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REPORT

From:	Presidency
To:	Permanent Representatives Committee (Part 2)
Subject:	Presidency progress report on the strengthening of the Banking Union

PRESIDENCY PROGRESS REPORT

ON THE STRENGTHENING OF THE BANKING UNION

I. INTRODUCTION

1. Pursuant to the Council conclusions on the Roadmap to complete the Banking Union (10460/16), the Council continued to work towards the strengthening of the Banking Union while monitoring progress on risk reduction and other foreseen measures.

2. The December 2019 discussions in the Eurogroup and Euro Summit (meeting in inclusive format) outlined the need to continue to work on all elements of the further strengthening of the Banking Union on a consensual basis, with the aim to come back to these issues in June 2020.

3. In the meantime, the Covid-19 pandemic deeply altered circumstances in the EU and beyond, and required reprioritization of efforts. It is in this context that the focus of the Croatian Presidency of the Council of the European Union turned to the implementation of urgent Covid-19 related measures. Together with the necessary and unprecedented adjustment to new working methods, this meant that two meetings of the Ad Hoc Working Party on the Strengthening of the Banking Union (AHWP, 5006/16) initially foreseen in March had to be cancelled.

4. Nevertheless, further technical work continues to be essential to define a transitional path to the steady state Banking Union. With a view to facilitate this important work, and in line with the stated priorities of the Croatian Presidency in the area of deepening the Economic and Monetary Union, AHWP members held an informal videoconference on 18 May 2020, where they discussed the progress achieved in the various work streams. These technical discussions were without prejudice to the outcome of political negotiations on the further strengthening of the Banking Union.

5. This progress report summarizes the state of play as discussed at that informal meeting and has been prepared under the responsibility of the Croatian Presidency, taking into account the views expressed by AHWP members. It is intended to provide continuity and 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.

6. 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) and Finland's (14354/19 REV1) Presidencies.

II. EDIS PROPOSAL

7. On 18 May, AHWP members recalled the main features of the hybrid model for EDIS as introduced by the Austrian Presidency, which relies on a central fund that reinsures national systems, complemented by mandatory lending among existing national Deposit Guarantee Schemes (DGSs) as discussed under the Bulgarian Presidency. They further considered the various additional technical discussions that took place during 2019 and which aimed at (i) developing a better common understanding of the model and its possible parameters and (ii) exploring conditions for various stages of the implementation of EDIS and the transitional path toward the steady state of the Banking Union. Overall, there was much support in favour of the hybrid model as the best basis for further discussions on the liquidity phase of EDIS. Some of the known stances regarding the overall ambition for the steady-state, or the attached conditions, were repeated. For example, some AHWP members considered in particular the actual calibration in terms of contributions to the central fund in terms of covered deposits as too high. Many AHWP members called for a sufficient level of ambition towards the steady state.

8. At the meeting, the ECB gave a presentation on risk-based contributions (RBCs), considered key to address concerns related to deposit insurance. The ECB concluded, in particular, that when considering distribution across Member States and banks, RBCs benchmarked at Banking Union level would be key to tackle moral hazard concerns and to avoid cross-subsidisation, by implementing a "polluter pays" approach. Regarding the referencing benchmark, a few delegations mentioned they could also consider a mixed approach during the transitional period. The Commission services described the state-of-play of the EDIS risk-based contribution and of the data collection exercise launched under Finland's Presidency, which had also slowed down due to the Covid-19 emergency (three Member States are still missing). The SRB, supported by a number of AHWP members and the Commission, pointed to the importance of the methodology being transparent to mitigate risks of litigation and not overly complex, as it needs to be easily understood and implemented by banks. The SRB further noted that applying a flat fee for small banks would be proportionate. The ECB clarified that if there were a flat fee for smaller banks, then a central question would be at what level the threshold should be set. Some delegations mentioned that the EBA guidelines underlying the employed methodology are now outdated.

Some delegations also raised doubts on the accuracy of the calculations provided by the ECB. Also, they asked for more transparency on the applied methodology. Moreover, several agreed that there currently were limitations to the analysis and that further information and discussion would be necessary, particularly on the identification of the appropriate risk-based indicators, such as L2 and L3 assets. The Commission stands ready to perform further analyses as soon as the new data becomes available. In relation to data, the Commission also underlined that some of the points raised in the discussion could require the collection of new data as soon as feasible.

