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

I. INTRODUCTION

1. On 17 June 2016, the Council adopted Conclusions on the Roadmap to complete the Banking Union, in which it stressed, inter alia, the importance of taking further steps towards risk reduction and risk sharing in the appropriate sequence.
2. Pursuant to the Council's 2016 Roadmap, the Commission adopted on 23 November 2016 a package of legislative proposals (the "Banking Package") with amendments to various legislative instruments currently in force dealing with banking prudential requirements, specifically the Capital Requirements Regulation and the Capital Requirements Directive (the CRR and the CRD), the Bank Recovery and Resolution Directive (the BRRD) and the Single Resolution Mechanism Regulation (the SRMR).

3. The Financial Services' Working Party met 38 times under the Slovak, Maltese, Estonian and Bulgarian Presidencies to scrutinise the Banking Package proposals. Coreper discussed various outstanding issues in March and May 2018.
4. The 15 May Coreper discussed the Presidency compromise texts on the CRR, the CRD, the BRRD and the SRMR proposals, as set out in documents 8626/18, 8627/18, 8628/18 and 8629/18, respectively on the basis of a Presidency note setting out the four outstanding political issues.
5. As regards the first issue, Member States were broadly supportive of the Presidency's proposed approach on the implementation of the fundamental review of the trading book, but requested a clearer commitment for a timely implementation of the new market risk capital requirements.
6. As regards the second issue, many Member States opposed the Presidency's proposed additional treatment of activities across Member States participating in the Banking Union for the purposes of calculating the score of global systemically important institutions (G-SII score). The Presidency has therefore made a number of changes to its initial compromise to take due account of the concerns expressed, and is submitting an amended compromise on this matter that should be acceptable.
7. As regards the third issue, the scope of the CRR/CRD, no agreement could be reached at Working Party level and the Presidency believes that the discussions at Coreper confirmed that this is an issue to be decided by Ministers.

8. Finally, as regards the fourth issue, which relates to MREL subordination, the differences in Member States' positions highlighted the difficulty in finding an acceptable compromise. However, the Presidency believes that the suggested approach for Coreper bridged many gaps in the differences expressed by Member States. The MREL framework should ensure a sufficiently ambitious level of risk reduction and financial stability, while not endangering the role of financial institutions in financing the economy and fostering growth.
9. Taking into account the discussions at Coreper and underlining the need to maintain an appropriate overall balance for the legislative package, the Presidency suggests as a compromise the approach outlined below in order to address the four outstanding issues.

II. **OUTSTANDING ISSUES**

A. **IMPLEMENTATION OF THE FUNDAMENTAL REVIEW OF THE TRADING BOOK**

The **Fundamental Review of the Trading Book (FRTB)** sets out the new international standards on bank regulatory capital for market risks. Market risk capital standards can be defined as the amount of capital that banks must put aside as protection for potential losses resulting mainly from their trading business, thus covering the risks of changes in the value of traded instruments (i.e. shares, bonds), foreign exchange risk, interest rate risk, etc.

10. The Commission proposal implemented the FRTB in EU law consistent with the 2016 Basel standards, taking into account a number of EU specificities.

11. In December 2017, the Basel Committee published a statement announcing a three year delay in the implementation of the FRTB and announced a review of the capital requirements applicable for market risks.
12. The Basel Committee issued a consultation document in March 2018 on the precise components of the market risks included in the scope of the review.
13. The compromise put forward by the Presidency to Coreper with respect to the implementation of the FRTB in a first stage as a reporting requirement was broadly accepted by Member States. However, Member States reiterated the importance of sending a strong message that the EU remains committed to full and timely FRTB implementation when the standards are finalised in Basel. Therefore, a stronger commitment was introduced in the legal text as also reflected in the Commission statement in the Annex.

B. G-SII SCORE: ACTIVITIES ACROSS MEMBER STATES PARTICIPATING IN THE SINGLE RESOLUTION MECHANISM

The largest banks and investment firms are classified as "globally systemically important institutions" (G-SII) where, on the basis of certain relevant parameters such as their size, interconnectedness with other financial institutions, group complexity or cross-border activity, they are deemed to pose a significant threat to the stability of international financial markets should they fail. These factors are used as parameters to calculate a score for each such institution (the "G-SII score") and the higher the score of a G-SII, the higher the applicable capital buffer the G-SII must hold.

