safeguarding the credibility of the system.

As regards **governance**, there was broad agreement among Member States that the introduction of new tools such as P&A transactions requires public administrative powers, which could be granted to a public authority at national level (for example, the national resolution authority). The SRB added that there would be clear benefits to attribute the powers of administrative liquidation to a central EU public authority with European funds, learning from the US experience. The need to avoid duplication of expertise due to efficiency reasons was also mentioned. Some Member States expressed concerns about the involvement of the SRB as long as DGSs' financial resources remain national. They were opposed to any involvement of the SRB in the final decision, as, in their view, the decision-making power should be at the level where the costs are borne. Other Member States, however, were in favour of the SRB having a stronger role. They argued that, if a detailed least-cost methodology is to be introduced, it would be desirable for a central European authority to have coordination and oversight on its consistent application.

The **EFDI's presentation** focused on the technical aspects of the **least-cost test, as laid down in Article 11(6) of the Deposit Guarantee Scheme Directive** ("alternative measures"). The test typically includes: (i) a forecast of the result of the insolvency proceedings and the losses to be borne by the DGS; (ii) an estimation of the costs of each available alternative measure; and (iii) selection of the most feasible measure, based on steps (i) and (ii). The EFDI concluded that the least-cost test methodology should be accurate and fair. In addition to direct costs, indirect costs should also be taken into account. In the EFDI's view, the super priority of covered deposits and DGS claims is strongly supported by almost all DGSs in the EU, as it ensures minimal losses for the DGS. In this context, the EFDI also noted that, without super priority, the estimation of the counterfactual would be, in many cases, considerably less precise due to the enlarged sample of claims to be taken into consideration.

The **Presidency** took note of the discussion among Member States. Overall, there was agreement that the current situation in the Banking Union is unsatisfactory and that changes to the framework, either by a separate set of rules for banks with negative public interest assessment, by a broader interpretation of the public interest assessment, or a combination of the two are necessary.

The Commission confirmed that all these issues will be assessed as part of the forthcoming crisis management and depositor insurance framework review (see section 3).

II.2 Market integration

At the **third AHWP meeting on 12 October**, the Presidency presented two options for how to achieve better integration in the EU's banking market. The group discussed how a more flexible allocation of capital within banking groups throughout the Banking Union could be achieved, while at the same time introducing adequate safeguards for host countries. The Presidency acknowledged that, in case of adverse events, it would need to be ensured that capital is made available to subsidiaries in the host countries regardless of where it was previously held in the group.

The Presidency non-paper envisaged two possible options to achieve the above objective. Option 1 would involve introducing a **cross-border capital waiver combined with statutory safeguards** (recapitalisation claim) for subsidiaries. This would ensure recapitalisation of the subsidiary by the parent entity if pre-determined triggers indicate that the parent entity or subsidiary is in a deteriorating financial situation. Option 2 would involve introducing a **waterfall mechanism** determining (*ex ante*) in a level 1 text the loss sharing within the banking group in case of resolution or liquidation under normal insolvency proceedings.

A group of 12 Member States, on the basis of a joint dedicated non-paper and supported by other Member States, emphasised the importance of the home-host balance and recent agreements reached in relation to it. In particular, they stressed the important role played by individual prudential requirements in protecting depositors and the financial stability, in operationalising the resolution schemes and the micro- and macro-prudential policy, and in ensuring level playing field and the funding of the real economy. These Member States encourage therefore to explore the non-prudential obstacles to market integration.

It emerged during the discussions that, while some Member States considered option 1 to be a feasible basis for further discussions, providing an acceptable balance is reached between a more flexible flow of capital and appropriate safeguards, a large group of Member States considered the safeguards included in this option insufficient to address their concerns. Concerns were notably raised with regards to the effectiveness of a claim right mechanism, in particular in moments of crisis where its enforceability might prove to be weak. These Member States questioned the benefit of having maximum flexibility with respect to the allocation of capital.

As regards option 2, Member States emphasised its complexity, the longer-term horizon of its implementation and the necessary potential prerequisites (i.e. harmonisation of the creditor hierarchy). One Member State criticised the perceived asymmetrical support which is envisaged to function mainly from the parent entity to its subsidiaries and not vice versa. The group of 12 Member States noted nonetheless the fact that option 2 raises the important question of burden sharing among creditors of a banking group which is a key concern in the home-host balance.

