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NOTE

From:	Presidency
To:	Permanent Representatives Committee/Council
Subject:	Banking package (CRR/CRD/BRRD/SRMR) - Policy debate

1. On 17 June 2016, the Council adopted Conclusions on the Roadmap to complete the Banking Union, in which it stressed the importance of pursuing risk reduction and risk sharing measures in an appropriate sequence.

2. Pursuant to the Council's 2016 Roadmap, on 23 November 2016, the Commission presented a package of Banking legislative proposals (the "Banking Package") comprising, in particular, the CRR, the CRD, the BRRD and the SRMR proposals.

3. The Estonian Presidency considers that considerable progress has been made on the Banking Package. As a result of its work, the Presidency has prepared compromises on the CRR, the CRD, the BRRD and the SRMR proposals (as set out in documents 14891/17, 14892/17, 14894/17 and 14895/17 respectively).

4. The Presidency believes that the above-mentioned legal texts reflect a well balanced package and the best possible compromise at this stage. As set out in the legal texts, there is a wide range of issues where preliminary agreement has been reached, subject to an overall compromise.

5. However, a number of outstanding key political issues are still to be resolved. These key outstanding issues are set out in detail in the annex and, where appropriate, the Presidency is suggesting a way forward.

6. In addition, the Presidency recognises that there is a number of technical adjustments that need to be made to the compromise texts, as appropriate.

7. With a view to providing guidance to take forward the work on Strengthening the Banking Union and, in particular, on the Banking Package, the Presidency recommends that Coreper invites Ministers to express their views on the following questions:

   Question 1: In order to preserve financial stability, should supervisory and resolution authorities have flexibility to set macro-prudential or bank-specific requirements?

   Question 2: How should recent international standards be transposed? Are the proposed implementation timeline and arrangements appropriate?

   Question 3: Should current principles of bail-in buffers and home-host balance be maintained? Are the suggested bail-in buffers and compliance deadlines appropriate?

   Question 4: In accordance with current rules for access to the resolution fund, should a quantitative subordination requirement apply? If so, how much and to which banks should it apply?

KEY OUTSTANDING ISSUES

A. MACROPRUDENTIAL FRAMEWORK AND PILLAR 2

1. Under the current CRD, the Pillar 2 framework is a set of provisions that give competent authorities the discretion to impose additional capital requirements and other precautionary measures where, in the authorities' assessment, the CRR- and CRD-based requirements fail to capture (in full or in part) certain risks. The Pillar 2 framework allows the competent authorities to use those powers for both "micro-prudential" and "macro-prudential" purposes.

2. The Commission's proposal amends the current Pillar 2 framework significantly. Under the new framework, competent authorities would be able to impose additional capital requirements only for micro-prudential purposes and strictly on an institution-by-institution basis.

3. Various Member States strongly oppose this approach because they consider that the loss of macro-prudential tools in Pillar 2 is not matched by corresponding amendments elsewhere in the prudential framework that would allow their authorities to address macro risks using other appropriate means.

4. The Presidency has proposed several changes to the current prudential supervisory framework in order to address these concerns. In particular, the Presidency has proposed amendments to ensure that the macro-prudential toolbox remains flexible and comprehensive. The Presidency has also streamlined procedural requirements (as and where needed), thus offsetting the perceived loss of flexibility in the Commission's proposal. Given that the objective of macro-prudential supervision is to fill the gap between macroeconomic policy and the micro-prudential regulation of financial institutions, there is a vital need for a sufficiently flexible (but non-obligatory) macro-prudential toolbox to prevent an excessive build-up of systemic risk.

5. Two main issues remain outstanding in this area: (i) the level of the other systemically important institutions (O-SII) buffer cap, including for subsidiaries; and (ii) overall cap and additivity of G-SIBs (global systemically important banks) or O-SII buffer and the SRB, instead of just applying the higher of the two as allowed currently.

O-SII Buffer Cap and O-SII buffer cap for subsidiaries

6. O-SII are those institutions which do not qualify as "systemic" under the international banking standards but which are nevertheless deemed to be systemic for the purposes of the domestic banking market in a Member State. These O-SIIs are subject to specific additional capital requirements in the form of a buffer that takes account of their systemic nature. However, the power of Member States' authorities to impose this buffer is subject to a cap.

7. A large number of Member States would like to be able to set a high cap in order to permit a higher capital buffer for financial stability reasons. By contrast, some other Member States would like to have a lower cap so that supervisory authorities in particular cannot set excessively high levels for capital buffers.

