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REPORT

From: Presidency

To: Permanent Representatives Committee (Part 2)

Subject: Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulation (EU) No 575/2013 as regards requirements for credit risk, credit valuation adjustment risk, operational risk, market risk and the output floor (CRR);

Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Directive 2013/36/EU as regards supervisory powers, sanctions, third-country branches, and environmental, social and governance risks, and amending Directive 2014/59/EU (CRD);

Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulation (EU) No 575/2013 and Directive 2014/59/EU as regards the prudential treatment of global systemically important institution groups with a multiple point of entry resolution strategy and a methodology for the indirect subscription of instruments eligible for meeting the minimum requirement for own funds and eligible liabilities (Daisy Chain)

- *Progress Report from the Slovenian Presidency on the state of play of the Banking Package (Basel III finalisation package)*

I. INTRODUCTION

On 27 October 2021, the European Commission¹ (the Commission) adopted a package of proposals for amending the EU banking rules (the Capital Requirements Regulation and the Capital Requirements Directive). These new rules aim at ensuring that EU banks become more resilient to potential future economic shocks while contributing to Europe's recovery from the COVID-19 pandemic and the transition to climate neutrality. The proposed package also finalises the implementation of the Basel III agreement in the EU. This agreement was reached in the Basel Committee on Banking Supervision with the aim to make banks more resilient to possible economic shocks.

The package consists of the three following legislative elements: (i) a legislative proposal to amend the Capital Requirements Regulation (**CRR**)², (ii) a legislative proposal to amend the Capital Requirements Directive (**CRD**)³, and (iii) a separate legislative proposal to amend the Capital Requirements Regulation in resolution related matters (**Daisy Chain**)⁴.

¹ https://ec.europa.eu/commission/presscorner/detail/en/ip_21_5401.

² A proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulation (EU) No 575/2013 as regards requirements for credit risk, credit valuation adjustment risk, operational risk, market risk and the output floor.

³ A proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Directive 2013/36/EU as regards supervisory powers, sanctions, third-country branches, and environmental, social and governance risks, and amending Directive 2014/59/EU.

⁴ A proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulation (EU) No 575/2013 and Directive 2014/59/EU as regards the prudential treatment of global systemically important institution groups with a multiple point of entry resolution strategy and a methodology for the indirect subscription of instruments eligible for meeting the minimum requirement for own funds and eligible liabilities.

2. CONSIDERATION OF THE PROPOSAL

The Slovenian Presidency (the Presidency) launched Council negotiations holding two introductory meetings of the Council Working Party at the beginning of November 2021. On 3 November 2021, the Commission first presented the impact assessment and provided a general presentation of the CRD and CRR proposals. This was followed by a round of initial feedback from the Member States (MSs). On 4 November 2021, the Commission presented the Daisy Chain proposal, which was then also followed by more specific feedback of MSs.

On 9 November 2021, ECOFIN ministers held an initial exchange of views on the banking package, based on a Commission presentation. The initial ECOFIN discussion generally showed that there was an appreciation and openness on a number of elements of the Commission's proposal. Ministers in particular welcomed areas that are considered to be Basel compliant but also highlighted that EU specificities should be catered for. Additionally, risk sensitivity should be preserved and the impact on capital requirements mitigated. The importance of a timely and consistent transposition of the Basel agreement was reiterated by several ECOFIN ministers. On other elements, notably the level of application of the output floor (OF), the ECOFIN discussion highlighted overall strong disagreement by a large majority of MSs with the Commission's proposed approach.

After the Presidency received the first written feedback from MSs, the Working Party continued its examination of the legislative proposals at three subsequent Working Party meetings, namely on 22 November 2021 (Daisy Chain), 3 December 2021 (CRR and CRD) and 8 December 2021 (Daisy Chain). At the Working Party meetings, some MSs stated that their views were still preliminary or clarified that they had scrutiny and parliamentary reservations on the proposals.

3. TOPICS COVERED

Owing to the late-October presentation of the proposals by the Commission, the Presidency fast-tracked the discussion on the Daisy Chain proposal. Concerning the CRR and CRD proposals, the Presidency had to prioritise the consideration of certain topics accordingly. After the general presentation, it consequently focused on a few selected topics based on the written comments received.

