Amending capital requirements

The 'CRD V package'

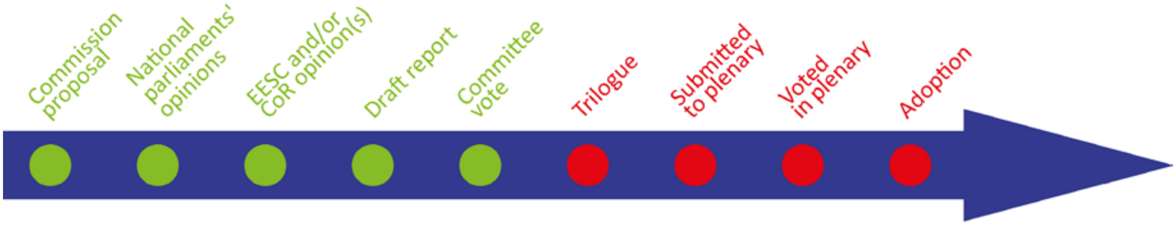
OVERVIEW

In June 2018, the Parliament's Economic & Monetary Affairs Committee (ECON) voted its report on the legislative proposals amending the current Capital Requirements Directive and Regulation (the 'CRD-IV package') which set the prudential framework for financial institutions operating in the EU. The Council (Ecofin) achieved agreement on its position on the initiative in May. The proposed amendments to the package, now being discussed by the two institutions in trilogue, implement the most recent international regulatory standards for banks, set by the Basel Committee on Banking Supervision ('Basel III framework'). They also address some regulatory shortcomings and aim to contribute to sustainable bank financing of the economy.

Proposal for a directive of the European Parliament and of the Council amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures

Proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements and amending Regulation (EU) No 648/2012

Committee responsible:	Economic and Monetary Affairs (ECON)	COM(2016)850 & 854
Rapporteur:	Peter Simon (S&D, Germany)	23.11.2016
Shadow rapporteurs:	Othmar Karas (EPP, Austria); Ashley Fox (ECR, UK); Caroline Nagtegaal (ALDE, The Netherlands); Matt Carthy (GUE/NGL, Ireland); Sven Giegold (Greens/EFA, Germany); Marco Valli (EFDD, Italy); Marco Zanni (ENF, Italy)	2016/0360A(COD), 2016/0364(COD) Ordinary legislative procedure (COD) (Parliament and Council on equal footing (formerly 'co-decision')
Next steps expected:	Trilogue negotiations	



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Introduction

Completing and implementing the significant overhaul of the financial regulatory framework in response to the financial crisis remains a major area of the European Commission's work, and includes revising the prudential requirements for financial institutions and investment firms. The Commission put forward a proposal for a directive and a proposal for a regulation amending the legislative cornerstones of the EU's prudential framework for banks and financial institutions in November 2016. Referred to as the **'CRD V package'**, the aim of the amending texts is to implement recent international regulatory provisions for banks, set by the Basel Committee on Banking Supervision (BCBS), address remaining regulatory shortcomings and contribute to more sustainable bank financing of the economy, especially regarding small and medium-sized enterprises (SMEs).

Context

Prudential requirements, or 'capital requirements', are a set of provisions with which banks and investment firms must comply to obtain authorisation from competent authorities to provide their services. The requirements aim to establish the level of adequate capital that those institutions must hold to face the risks they undertake, and are expressed as a ratio between the institutions' capital base (equity and equity-like instruments) and their risk-weighted assets (RWAs).