8. The Presidency has reflected on the discussions that have so far taken place within the Council and suggests that the O-SII cap should be set in the range between 3% and 3.5%, but with the possibility for supervisors to go higher with the approval of the Commission. This represents an increase from the current CRD level of 2% and is intended to compensate for the inability to address macro-prudential risks via Pillar 2.

9. Setting the level of the cap on the O-SII buffer for subsidiaries - which determines the leeway that competent/designated authorities have to impose higher levels of capital on subsidiaries that are deemed systemic for the domestic market - has also proven controversial.

10. Many Member States would like to have either no cap at all or a high cap on the O-SII buffer for subsidiaries, because they consider that it is important to ensure an appropriate level of capital in local subsidiaries in order to ensure financial stability and a level playing-field across a Member State's domestically systemically important institutions. However, some Member States would like the O-SII buffer cap for subsidiaries to remain limited, because they are concerned that a higher cap may result in significantly higher capital requirements for the subsidiaries of banking groups and lead to the fragmentation of capital.

11. Nevertheless, given the need to address risks posed by subsidiaries (which are more important for a domestic market than the parent bank is in its home market or the banking group as a whole), authorities should be permitted to set a buffer rate for subsidiaries that is higher than the banking group buffer.

12. The Presidency has proposed to set the cap for the buffer rate for subsidiaries at the level of the banking group plus a further 1% or 1.5% (at most) - with an overall cap of 3% or 3.5% respectively. However, taking into account the different areas of the Banking Package and the broad initial agreement reached in other parts of the Package subject to the final agreement, the Presidency believes that setting the cap for the buffer rate for subsidiaries at the level of the banking group plus a maximum of 1% (i.e. with an overall cap at 3%) would represent a balanced compromise.

Additivity and overall cap of O-SII buffer and SRB

13. Another issue that has been intensively debated is the question of whether it should be permissible to add the specific G-SII or O-SII buffer and the SRB - and, in that case, whether an overall cap should apply to the sum of the two requirements.

14. Many Member states support additivity of buffers, without imposing a cap. However, some others could accept additivity - but would like an overall cap in order to avoid the build-up of potentially excessive capital requirements.

15. The Presidency proposes an overall threshold of 5%, which could be exceeded only under prior Commission authorisation. The Presidency considers that, regardless of the O-SIIs cap level, the overall threshold should be maintained as suggested.

B. IMPLEMENTATION OF BASEL REFORMS

16. The key open issue as regards the implementation of Basel reforms is that of the transitional arrangements for phasing in the application of certain elements of the new liquidity standard (Net Stable Funding Ratio - NSFR) and the new market risk standard (Fundamental Review of the Trading Book – FRTB).

Financial Risk in the Trading Book (FRTB) phase-in

17. The calibration of the FRTB which has been discussed at international level implies a significant increase in capital requirements for market risk. A phase-in to smooth the transition is therefore necessary. However, the Member States have diverging views as regards the features of the phase-in (duration, the procedure for introducing new requirements and the question of whether the new international requirements will be automatically introduced). Most Member States would prefer to maintain the alignment with the timeline and the requirements of international agreements; even though these are still under discussion. Other Member States would prefer to await the result of international negotiations and to assess the need to take into account European specificities before a final decision is taken on their application.

18. The Presidency therefore suggests an implementation period of four years, in order to allow banks and supervisors to adapt to new requirements. This implementation period would be followed by a Commission Delegated Act to introduce the new internationally agreed modelling requirements, followed by a two-year flat phase-in at 65% of the full capital requirements, with an automatic increase to a 100% calibration at the end.

Net Stable Funding Ratio for derivatives

19. The international agreements permit the stable funding requirements for the funding risk generated by derivatives to be set at between 5% and 20%. The Member States currently have diverging views as to the right percentage. Several Member States take a more conservative stance and would like to apply 20%, but others would only want to apply 5% and point to the fact that it would still be sufficient to comply with international agreements.

20. Given the lack of agreement during the negotiations and the fact that the lower 5% requirement is still considered to be sufficiently conservative at the international level, the Presidency considers that a 5% requirement for derivatives - accompanied by a review clause in case the standard is reviewed at international level - would be appropriate.

Net Stable Funding Ratio for repos and reverse repos

21. The internationally agreed NSFR standard is asymmetric for short-term transactions that require banks to hold stable funding sources when lending cash (reverse repos or repurchase agreements), but it does not recognise stable funding when borrowing cash (repos). Some Member States consider this to be overly conservative.