14. The parameter relating to the group's cross-border activity is justified on the grounds that the resolution of a group of this type is more difficult to coordinate and manage and, therefore, riskier for all the jurisdictions involved. Under the current G-SII scoring rules, a group's activities across Banking Union participating Member States receive the same "cross-border activity" treatment as the cross-border business conducted in non-Banking Union Member States or in third countries, despite such activity now occurring within the remit of the Single Resolution Mechanism.
15. Under the proposed drafting in the Presidency Compromise text, while the default treatment of cross-border activity within the Banking Union would remain the same for all G-SIIs as described in the box above, competent authorities would also calculate an additional score for G-SIIs using the same set of parameters as the default methodology but discounting its intra Banking Union activities. In order to limit the potential consequences of this additional calculation, however, discretion would be left to the Competent Authority as to whether or not they would take this secondary score into account.
16. Following the discussion at Coreper, several changes were made to the text. Both the recital and the legal text were amended to clarify that it is the establishment of the Single Resolution Mechanism that justifies the introduction of the additional methodology for the calculation of the G-SII score. The Presidency considers that no precedent should be set with regard to other measures related to the completion of the Banking Union. Furthermore, the potential impact of the additional methodology has been framed to ensure that on the basis of this additional score it would not be possible for a G-SII to cease to qualify as such.

17. The above should constitute an acceptable compromise to Member States. While the proposed approach reflects the progress made on the establishment of the Single Resolution Mechanism, it only provides for a limited recognition of that progress for G-SII scoring purposes, thus taking into account the reservations raised by many Member States on the matter.

C. EXEMPTIONS FROM THE CRR/CRD SCOPE

18. Under current Article 2(5) of the CRD there are a number of legal entities explicitly exempted from both the CRD and the CRR, and as a result also from the resolution framework. These legal entities are for the most part credit unions and promotional and development banks. In the absence of an exemption, they would qualify as "credit institutions" thus requiring licensing and supervision under the CRR/CRD.
19. Three Member States requested adding their national development banks to the list of exemptions, which was supported by a large majority of Member States. There was also large support to exempt the credit unions from three Member States for consistency with other currently exempted credit unions.
20. Another Member State had requested to exempt 14 promotional banks (one national and 13 regional). This Member State already has a national promotional bank exempted from the CRR/CRD. The Presidency compromise text exempts the 14 promotional banks.

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

In November 2015, the Financial Stability Board (FSB) adopted an international standard for Global Systemically Important Banks (G-SIBs or "Systemically Important") providing for adequate loss-absorbing capacity when banks fail (TLAC).

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

MREL stands for Minimum Requirement for Own Funds and Eligible Liabilities and defines the necessary amount of capital and debt that each bank in the EU must hold to cover losses and enable recapitalisation in case of resolution. MREL has been introduced into EU law in 2014 through the Bank Recovery and Resolution Directive (2014/59/EU) and the Single Resolution Mechanism Regulation (EU) No 806/2014.

22. The overall amount (quantity) of MREL and the level of subordination of eligible debt should provide for an effective application of the bail in tool via an appropriate loss-absorption and recapitalisation capacity of a bank.

Subordinated instruments are those designed to be bailed-in before other liabilities that could be excluded from the application of bail-in. Due to the increased risk of potential losses, such subordinated instruments are more costly for banks to issue.

i. Minimum subordination requirement for G-SIIs and Top-tier banks

23. There was a broad agreement on the CRR text proposed by the Bulgarian Presidency that aligns the minimum subordination requirements for G-SIIs as close as possible with the language of the TLAC standard: 18% Risk Weighted Assets or 6.75% Leverage Ratio Exposure Measure, that can be adjusted downwards by up to 3.5% Risk Weighted Assets in case of no litigation risk based on the breach of the No Creditor Worse Off principle (NCWO). However, some Member States considered that the legal text should be adjusted further to provide for more clarity and legal certainty that once the resolution authority assesses that there is no litigation risk, it shall permit the downward adjustment.
24. The Bulgarian Presidency introduced the notion of "Top-tier bank" in order to capture financial institutions, other than Systemically Important Institutions, that are important from a financial stability point of view. A minimum subordination requirement should apply to those institutions whose consolidated balance sheet (at resolution group level) is higher than EUR 100 bn. The level of such requirement should be based on the recommendations by the European Banking Authority (EBA).
25. Resolution Authorities should also be able to impose stricter conditions, as provided for Top-tier banks, to other banks posing a systemic risk, based on the conditions outlined in the level 1 legal text.

26. Notwithstanding the above, at Coreper many Member States agreed to having a level of subordination requirement for G-SIIs and Top-tier banks of at least 8% of Total Liabilities and Own Funds (TLOF) along with sufficient flexibility of the resolution authorities to adjust that amount as appropriate and to require additional subordination, where necessary. However, other Member States expressed concerns that the level of subordination that the above approach might imply would be disproportionate as well as that it would lead to potentially significant market shortfalls for subordinated debt. These Member States also insisted on a more framed flexibility for the resolution authorities both in terms of maximum amount and conditions.
27. Following these discussions, the Presidency considers that the proposed compromise provides an appropriate balance between the minimum level of the subordination requirement and the framing of the discretion of the resolution authority to adjust that level and to require an additional amount of subordinated debt for some banks.