In 2013, the European Union adopted the **'CRD IV package'**, the third set of amendments to the original Capital Requirements Directive (CRD) recast in 2006, following two earlier sets of revisions adopted in 2009 (CRD II) and 2010 (CRD III). The CRD IV package is comprised of a directive (CRD IV) governing the access to banking activity, and a regulation (CRR) establishing how to calculate the amount of capital that banks and investment firms must set aside; it also lays down requirements on reporting and liquidity. The CRD IV package introduced in EU law the bulk of the internationally agreed standards on capital requirements developed by the BCBS in December 2010[1] in response to the financial crisis of 2007-2009, known as the 'Basel III framework'. The Basel III framework set out enhanced standards to strengthen financial institutions' capital base, improve risk management and governance, and increase transparency for market participants. It builds on the 'Basel II' three-pillar architecture, according to which: (i) Pillar 1 (minimum prudential requirements) sets the binding minimum level of capital banks and investment firms need to face major risks; (ii) Pillar 2 (supervisory review) allows supervisors to evaluate institution-specific risks and impose additional capital charges to face them; (iii) Pillar 3 (market discipline) aims to increase transparency in banks' financial reporting allowing marketplace participants to better reward well-managed banks. Implementation of the Basel III framework in the EU began in 2013 and is to be gradually phased in up to 2019.

However, Basel III did not mark the end of the post-crisis reform initiatives on prudential requirements taken up at international level. Firstly, elements of that framework required further specification. For example, while Basel III introduced a requirement to calculate and disclose the leverage ratio, it did not provide for a minimum level for that ratio. Similarly, although Basel III acknowledged the need to introduce liquidity requirements, it did not provide detailed rules for those requirements. There were also remaining weaknesses to tackle. Therefore, the BCBS initiated a comprehensive review of Basel III in 2012, to ensure consistent implementation and to help strengthen global banking system resilience. Among the main initiatives, the BCBS proposed a review of the standardised approach for measuring credit risk. It published consultative documents on withdrawing the use of internal modelling when estimating operational risks and on constraining banks' flexibility in calculating RWAs through internal models,[2] in order to reduce the high RWA-variation across banks. Other consultations followed. The overall outcome of this process was a set of provisions known as 'Basel III finalisation', which was definitively agreed in December 2017. In parallel, the BCBS started reviewing the prudential framework for market risk (set out in the 'Basel II' framework) via a 'fundamental review of the trading book' (FRTB), aimed at addressing regulatory shortcomings unveiled by the financial crisis and reducing the variability of market risk-weighted assets (MRWA) across jurisdictions. A first revised version of the relevant standard was published in January 2016, followed by a further consultation paper in June 2017. After deferring the implementation timeline of FRTB to January 2022 (from 2019), the BCBS released the latest consultation paper on the new market risk framework in March 2018. The document proposed a number of additional substantial changes.

A second strand of international developments concern the resolution framework for financial institutions. In light of the massive amount of public money that many EU countries had to inject into their banking systems to rescue banks in the wake of the 2008 financial crisis, the Financial Stability Board (FSB) published the key attributes on effective resolution regimes in 2011, which were later endorsed by the G20 as 'a new international standard for resolution regimes'. The key attributes establish the core elements for an orderly resolution of distressed financial institutions that preserve the continuity of vital functions while minimising costs for taxpayers. Those standards have been incorporated into EU law through the Banking Recovery and Resolution Directive (BRRD). For Member States participating in the Banking Union, this framework was completed by a regulation establishing a Single Resolution Mechanism (SRMR).

Further developments in this area affect the capacity of global systemically important banks (G-SIBs) to absorb losses and recapitalise in case of resolution. On 9 November 2015, the FSB published the Total Loss-Absorbing Capacity (TLAC) standard, endorsed a week later by the G20. The TLAC standard requires G-SIBs to have a sufficient amount of instruments and liabilities readily available for bail-in within resolution, but does not limit authorities' powers to impose that losses are absorbed through bail-in of further liabilities or the application of other resolution tools. Aimed at addressing the 'too-big-to-fail' issue and reducing the impact of bank failures on public funds,[3] the TLAC standard should apply to all G-SIBs (30 worldwide, including 13 banks within the EU) from January 2019. Since it is not binding, the standard has to be transposed into law. Currently, CRD IV only establishes criteria to define 'global systemically important institutions (G-SIIs)' in the EU.