22. Some Member States want to apply international standards with a transition period, but others want to introduce a lower stable funding requirement (including when lending cash - reverse repos) in order to reduce the asymmetry. Given the lack of agreement during the technical negotiations and given the fact that the views of some Member States would deviate from the spirit of what can be internationally seen as conservative, the Presidency considers that an appropriate compromise is to introduce a longer phase for the application of international agreements.

23. In sum, the Presidency suggests to introduce the NSFR for repos and reverse repos with a four-year flat phase-in (5% and 10%), with an automatic increase to 10% and 15% respectively at the end of the phase-in (unless the Commission proposes otherwise in a separate Level 1 legislative proposal).

C. CAPITAL AND LIQUIDITY WAIVERS IN CRR

24. The CRR proposal allows supervisors, under strict conditions, to waive the individual application of capital and liquidity requirements within banking groups on a cross-border basis.

25. However, a majority of Member States consider this possibility to be detrimental to financial stability and also premature so long as the consequences of bank failures still have to be borne in part at the national level until the completion of the Banking Union. At the same time, some Member States think that the waivers facilitate the cross-border management of liquidity and capital within pan-European banking groups, and consider that they are reasonable given the conditions attached at the current stage of completion of the Banking Union.

26. Given the strong opposition towards waivers expressed since negotiations took place during the Maltese Presidency, the Presidency proposes the removal of the respective changes to cross-border waivers from the legislative text.

D. SCOPE: EXEMPTIONS FROM THE CRR/CRD

27. Two Member States have requested their national development banks to become exempted from the CRR/CRD as per an existing provision already available for a number of development banks in other Member States. Another Member State has requested the same exemption for their sixteen regional promotional banks.

28. A broad majority of delegations agree that the list of exemptions from CRR/CRD scope should remain open to credit unions and promotional or development banks not currently in the list. There is also broad support for the request made by the above-referred two Member States in connection with their national development banks. However, some delegations have expressed concern about exempting the sixteen regional promotional banks as requested by the third Member State on the grounds that this would exempt a relatively large segment of the banking system in that Member State from the Single Rulebook.

29. As a compromise, the Presidency suggests allowing the two Member States mentioned above to exempt their national development banks from the CRR/CRD, and doing the same only for the the smaller regional promotional banks in the third Member States, that is, those with assets below EUR 30 billion.

E. MINIMUM REQUIREMENT FOR OWN FUNDS AND ELIGIBLE LIABILITIES (MREL) CALIBRATION

30. The Total Loss Absorption Capacity (TLAC) standard for Global Systemically Important Banks (G-SIBs) adopted by the Financial Stability Board (FSB) needs to be implemented into the current MREL framework. A number of aspects of the MREL framework for other banks are also revised in order to enhance the resolvability of banks in general.

Scope of MREL Pillar 1 requirement

31. The TLAC standard sets a harmonised minimum level of loss absorption and recapitalisation capacity for G-SIBs to be generally complied with subordinated instruments. The Commission has proposed that TLAC should be transposed as a MREL Pillar 1 requirement.

32. A few Member States would prefer to extend the scope of application of MREL Pillar 1 to other systemically significant banks (O-SIIs and/or banks under the Single Resolution Board over a certain threshold). The great majority of Member States would rather retain the TLAC scope.

33. The Presidency has therefore retained the TLAC scope of application of the MREL Pillar 1 requirement, which applies to G-SIBs.

Calibration of MREL Pillar 2 requirement: *The impact of breaching the Market Confidence Buffer on restrictions to Maximum Distributable Amount*

34. The overall calibration of the MREL Pillar 2 requirement should allow for an appropriate loss absorption capacity (equivalent to the prudential capital requirements including the capital guidance) and for recapitalisation of a bank up to the level that would allow the bank to comply with prudential authorisation requirements and to have a sufficient market confidence buffer (MCB), in accordance with measures included in the resolution plan.

35. In order to establish a proportionate ladder of intervention measures available to resolution authorities at the time of an MREL breach, the Commission has proposed to introduce guidance for MREL Pillar 2 so that restrictions to the Maximum Distributable Amount (MDA) would be applied at a later stage when the breach of MREL reaches a certain level (i.e. at a lower level of capital).

36. The MREL Pillar 2 proposed by the Commission thus comprises the MREL requirement and the MREL guidance. Both the requirement and the guidance are mandatory and must be met at all times.

37. The MREL Pillar 2 requirement proposed by the Commission is intended to cover (i) the loss absorption equivalent to prudential capital requirements and (ii) recapitalisation requirements that would enable a bank to meet its authorisation requirements after resolution.