Moreover, some Member States mentioned the need to broaden the discussions so as to cover not only capital but also liquidity and resolution measures, in order to provide more clarity on the impact of the various options. Those and other Member States explained that other measures could be implemented in smaller steps to improve market integration, based on existing possibilities and analysing why they are not used in practice (e.g. liquidity waivers). One Member State suggested that prudential ratios of subsidiaries could be subject to targeted amendments to better accommodate intragroup flows of capital, internal MREL and liquidity; besides the pillar 2 methodology could be clarified to reward geographical diversification in groups. The ECB referred to the publication of a personal blogpost by Andrea Enria and Edouard Fernandez-Bollo on fostering the cross-border integration of banking groups in the Banking Union, which included concrete proposals to foster an efficient allocation of liquidity resources across banking groups, while at the same time, in the view of the authors, providing adequate safeguards to the host authorities.

The **Presidency** took note of the views expressed in the discussion, informed the HLWG at its meeting of 13 November, and encouraged further technical work/stocktakes to assess the impediments to the use of existing provisions (namely liquidity waivers).

II. 3 Treatment of sovereign risks

The **regulatory treatment of sovereign exposures (RTSE) was discussed <u>at the meeting of 12 October</u>**. At the request of the Chair, the Commission presented the impact of various options for implementing capital charges, calculated on the basis of updated data from the EBA going up to Q2 2020. Most of the options were based on concentration risk.

The aim of capital charges is to mitigate sovereign risk through both the gradual implementation of risk weights for exposures beyond certain concentration thresholds and the concurring incentive to diversify the sovereign portfolio. The Commission impact analysis showed that, based on existing data, the total level of sovereign exposures of banks has increased. The analysis also showed that of the three parametrisations of RTSE discussed, the BCBS and EFC calibrations have the lowest impact on Tier 1 capital at the aggregate level, whereas the impact of the SCCR calibration is significantly higher.

From a regulatory perspective, Member States expressed well-known divergent views on capital charges. Some Member States insisted that work should continue and that various options for addressing sovereign risk via capital charges (concentration and credit risk) should remain on the table. It was emphasized by these Member States that this work is key to further progress on completion of the Banking Union and that these assets do carry risk that should be treated like all other assets in the prudential framework. These members highlighted that a prudential treatment of sovereign risks can be designed in such a way that it is manageable and does not impact financial stability. This was also shown by the Commission effect analysis, as up to Q2 2020 COVID-19 had only moderate impact under the different calibrations.

The other Member States opposed capital charges or were reluctant to introduce changes. Some said that any RTSE initiatives should be closely aligned with international standards as proposed by the Basel Committee on Banking Supervision. These Member States highlighted the risks that introducing regulatory treatment of sovereign exposures may have in crisis times, notably under an incomplete Banking Union. Others considered that it would be inappropriate to continue discussions on this topic until the impact of the COVID-19 crisis has been addressed, as they fear that the discussions would send contradictory messages to the banking industry which plays an important role in the overall support of the real sector. Some of the Member States opposed to capital charges also mentioned that the approach considered should not lead to differentiation between Member States based on credit risk.

Moreover, some non-euro area Member States and some Member States with smaller or less developed capital markets expressed concerns regarding the ability of their banking systems to diversify their holdings of sovereign exposures and the impact of any changes on their sovereign bond markets and financial stability. Several Member States reiterated their strong view against an adverse impact of any changes in RTSE on government debt, even if implemented gradually, also noting that such concerns are even more relevant in view of the market conditions ensuing the COVID-19 pandemic. Some would only be in favour of revising risk-based contributions to the EDIS, and insisted that a calendar and appropriate sequencing would be needed for all the elements necessary for completing the Banking Union. However, for members that were in favour of RTSE, risk-based contributions calibrated for sovereign risk were insufficient on a stand alone bases.

The Commission agreed that further work would be needed to overcome data limitations, especially for small banks, and to check the impact of public guarantee schemes on bank loans.

The **Presidency** acknowledged that Member States' views on the regulatory treatment of sovereign exposures remained divided. The Presidency also noted the need to assess the impact of the proposals on smaller markets and banks, including for non-euro area Member States, and agreed that further analysis would be needed to inform future discussions. This analysis would also cover the impact of the proposals on Member States' room for financial manoeuvre in a potential future COVID-like crisis. The Presidency acknowledged that a dedicated data collection exercise would probably be required in order for further analysis to be carried out. Some Member States expressed reluctance to proceed with this in the current situation, however, in view of the resulting operational burden on banks. The Presidency invited the Commission, together with the European Banking Authority, to continue its analysis, taking into account the above-mentioned considerations.

II.4 EDIS

The Commission's data collection

On **12 October**, the AHWP took stock of the **data collection exercise carried out to support the development of the methodology for calculating risk-based contributions under the EDIS**. The Commission presented an overview of the latest data collection exercise, which was completed in February 2020. The data collected remains incomplete for some indicators. Nonetheless, this data will constitute an important basis for future technical work and will facilitate an informed debate on the specifics of the methodology, including the aggregation method and the choice of risk indicators.