9. The ECB also elaborated on the scope of EDIS application. It focused on the impact on EDIS depending on whether IPS (Institutional Protection Scheme) membership is recognised for the purpose of contributions or not, concluding that IPS account for a significant share of covered deposits and that full exclusion of IPS from EDIS would lead to a reduction of the target size of the deposit insurance fund. In the ensuing discussion, some delegations were interested in better understanding the specificities and differences between IPSs and were open to their possible inclusion in the scope of EDIS, while some opposed such inclusion. There was a call to ensure that schemes with similar tools to IPSs, such as cooperatives, are treated consistently. The Commission informed that a survey on IPSs was conducted within the Expert Group on Banking, Payments and Insurance (EGBPI) and could provide a useful complement to further discussions within the AHWP.

10. Two other important issues in the scope of EDIS were discussed: i) the treatment of non-CRR institutions (some AHWP members expressed the view that the scope should be broad, while other AHWP members would prefer to limit the scope to CRR institutions only, in line with the first two pillars of the Banking Union) and ii) the inclusion of measures other than pay-outs under Article 11(3) and (6) of the DGSD (hereinafter, alternative and preventive measures) with some AHWP members in favour of a broad scope, especially regarding measures in the context of national insolvency proceedings, and others for a more limited scope.

11. Based on a presentation by the Commission, AHWP members held a discussion on the other main parameters of the hybrid model in order to prepare the ground for more detailed discussions in the future. These parameters included the allocation of funds between the central fund and the national DGSs, and caps on mandatory lending and on loans from the central fund to a DGS in the liquidity phase.

12. The views expressed on these issues remained broadly divided. Features of the loans (interest rates, maturities, repayments) were also discussed. Some AHWP members highlighted that interest rates, if agreed, should be the same irrespectively of the source of the funds. The discussion also covered issues like the preferred interventions for EDIS (pay-outs only, or also alternative and preventive measures), ex-post contributions, the build-up of the central fund as well as the mandatory lending mechanism, and a loss coverage phase. Some of these parameters were understood to be highly correlated with further work was desirable on the mapping of parameters and their interactions. In this context, the Commission suggested that additional work could be performed. The Commission also expressed readiness to revert with a survey to Member States, initially planned to be shared in the first half of 2020. Overall, a careful technical calibration of parameters would be essential.

III. MONITORING OF OTHER DEVELOPMENTS IN THE BANKING UNION

III.A IMPLEMENTATION OF THE BANKING PACKAGE

13. In May 2019, the Council and the European Parliament adopted a package of legislative acts referred to as the "Banking Package". The Banking Package introduced various measures agreed upon in international regulatory fora, aiming at strengthening banking supervision and resolution while also catering for EU specificities. Some of these measures require national transposition which is currently ongoing within Member States, with the transposition deadline of 28 December 2020. In order to ensure a common understanding of the underlying legal acts, the European Commission started organizing transposition workshops.

14. Extensive preparations for the so-called "Finalization of the Post Crisis Reforms", which constitutes the final EU implementation step of rules endorsed by the Basel Committee of Banking Supervision (BCBS), were also conducted by the Commission. These preparations aimed at gathering sufficient input from stakeholders in order to propose to the Council and the European Parliament, by June 2020, a new legislative proposal in order to fulfil international commitments to finalize post crisis reforms by 2022.

15. However, following the Covid-19 outbreak and its significant repercussions on the European and global economies, such implementation was considered difficult to put in place for regulators, supervisors and banks alike, who were all experiencing operational constraints given the high impact of the pandemic on everyday life. Among other measures, the BCBS agreed to postpone the implementation of the final standards by one year (to 2023), leading to a postponement of the process within the EU. Consequently, the European Commission has also decided to postpone the legislative proposal planned for June 2020.

III.B SPECIFIC COVID-19 RELATED MEASURES

16. The Covid-19 pandemic is proving demanding not only from an operational perspective. Due to the numerous lockdown measures implemented across countries, many companies have faced urgent liquidity needs. In the same vein, volatility in financial markets increased significantly. In the EU, the ECB and Member States put in place strong measures to overcome the economic shock, mainly by providing liquidity to the real economy.