38. The MREL guidance proposed by the Commission covers additional loss absorption up to the level of prudential capital guidance and the MCB. In order to avoid MDAs being restricted in situations where banks still comfortably comply with prudential requirements, the Commission proposed that restrictions to MDAs should not be applied when the MREL guidance (which includes MCB) is breached. However, if MREL guidance is consistently breached, resolution authorities may convert it into an MREL requirement (where the restrictions to MDAs are applicable).

39. The question of whether MCB should be kept in the MREL guidance or moved to the MREL requirement (which would, in the latter case, trigger earlier restrictions to MDAs) has been discussed at length over the last year.

40. Many Member States have a preference for the MREL requirement covering the MCB. In addition, those Member States are of the view that, if the MCB were to stay in the MREL guidance, then the guidance should automatically be converted into the MREL requirement if the breach lasts longer than three months.

41. Other Member States consider that the MCB should be part of the guidance. In addition, those Member states also prefer that the conversion of MREL guidance into the MREL requirement should only occur on the basis of a discretionary decision by a/the resolution authority.

42. As a compromise and with a view to balancing the extremely diverging positions of the Member States, the Presidency suggests that the MCB should be maintained in the Pillar 2 guidance and should be made obligatory for G-SIBs and O-SIs. If that Pillar 2 guidance is consistently breached, resolution authorities should be required to take a decision on the conversion of that Pillar 2 guidance into the Pillar 2 requirement at an appropriate point in time.

Calibration of MREL Pillar 2 requirement: *Sanctions to MREL breaches*

43. The Commission further proposed that restrictions should be applied to the MDA only after a six-month grace period in case such restrictions result from a failure to roll over liabilities eligible for MREL.

44. Several Member States disagreed with the need for such a grace period and pointed to international standards on TLAC, which require loss-absorption and recapitalisation capacity to be treated like a minimum capital requirement. Some Member States wished to delete any automaticity and to make MDA restrictions an optional tool in case of an MREL breach.

45. As a compromise, the Presidency suggests to accept the Commission proposal and to automatically apply MDA restrictions after a six-month grace period.

Calibration of MREL Pillar 2 requirement: *Linking the MREL requirement to the minimum 8% bail in rule*

46. A key question that has emerged during the negotiations is that of whether the MREL requirement should be linked to the minimum bailin rule of 8% of total liabilities and own funds - and, if so, how.

47. Several Member States want MREL for all banks to be at least 8% of total liabilities and own funds.

48. Other Member States disagree with such a concept, on the grounds that reaching 8% bail-in would not guarantee any contribution by the Single Resolution Fund (SRF) in an actual resolution case. These Member States are of the opinion that the level of 8% of bail-in could be met not only with MREL, but also with all other instruments (because the scope of bail-in-able instruments is broader than MREL).

49. The Presidency therefore suggests that resolution authorities should, while setting the level of MREL guidance, have the discretion to take into account the 8% bail-in rule where this is consistent with resolution plans and by taking into account the availability of other bail-in-able liabilities not eligible for MREL.

50. The Presidency believes that this compromise achieves an appropriate balance between the views of the various Member States

Subordination

51. The Commission proposed that MREL Pillar 1 is to be met with subordinated instruments. However, resolution authorities have the discretion to require subordination for MREL Pillar 2 (both for MREL requirement and for MREL guidance) where this is necessary to ensure that creditors do not receive worse treatment in resolution than in insolvency proceedings.

52. The key question is whether subordination should be mandatory at higher calibration levels than the MREL Pillar 1 and for a broader subset of banks than G-SIBs.

53. Some Member States call for the entire Pillar 2 MREL requirement to be met with subordinated instruments for all banks. They also call for MREL equivalent to 8% to be met with subordinated instruments for all banks.

54. Other Member States prefer to limit mandatory subordination to the Pillar 1 MREL requirement alone. Moreover, some Member States prefer that resolution authorities should not be allowed to require subordination for the MREL guidance.

55. As a compromise, the Presidency suggests that mandatory subordination should apply only to the Pillar 1 requirement (which applies to G-SIBs only). As regards subordination for the Pillar 2 requirement and guidance, subordination is discretionary and resolution authorities shall (once certain thresholds are met) assess whether subordination is necessary.

56. Regarding transition periods, some Member States argued that the existing MREL framework based on current BRRD, which is applicable since 2016, should be applied without any need for particular transition periods, except where this is necessary for specific banks. Other Member States prefer explicit minimum transition periods, and sufficient transition periods for particular banks such as largely deposit-funded institutions.

57. The Presidency also proposes that individual MREL compliance deadlines could be granted up to 2024 and further extended (if justified on a case-by-case basis).