Existing situation

In implementing the Basel III framework, the CRR provides for a harmonised definition of regulatory capital, establishing that it must be predominantly made up of common shares and retained earnings (Common Equity Tier 1, CET1), and sets minimum prudential requirements (Pillar 1 requirements) to address major risks inherent in activities carried out by credit institutions and investment firms, such as credit, market, operational and settlement risk. It also lays down reporting and general obligations for liquidity requirements. The CRD IV regulates access to credit institution activity and the prudential supervision of credit institutions and investment firms. It establishes rules on corporate governance, powers and responsibilities of competent authorities, and additional capital requirements stemming from the supervisory review (SREP) to cover institution-specific risks (Pillar 2 add-ons). The directive transposes the macro-prudential tools ('capital buffers') into EU law, which originated as a key component of the Basel III capital reforms: the capital conservation buffer and countercyclical buffer, which require all banks to fulfil supplementary CET1 requirements in prosperous times to provide greater resilience to procyclical dynamics. In addition to Basel III buffers, the CRD IV provides for a systemic risk buffer meant to prevent and mitigate long-term non-cyclical systemic or macro-prudential risks; and implements the mandatory buffer set by the FSB and the BCBS for systemically important institutions (G-SIIs buffer). It also envisages a buffer on 'other systemically important institutions (O-SIIs)', identified by national supervisors. Both CRR and CRD IV came into effect on 1 January 2014 and are supplemented by several European Commission delegated and implementing acts, as well as by a number of technical standards.[4]

The EU resolution framework, consisting of the BRRD and the SRMR (see 'Context'), established the minimum requirement for own funds and eligible liabilities (MREL), which requires banks to hold a minimum level of easily 'bail-in-able' instruments to ensure that losses are absorbed and banks are recapitalised once they are placed in a resolution. MREL is a bank-specific (Pillar 2) requirement fixed by resolution authorities when preparing bank resolution plans. However, the BRRD gives the

Commission the mandate, if deemed appropriate, to put forward a legislative proposal on necessary revisions to MREL by 31 December 2016, including the possibility of introducing a common minimum level of the requirement. One of the mandatory features of this review is the need to ensure MREL is consistent with any standards developed in the international fora, including TLAC.

Parliament's starting position

The European Parliament addressed the topic of capital requirements in its annual report on the banking union in 2015, where it was noted that capital requirements 'beyond a certain threshold may in the short term create unintended consequences, limiting banks' lending capacity' to the real economy. The report also remarked that, for financing of SMEs, the European supervisory authorities should 'conduct a comprehensive assessment of capital requirements embedded in current and future legislation', as well as take 'the balance between short-term and long-term impact of capital requirements' into account. The report encouraged the Commission to align the EU prudential requirements framework with the banking union framework. The report finally pushed for regulations rather than directives. In April 2016, Parliament adopted its position on the EU's role in the framework of international financial, monetary and regulatory institutions and bodies, and called for better coordination of Member States' positions. Furthermore, on 23 November 2016, in view of the finalisation of the Basel III framework (see 'Context'), the Parliament adopted a resolution where it stressed that upcoming changes should not lead to an overall significant increase in the capital requirements for banks and should not harm the ability of banks to finance the real economy, in particular SMEs. Next to the plea for no overall increases in capital requirements that could be potentially harmful for banks, in its annual report on the banking union in 2016, the Parliament called on the Commission to take the proportionality principle and the European specificities into account. A similar position was reiterated in the annual report on the banking union in 2017.

Council starting position

In its June 2016 conclusions on the roadmap to complete the banking union, the Economic and Financial Affairs Council (ECOFIN) stressed the importance of pursuing risk reduction and risk sharing measures in the financial sector and invited the Commission to put forward legislative proposals to this effect no later than the end of 2016. Amendments to the legislative framework were proposed in view of the implementation of the TLAC standard and the review of the MREL. As part of an overall review of the CRD IV package, the Council proposed amendments seeking harmonisation or further specification of options and national discretions (ONDs) currently granted to Member States, and implementing and finalising remaining Basel reforms including the introduction of a leverage ratio, possibly set higher than 3 % for systemic banks, and the introduction of a net stable funding ratio (NSFR).