During the meeting, some Member States, for example, raised specific issues on the set of risk indicators highlighted in the Commission's analysis. Some Member States questioned whether available minimum requirement for own funds and eligible liabilities (MREL) could be taken into account in the calculation given the heterogeneity in banks' sizes. Other Member States and institutions also raised questions on the methodology, for example, regarding the legality of the European Banking Authority methodology in light of the EU General Court´s ruling on the contributions to the Single Resolution Fund (SRF) set by the SRB. Moreover, some Member States pointed out the need to include sovereign-specific risk indicators, such as indicators developed on the basis of country ratings. . Some Member States underlined that this, if decided, can only be alternative and in no case complementary to the treatment of sovereign exposures. The Presidency concluded that it would be important to assess the technical feasibility of taking into account additional indicators, since the overall analysis could benefit from a broader sample of indicators.

The Commission stressed the importance of ongoing work on data collection and related quality assurance such as the MREL data reported. Once this work has been concluded, the Commission will start the technical feasibility assessment, including by testing potential new indicators, without pre-empting the political/policy choices that also depend on the overall design of the Banking Union.

The **Presidency** invited the Commission to take on board the Member States' requests when providing future analysis on the design of the methodology for calculating risk-based contributions.

The Commission´s survey on the hybrid model

On **<u>19 November</u>**, the AHWP discussed the parameters for the 'hybrid model' for EDIS which was initially presented by the Austrian Presidency in July 2018. **The hybrid model** is built around the idea of a coexistence of a central fund and a mandatory lending capacity between the national DGSs. The central fund would provide liquidity support to a beneficiary DGS, once the latter has exhausted its funds ("liquidity support scheme"). If the central fund were depleted at the time an intervention is needed, the SRB, on behalf of the central fund, would be able to borrow from national DGSs through a mandatory lending mechanism. Depending on political decisions as to the calibration of several parameters such as the allocation of funds between the central fund and the national DGSs or the size of caps on the liquidity support, the hybrid model could have various designs. Commission presented the outcome of a **survey** launched in the July meeting of the AHWP.

On a general note, the survey revealed diverging views of respondents on almost any feature addressed, so further technical discussions are needed Most questions raised in the context of this model do not differ from the questions posed by the original model. Member States also underlined that their position on the various design features would be contingent on the possible future developments on the overall legal framework on crisis management and the functioning of DGSs in particular. As regards the final objective, some Member States underlined the importance of a fully-fledged EDIS (ie. mutualised fund with full loss coverage, as provided in the Commission 2015 proposal). Other Member States argued that any political decision-making on the features of a common deposit insurance is contingent on steps towards further risk reduction while recalling the June 2016 Roadmap and that design features of the hybrid model do not substitute for risk reduction.

Member States´ views on the allocation of funds between the central fund and the national DGSs were divided. Nearly an equal number of Member States argued in favour of one of the three options available, which are i) a large central fund and limited national DGS, ii) a limited central fund and large national DGSs and iii) an even allocation of funds. One Member State furthermore highlighted that the allocation of resources between the central fund and national DGSs would be highly dependent on the coverage of temporary high balances, as well as the treatment of non-CRR entities within the new framework.

Almost all Member States argued in favour of the introduction of a cap on the mandatory lending to protect the financial capacity; a slight majority of Member States were in favour of the introduction of a cap on the central fund .

On the credit terms, most Member States supported the introduction of interest rates on the loans coming from the central fund. Views on the maturity of the loans were split among Member States, the majority of them leaned towards a maturity above 5 years.

With regard to the scope of intervention, several respondents argued in favour of a restricted scope focussing on payout and contribution to resolution while other Member States would argue for a broader scope. Among these Member States some were in favour of including the financing of measures under both Articles 11(3) and 11(6) DGSD ("failure prevention", "alternative measures") while some Member States, were against the coverage of failure prevention measures. One Member State argued that the inclusion of such measures would make a political compromise on EDIS even more difficult. On the issue of Institutional Protection Schemes (IPS) recognised as DGS Member States views were divided as well. Only a few Member States argued that IPS´ failure prevention measures should be covered by EDIS. Several MS agreed that the different nature and the low risk profile of the IPS can be reflected via discount factors in the contributions to EDIS. In view of the core function of IPSs, which is framed under Art. 113(7) CRR, and the "cost neutrality principle"[3], one Member State, in its written comments, argued in favour of excluding IPSs from the scope of the hybrid model or to allow for exceptions that reflect their specific situation.