3.1. CRR

Output floor – level of application

The Commission is proposing to apply the OF to all capital requirements ('single stack'). As regards the level of application, it is proposed to apply the OF only at the highest level of consolidation with a redistribution mechanism (within EU banking groups) to allocate the capital requirements deriving from the application of the OF⁵, taking into account the risk-profile of the group entities located in different MSs. At the Working Party meeting on 3 December 2021, the Commission explained the functioning of the distribution mechanism, which is in its view designed to implement the Basel standard whilst limiting the impact on capital requirements, in particular for certain group structures or business models, and at the same time trying to ensure that capital would be to some extent allocated where the risks addressed by the OF are located. The Commission also provided some numerical examples of how the distribution mechanism would work in various situations.

⁵ (a) direct application of the OF at the highest level of application for EU banking groups and stand-alone institutions in the EU; (b) within banking groups, redistribution mechanism of the OF impact incurred at highest level of consolidation across parents and stand-alone subsidiaries in MSs for the purposes of calculating sub consolidated or, in case of stand-alone subsidiaries, solo requirements, (c) No application to other individual subsidiaries than those mentioned.

A large majority of MSs that intervened expressed strong opposition and concerns towards the proposed application of the OF at the highest consolidated level only. According to these MSs, the OF shall be applied at all levels, namely at the individual, sub-consolidated and consolidated levels. These MSs recalled the conclusions of the EBA impact study and the following arguments: (i) it is necessary to maintain the current home-host balance, which was agreed in the last banking package in 2019, (ii) there are no material justifications for changing the currently valid CRR principles and model risk needs to be addressed at all levels, (iii) the risks in all MSs must be adequately covered at the national level, and financial stability in all MSs should be taken into account, (iv) the risk of double counting, (v) the suggested redistribution mechanism is insufficient and introduces too much complexity, and (vi) there is a political concern that this approach would create a precedent for other areas of regulation. In this regard, it should also be highlighted that the same general position was also expressed by these MSs in the ECOFIN on 9 November 2021.

A few MSs expressed support for the Commission proposal regarding this issue, arguing it would strike a fair balance between ensuring financial stability and at the same time fostering cross-border integration and strengthening the Banking Union. However, they expressed their willingness for reaching a compromise.

Centralisation of disclosures

The approach set out in the Commission's proposal was supported by some MSs. However, several MSs expressed reservations pointing to, among other elements, the need for greater clarity of the text, compliance with proportionality, accountability for the accuracy of disclosures, avoidance of duplicating disclosure requirements and the impact on administrative costs. Clarifications were requested as well in connection with the role of the EBA. Some MSs also highlighted the need for reducing disclosure requirements for smaller and non-complex institutions.

Definitions of entities to be included in the scope of prudential consolidation

Regarding the definitions of entities to be included in the scope of prudential consolidation, many MSs have not yet provided their position since MSs are still reviewing the text. However, while most MSs intervening at the Working Party meeting have expressed preliminary positive and supportive views on the general intention to clarify the prudential consolidation perimeter, some asked for further clarity on technical issues to better understand the reach of such proposals and the implications for the current prudential framework.

3.2. CRD

Environmental, Social and Governance (ESG) risks

In general, there was agreement among MSs on the proposal to expressly introduce ESG risk factors in banks' internal management processes and policies, as well as in supervisory reviews. However, MSs expressed some concerns, in particular on: (i) the new ESG-related definitions and requested clarifications of the legal text, notably regarding the reference to "relevant public policy objectives and broader transition trends", (ii) whether it is appropriate to make a reference to the EU policy in the legal text, (iii) the link of the new supervisory power with the broader EU's policy objectives and (iv) limited clarity regarding what constitutes the actual risks that are intended to be covered under the proposed rules. Some MSs suggested a more detailed breakdown of the new requirements for the regulatory technical standards to be developed by the EBA.

In general, there was agreement among MSs on the proposal to expressly introduce ESG risk factors in banks' internal management processes and policies, as well as in supervisory reviews. However, MSs expressed some questions or concerns, in particular on: (i) the new ESG-related definitions and their consistency with other Regulations (e.g. SFDR), (ii) whether it is appropriate to make a reference to the "relevant Union policy objectives and broader transition trends" related to ESG, and (iii) the link of the new supervisory power to adjust bank's business models with the broader EU's policy objectives. Some MSs suggested for regulatory technical standards to be developed by the EBA instead of guidelines.