Preparation of the proposal

In the course of 2015, the Commission launched a public consultation on the impact of the CRR and the CRD IV on the financing of the EU economy (particularly micro, small and medium-sized enterprises and infrastructure). In its November 2015 communication 'Towards the completion of the Banking Union', the Commission indicated it was planning new targeted prudential measures addressing identified weaknesses' in the existing framework. These measures would aim to limit bank leverage, ensure stable bank funding and improve the comparability of risk-weighted assets. On 26 May 2016, the Commission's Directorate-General for Financial Stability, Financial Services and Capital Markets Union (DG FISMA) launched two 'targeted consultations', on (i) market risk capital requirements and the original exposure method and (ii) the implementation of the net stable funding ratio. The Commission also published a communication on the cumulative impact of the current regulatory framework for financial services. The publication is a follow-up to a call for evidence on this topic, concluded in January 2016.

On 23 November 2016, the Commission published an impact assessment (IA) on an overall banking reform package, covering the CRD V as well as the amending proposals of the BRRD and the SRMR. The IA's main strengths as singled out in an initial appraisal carried out by EPRS, appear to be: thorough research, tying in with relevant international work strands, notably by the BCBS, the FSB and the European Banking Authority (EBA); an extensive consultation process; a structured approach; and the monitoring indicators, which should help evaluation. Main weaknesses concern the limited analysis devoted to 12 apparently important areas, relegated to an annex.

The changes the proposal would bring

Against the background outlined above, the Commission presented a review of the current prudential framework coined as the '**CRD V package**' on 23 November 2016, comprising a proposal for a regulation amending the CRR and a proposal for a directive amending the CRD IV. Part of a comprehensive 'banking reform package', it aims at: (1) reducing excessive leverage; (2) addressing long-term funding risk; (3) addressing market risks by increasing the risk sensitivity of existing requirements and enhancing the proportionality of the relevant prudential framework for institutions; (4) easing the compliance burden for smaller and non-complex banks without compromising their stability; (5) improving banks' lending capacity to support economic growth, in particular for SMEs; (6) increasing G-SIIs' loss absorption and recapitalisation capacity. The CRD V amendments contain three main groups of provisions, covering capital and liquidity requirements, aspects of proportionality, and the EU's resolution framework.

Capital and liquidity requirements

New Pillar 1 requirements

(CRR) Introducing **a binding 3 % leverage ratio**. If an entity's assets exceed its capital base, it is leveraged. Leverage is an inherent element of banking. However the financial crisis revealed that credit institutions and investment firms were exceedingly leveraged, meaning that they set aside relatively limited capital for ever increasing balance sheets, thanks to risk weights applied to assets. For this reason, Basel III proposed to limit the overall leverage of financial institutions (leverage ratio), providing that the regulatory capital (Tier 1) is at least 3 % of all non-risk-weighted assets (including off-balance sheet assets and derivatives). Similarly, the CRR amending proposal provides for a binding 3 % leverage ratio for all institutions subject to the CRD. Such a requirement would supplement the current requirements in the CRD and the CRR to calculate the leverage ratio, to report to supervisors and, since January 2015, to disclose publicly. Some adjustments to the calculation of leverage ratio are allowed, mainly concerning public development and promotional banks.

(CRR) Introducing a harmonised binding **net stable funding ratio (NSFR)**: The NSFR is a long-term structural ratio set out in Basel III to address liquidity mismatches in banking activity. It requires banks to hold an adequate amount of long term funding in relation to their on- and off-balance sheet activities, as of January 2018. The ratio is that between the available stable funding (ASF) held by an institution and the required stable funding (RSF) that an institution needs over a one-year horizon, calibrated (by multiplying single components by appropriate factors) to reflect the presumed degree of stability and liquidity respectively. The ratio is set at a minimum level of 100 %. The provisions set out in the CRR amending proposal reflect the internationally agreed asymmetric treatment for short-term transactions (repos and reverse repos), that requires banks to hold stable funding sources when lending cash, while not recognising stable funding when borrowing cash.