17. The banking sector, with its essential role in financial intermediation, has a central role to play in the crisis response and in particular in the provision of liquidity to the economy. In that respect, it was considered necessary to free up as much lending capacity as possible within the banking sector without endangering financial stability. In a first step, the European Supervisory Authorities and the ECB issued statements making use of existing flexibilities in EU banking law, clarifying the application of rules concerning the accounting framework, non-performing loans, the market risk frameworks and other targeted and temporary relief measures. At the same time, banks were called upon to refrain from using the capital relief for dividend distribution and the pay-out of bonuses. These measures were supported by EU Ministers of finance[1] and in a communication from the Commission.

[1] https://www.consilium.europa.eu/de/press/press-releases/2020/04/16/statement-of-eu-ministers-of-finance-on-continuing-bank-lending-and-on-maintaining-a-well-functioning-insurance-sector-amid-the-covid-19-pandemic/

18. In parallel, the SRB is ensuring that short-term constraints on the minimum requirement for eligible liabilities ("MREL") do not prevent banks from lending to businesses and the real economy. The SRB has been working together with banks under its remit and national resolution authorities to prepare the implementation of the 2020 resolution planning cycle, including changes to MREL decisions under the new banking package, while reflecting any changes in capital requirements as part of the prudential response to the crisis. It will also take a forward-looking approach to banks that may face difficulties meeting current binding MREL targets by making use of the flexibility already embedded in the framework. Some AHWP members are worried that this case-by-case, pragmatic approach, although welcome, may not guarantee equal treatment across banks under SRB remit, and have called for further transparency.

19. Furthermore, the Commission proposed, on 28 April, a Covid-19 Banking Package, in close liaison with the Financial Services Committee. This comprises an Interpretative Communication on the EU's accounting and prudential frameworks as well as a legislative proposal for targeted and temporary amendments to the Capital Requirements Regulation (CRR). The objective of these proposals is to unlock further funding for the real economy without opening the entire European single rulebook, while ensuring continued bank resilience. Negotiations on this "crisis response package" are still ongoing but it is expected that the Council and European Parliament will collaborate closely in order to adopt the measures quickly. A guiding principle is that the proposed measures are timely, targeted and COVID-19 related.

III.C MEASURES TO TACKLE NON-PERFORMING LOANS (NPLS)

20. The gross NPL ratio for all EU banks declined further, to 2.8 % by the end of Q3-2019. The provisioning ratio remained stable at around 59% (Q3-2019). Still, NPL ratios vary greatly across Member States and banks. High NPL ratios remain an important challenge in some banks in particular and can considerably weigh on their performance. Therefore, the further decline in the number of NPLs is still one of the key areas for reducing risk in the EU banking sector, while taking into account the Covid-19 pandemic and the severe economic impact this is bound to have possible repercussions on the financial sector.

21. In response to the Action Plan to tackle NPLs[2], the Commission put forward its NPL package in March 2018. The Action Plan as a whole is close to being delivered and the Commission is now working to achieve the remaining items. The EBA has finalised its last action by developing "guidelines on loan origination and monitoring". The ECB has also made significant efforts in implementing their parts of the Action Plan and have delivered most of the elements within its remit.

22. On the legislative front, two files remain open in the NPL remit. One consists of a Directive related to secondary markets and concerning credit servicers and credit purchasers, for which the Presidency obtained a mandate for negotiations with the European Parliament in March 2019 (7344/19 ADD 1), and the other consists of a Directive for accelerated extrajudicial collateral enforcement, with a mandate dated November 2019 (14261/19 ADD1). Negotiations can start on both files once the European Parliament as the co-legislator is ready.

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

III.D OTHER DISCUSSIONS ON BRRD/SRMR/DGSD REVIEWS

22. The Commission services organised two meetings of the EGBPI in early 2020. The first meeting on 27 January 2020 was dedicated to a first exchange between the members of the EGBPI on the opinions of the EBA submitted under Article 19(3) of the Deposit Guarantee Scheme Directive.

23. The second EGBPI took place on 20 February 2020 and discussed issues such as the triggers to initiate resolution and insolvency, the use of early intervention measures, and potential targeted clarifications to the rules on precautionary recapitalisation. Further EBGPI meetings were planned from March onwards. However, these were postponed due to the outbreak of Covid-19 pandemic. The Commission services informed the AHWP about possible follow-up.

IV. CONCLUSIONS

24. The Presidency invites the Committee of Permanent Representatives to take note of this Report, with a view to progressing work further.