Supervisory powers and processes

Under this heading, two areas were discussed. Firstly, supervisors' powers on prudentially relevant transactions. The CRD proposal introduces new supervisory powers in connection with bank transactions that may raise prudential and/or money laundering/terrorism financing concerns, namely: (i) the acquisitions or divestitures of qualifying holdings in other undertakings, (ii) material transfers of assets and liabilities and (iii) mergers and divisions. Some MSs were generally supportive of the proposal's main aim of harmonising these powers. However, some MSs suggested alternatives to enhance the proportionality and efficiency of the framework and reduce administrative burden, for instance: (a) by introducing an initial and simple notification requirement for transfers of assets and liabilities or through post-transaction notifications in certain cases, (b) with tighter approval deadlines, and (c) the better calibration of the scope of application. Questions were raised, in particular about the role of the ECB as the competent authority responsible for conducting the transaction's assessment. Therefore, consideration should be given as to the opportunity of making amendments that would enhance the proportionality of the proposed framework in light of these comments.

Secondly, fit & proper (FAP) assessments were discussed as well. MSs' initial views on the proposed changes as regards FAP assessments differed significantly. While some MSs are in favour of the Commission's proposal to further harmonise the processes and strengthen the supervisory powers in this field, other MSs disagree with the proposal arguing inter alia that the FAP assessment framework should take into account national specificities in other legal areas. According to these MSs, the FAP framework should respect national rules, including in the field of corporate law, including stock corporation law, labour law and rights of co-determination and employee participation. The proposed changes would contradict the well-established principle of subsidiarity and would increase the administrative burden for institutions and supervisors. Some MSs also asked for further explanations and suggested amendments to the legislative text aimed at making it clearer and more consistent. It was also suggested by some MSs that discretion should be retained as regards: (i) reservation to use domestically developed FAP and (ii) choice of key function holders.

3.3 DAISY CHAIN

The Daisy Chain proposal introduces targeted adjustments to effectively manage the resolution framework, which have already been foreseen in the 2019 banking package. Possible modifications were previously presented by the Commission Services at the March 2021 Commission Expert Group for Banking, Insurance and Payment System (CEGBPI) meeting, where they received broad support. The Daisy Chain proposal addresses the identified issues by the: (i) incorporation of a dedicated treatment for the indirect subscription of instruments eligible for internal MREL, (ii) further alignment of the treatment of G-SII groups with an MPE resolution strategy with the treatment outlined in the FSB TLAC standard, and (iii) clarification of the eligibility of instruments in the context of the internal TLAC.

The Daisy Chain proposal is seen as a technical proposal, and the MSs widely support to fast-track this proposal with a view to reaching a negotiating mandate in the Council. Some MSs raised level playing field concerns regarding the way certain banking structures would have to comply with the new rules and asked for more time to allow for proper scrutiny of the text and an analysis of its impact. Also, few MSs mentioned that this should not hamper a proper discussion at the Council, due to the complexity of the topics at stake and the lack of the impact assessment of the proposal. At the same time, a majority of the MSs emphasised that the scope of the proposal should remain a quick-fix and not be broadened beyond the scope of the initial Commission proposal.

Accordingly, the Presidency organised three Working Party meetings as mentioned above. Secondly, the Presidency prepared three compromise proposals amending the Commission proposal on Daisy Chain. Two of them were presented and examined at the Working Party meetings. On the basis of the third compromise proposal circulated on 13 December, the Presidency on the same day initiated an informal consultation of MSs.

The Presidency compromise proposals introduced some changes and clarifications based on the discussions and suggestions of the MSs, with a view to pursuing a fast-track approach and to maintain the scope of the Commission proposal.

On 16 December 2021, the Presidency informed MSs of the outcome of the non-objection procedure closed on 15 December 2021 on the third Presidency compromise text. On the basis of the replies received, the Presidency has concluded that a very strong qualified majority stands behind the Presidency compromise, and that it has also received the necessary support to process the corresponding negotiating mandate as an I-Item in Coreper on 21 December 2021.

4. CONCLUDING REMARKS

The Presidency invites the Coreper to take note of this report and progress achieved, with a view to taking the work further.

The French Presidency is invited to build on the progress made and continue to work on the package.