Revised risk-weighting and large exposure standards

(CRR) Setting out more risk sensitive capital requirements for market risk, following Basel work on the **'fundamental review of the trading book' (FRTB)** (see 'Context'). The Commission amendments transpose the BCBS's FRTB-related conclusions as follows: (1) clearer rules on the scope of application to prevent regulatory arbitrage (i.e., trying to pick the most favourable capital treatment between the trading book and the banking book); (2) making requirements proportionate to reflect the risks to which banks are exposed more accurately; (3) strengthening the conditions to use internal models to enhance consistency and risk-weight comparability across banks. Banks with small trading books (under €50 million and less than 5 % of the institution's total assets) would benefit from a derogation, allowing them to apply the treatment of banking book positions to their trading book. Banks with medium-sized activities subject to the market-risk capital requirements (under €300 million and less than 10 % of the institution's total assets), may use the simplified standardised approach equivalent to the existing standardised approach. The new rules would apply two years after the proposal's entry into force.

(CRR) Improving **large exposures** prudential treatment. Large exposures are an institution's exposure to a single client or a group of connected clients, representing more than 10 % of its eligible capital. In the current prudential framework, those exposures cannot exceed 25 % of the 'eligible capital'. The amending CRR proposal intends to improve the quality of capital that can be taken into account to calculate the large exposures limit (only Tier 1 capital), to introduce a lower cap of 15 % for G-SIIs' exposures to other G-SIIs and to impose the use of the standardised approach (SA-CCR) for determining exposures to derivative traded over the counter (OTC), even for banks that have been authorised to use internal models.

Other changes

(CRD) Streamlining the **Pillar 2** capital requirements. The CRD amending proposal clarifies the conditions for imposing additional own funds requirements (Pillar 2 capital add-ons, see 'Existing situation'). The Commission's proposal emphasises the institution-specific nature of Pillar 2 add-ons, which makes them unsuitable for macro-prudential purposes, for which other specific tools are set out. The Commission's proposal also clarifies the interaction between the Pillar 2 add-ons, the Pillar 1 requirements, the own funds and eligible liabilities requirement, the MREL and the combined buffers (the 'stacking order'). The proposal clarifies the distinction between Pillar 2 requirements imposed by supervisors to address institution-specific actual risks and (non-binding) Pillar 2 capital guidance, which refers to the possibility for competent authorities to indicate to banks the level of capital in excess of Pillar 1, Pillar 2 and combined buffers requirements that they expect them to hold to face forward-looking and remote stresses. In addition, the proposal constrains competent authorities' discretion when imposing additional reporting and disclosure obligations on institutions under Pillar 2.

(CRR) Introducing more flexibility regarding **waivers from capital and liquidity.** So far, waivers from prudential requirements can only apply at individual level for subsidiaries within the same Member State that are overseen on a consolidated basis by the same supervisor. Given the set-up of the Single Supervisory Mechanism (SSM), the Commission argued that group supervision is much stronger today, observing that 'where the same competent authority supervises parents and subsidiaries established in different Member States participating in the banking union, it should be able to waive the application of own funds and liquidity requirements', subject to clear safeguards for Member States in which subsidiaries are established ('host' Member States). Consequently, the Commission put forward provisions allowing for these waivers.

(CRD) Clarifying the **exemptions regime.** Some public development banks and credit unions in certain Member States are currently exempted from the CRD IV-CRR regulatory framework. To ensure a level playing field, the CRD amending proposal provides for an additional exemption for similar institutions in other Member States through a delegated act that would exempt institutions on an individual basis (for development banks) or as an entire category of institutions (in the case of credit unions), subject to certain criteria. The criteria take account of the features of entities currently on the list of entities exempted from CRD/CRR, i.e. promotional and development banks without cross-border activities and not exceeding the significance threshold in size set by the SSM regulation; as well as limited size credit unions without cross-border activities. The proposed amendments aim to change the current Commission's implementing power to modify this list with 'a better framed delegated power'.