[3] "A key principle is that all phases of EDIS should not increase the overall costs for the banking sector, as compared to current obligations under the 2014 DGS Directive." Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions "Towards the completion of the Banking Union" of 24 November 2015.

[4] https://www.consilium.europa.eu/en/press/press-releases/2017/07/11/conclusions-non-performing-loans/

During the discussion on Non-CRR entities, Member States expressed two views: Some respondents supported the inclusion of such entities (some with conditions though), in order not to discriminate amongst depositors in the Internal Market and to avoid a “two-tier system”. Other Member States called for a strict alignment of the scope with the SSM in the name of the regulatory consistency and equal treatment. As regards national options and discretions (ONDs) a slight majority of respondents to the survey supported the financing by the liquidity support scheme.

On a possible path towards loss sharing Member States´ views were split. Some Member States pointed out that the Hybrid Model could only be an interim stage on the way to establish a fully-fledged EDIS (with 100% loss coverage). Other Member States argued that the hybrid model should not entail any mutualisation at all or loss sharing should be subject to clear conditions or political decisions.

The **Presidency** took note of the views expressed in the discussion and informed the HLWG at its meeting of 24 November accordingly.

III. The Commission´s review of the bank crisis management and deposit insurance framework

At the meeting of **19 November**, the Commission presented on the roadmap regarding the review of the bank crisis management and deposit insurance framework published 11 November. The review focuses on the three EU legislative texts currently in force – the BRRD, the SRMR, and the DGSD. Based on the review and a comprehensive impact assessment the Commission intends to provide a concrete legislative proposal by the last quarter of 2021.

Some Member States, the ECB and the SRB supported the review. Other Member States, however, expressed some concerns and issues. One Member State, for example, expressed its regrets about the non-inclusion of the state aid rules into the review, and strongly suggested this is still included Another Member State stressed the importance of maintaining a DGS framework that would ensure at least the same level of depositor protection than under the current framework. Also, one Member State doubted whether the mandates set out in the BRRD/SRMR/DGSD were sufficiently broad to cover such a comprehensive initiative. In response to the question of how a "common deposit insurance mechanism" (EDIS) is integrated into the overall work, the Commission explained that the impact assessment will also address the creation of a common deposit insurance mechanism as part of the completion of the Banking Union.

The **Presidency** took note of the discussion on the review bank crisis management and deposit insurance framework.

IV. Monitoring progress on risk reduction - actions to tackle non-performing loans in Europe

At the AHWP of 19 November, the Presidency provided an overview on actions to address the problem of non-performing loans (NPLs) in Europe. In response to the 2017 ECOFIN Action Plan to tackle NPLs[4], the Commission put forward its NPL package in March 2018. The regulation on the prudential backstop was adopted by co-legislators and entered into force in April 2019[5]. The ECB, the EBA, the SRB and the ESRB have also delivered on different elements of the Action Plan within their remit. On top of this, Member States have initiated and enabled important actions at national level.

[4] https://www.consilium.europa.eu/en/press/press-releases/2017/07/11/conclusions-non-performing-loans/

[5] REGULATION (EU) 2019/630 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 17 April 2019 amending Regulation (EU) No 575/2013 as regards minimum loss coverage for non-performing exposures, OJ L111/4, 25.4.2019.

Despite these achievements, NPL ratios remain at high levels within some Member States and still vary across Member States and banks. Also, some key elements of the 2017 NPL Action Plan are still pending. Importantly, the proposal for a Directive on credit servicers and credit purchasers is still under discussion in the European Parliament. Since the implementation of this Directive could provide important support to tackle the fallout of the COVID-19 crisis, co-legislators should begin the trilogue as soon as possible. Beyond this, the EBA finalized the benchmarking exercise for insolvency and loan enforcement regimes. The outcome of the benchmarking exercise should incentivise targeted reforms on loan enforcement frameworks in Member States as envisaged in the 2017 Action Plan.

In view of the impact of the COVID-19 pandemic on the economy and potential increases of defaults and NPLs the Commission will publish a communication in December containing a new strategy and actions to deal with NPLs. Based on the elements mentioned above, this communication would focus on targeted measures in two areas: i) Further development of secondary markets for distressed assets and ii) putting forward reforms of the insolvency and debt recovery frameworks. Part of the strategy is also to remove regulatory impediments for NPL purchases and other barriers for the development of secondary markets for NPLs. Another measure in the toolbox to tackle NPLs could be national asset management companies. Furthermore, better data quality and comparability for distressed assets is needed.

The **German Presidency** invites the COREPER to take note of this Report, with a view to progressing work further.

The Portuguese Presidency is invited to build on the progress made when taking over and continue to work towards strengthening the Banking Union, addressing its various work-streams as agreed in the June 2016 Roadmap."