ii. Discretionary subordination for banks that are not GSIIIs or Top-tier

28. For banks that are not Global Systemically Important or Top-tier, there are no minimum subordination requirements.
29. In line with the Commission proposal, and based on the discussions in the Working Party and Coreper, the Presidency considers that resolution authorities should have the discretion to require subordination for eligible liabilities where and up to the level that such subordination is necessary to ensure that creditors would not receive worse treatment in resolution than in insolvency proceedings. This is known as No Creditor Worse Off (NCWO) principle. However, such a requirement should not exceed the maximum level of subordination provided for GSIIIs and Top-tier banks.

iii. Transition

30. Given the stricter MREL requirements, institutions should be granted sufficient time to address potential shortfalls for MREL eligible instruments, while resolution authorities should still be allowed to set individual deadlines. At Coreper many Member States insisted on setting a clear deadline for compliance with MREL requirements instead of a starting point. However, other Member States expressed concerns about the need to provide for sufficient time to reach the target without endangering banks' financial situation and their ability to finance the economy. On the basis of these discussions, the Presidency considers that the proposed compromise, as outlined in the conclusion, strikes a reasonable and feasible balance.

III. CONCLUSION

31. The Presidency believes that the following solutions to the four remaining political issues represent a balanced and acceptable compromise on the Banking Package:

1. IMPLEMENTATION OF THE FUNDAMENTAL REVIEW OF THE TRADING BOOK

- **Introduce the FRTB as a reporting requirement in the first stage**, on the understanding that the Commission statement set out in the ANNEX will be entered into the Council minutes, once the general approach is agreed.

2. G-SII SCORE: ACTIVITIES ACROSS MEMBER STATES PARTICIPATING IN THE SINGLE RESOLUTION MECHANISM

- **Introduce an additional G-SII score methodology** that would recognise the establishment of the Single Resolution Mechanism by giving competent authorities the discretion to adjust the G-SII score.

3. EXEMPTIONS FROM THE CRR/CRD SCOPE

- **Exempt the 14 promotional banks** referred to in paragraph 20 as per the request of a Member State.

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

i. Subordination for G-SIIs and Top-tier banks:

Level of MREL subordination requirement of 8% of total liabilities and own funds (TLOF) (*if higher than TLAC and Top-tier statutory minimums outlined in the legal texts*)

- **discretion** for the Resolution Authorities **to adjust this level downwards** by a maximum amount proportionate to the possible TLAC allowance for non-subordinated instruments if no material risk of successful legal challenge based on the breach of NCWO

Additional MREL subordination at the discretion of the Resolution Authority up to the higher of 8% TLOF or the prudential formula (as outlined in the legal text)

- **For up to 30% of G-SIIs and Top-tier banks** for which the Resolution Authority determines the MREL requirement (*in BRRD, MS have discretion to increase this percentage for GSIIIs and Top-tier banks outside the remit of the SRB*)
- Based on **broad alternative criteria** related to the **riskiness** of the bank, on **unaddressed impediments to resolvability** or characteristics of the resolution entity that might limit the **feasibility and credibility of the resolution strategy**
- List of factors that the Resolution Authority should take into account for the individual level of the discretionary subordination requirement

- ii. Discretionary subordination for **banks that are not GSIs or Top-tier:**
- based on **NCWO assessment**;
 - up to the level necessary under the NCWO assessment but **not exceeding the higher of 8%TLOF or the prudential formula** (as outlined in the legal text).
- iii. **Transitional arrangements:**
- TLAC deadline (2022) for compliance with the minimum MREL requirement for G-SIs (*18% RWA / 6.75% LREM*) and Top Tier banks (*13.5% RWA / 5% LREM*);
 - Target date for compliance with both external and internal MREL: 1 January 2024;
 - Intermediate target for external and internal MREL: 1 January 2022;
 - Possibility to extend beyond deadline of 2024 on a bank by bank basis (based on conditions outline in the legal text)
 - Interim targets and deadlines for compliance with internal MREL aligned with those for external MREL.
32. Council is invited to agree on the Presidency compromise texts of the Banking Package as set out in documents 9055/18, 9056/18, 9057/18 and 9058/18, for the CRR, the CRD, the BRRD and the SRMR proposals, respectively.
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Commission statement as regards the**"implementation of the fundamental review of the trading book"**

"In November 2016, the Commission proposed to implement the new market risk standard set out by the Basel Committee on Banking Supervision in January 2016 as part of the Fundamental Review of the Trading Book into Union law. The Commission takes note that the Council wishes to replace this by a reporting obligation while being committed to implement the standard at a later stage. Should this be the result of the political agreement between all co-legislators, the Commission will at the time of adoption continue to be ready to commit to a new legislative proposal which would implement the new market risk standard that has been reviewed and finalised at international level in December 2018 as a capital requirement in the EU by mid-2020. At this stage, this commitment would not include setting out rules concerning phase-in of that reviewed and finalised standard in the Union."