Proportionality

(CRR and CRD) Calibrating **reporting and disclosure requirements** for small, non-complex banks. In the existing framework, banks have to report to their competent authorities according to uniform reporting requirements developed by the EBA and implemented through an implementing regulation. These requirements include information about institutions' solvency (own funds and capital requirements), the overall financial situation, leverage, large exposures and liquidity. At the same time, disclosure requirements apply at 'consolidated (group) level' with some individual disclosure requirements for parents or subsidiaries that are significant in terms of relevance for their local market. For both kind of requirements, the Commission put forward amendments in the CRR and the CRD aimed at enhancing proportionality and reducing compliance costs for institutions. Furthermore, following-up on the results of an assessment of the current rules on remuneration, the Commission proposes a targeted amendment to address problems that emerged in the application of the CRD requirements to pay out part of the variable managers' remuneration in instruments and to defer the payment over time, and another targeted amendment aimed at allowing listed institutions to use share-linked instruments to meet those requirements.

(CRR) Making it easier for banks to lend to **SMEs and fund infrastructure projects**, and thereby support investment. Currently, banks receive a capital charge reduction of 23.81 % for SME lending under €1.5 million. The Commission's proposal maintains this 'SME supporting factor' and extends its scope with no upper limit. More specifically, above the €1.5 million limit, a 15 % reduction for the remaining part of the exposure would apply. Furthermore, to encourage private investment in infrastructure projects, the Commission laid down a more risk-sensitive regulatory environment able to promote high quality infrastructure projects and reduce risks for investors. Similar to what is envisaged for insurance undertakings, capital charges for exposures to infrastructure projects would be reduced, provided those projects comply with a set of criteria capable of lowering their risk profile and enhancing the predictability of their cash flows.

Resolution framework

(CRR) Implementing the **TLAC standard.** The CRR amending proposals introduce a Pillar 1 MREL requirement for G-SIIs to hold minimum levels of capital and other instruments which bear losses in resolution, in compliance with the TLAC standard (see ‘Context’). This requirement contains a risk-based ratio and a non-risk-based ratio. A similar requirement applicable at subsidiary level is set out for subsidiaries of non-EU G-SIIs. A new Chapter 5a on eligible liabilities is introduced in the CRR following the chapters governing own funds.

Advisory committees

The European Economic and Social Committee (EESC) adopted its opinion on the banking reform package on 30 March 2017 (rapporteur Daniel Mareels (Group I – Employers, Belgium)). The EESC welcomes the package, its holistic approach and the 'risk-reducing nature of these proposals'. The advisory body notes however that 'more efforts should be made' in favour of SMEs and small and non-complex banks.

National parliaments

The two legislative proposals were transmitted to the national parliaments with a deadline to submit a reasoned opinion on the grounds of subsidiarity of 15 March 2017 for the proposal for a directive and 24 March 2017 for the regulation (CRD and CRR). The Swedish Riksdag issued a reasoned opinion regarding both files, objecting to the proposed amendments, since the Pillar 2 requirement 'can no longer be imposed to cover systemic or macro-prudential risks, which is currently allowed'. Insofar as this limits Member States' flexibility, the chamber considers the Commission text as conflicting with the principle of proportionality.

European Central Bank

In its opinion of November 2017, the European Central Bank (ECB) supported the Commission's proposals, expecting them to contribute to the reduction of risks in the banking sector and pave the way for concurrent and commensurate progress on risk sharing. The opinion addressed several issues of importance to the ECB, focusing on the effects that the proposals would have on supervisory authorities' powers.

Stakeholders' views[5]

The European Banking Federation (EBF) statement on the proposals stressed that 'banks should be able to continue to play their role as lenders while remaining resilient'. The EBF called on the EU co-legislators 'to carefully review this package' and urged them 'to be more ambitious when it comes to creating jobs and growth in Europe through an efficiently regulated single market for finance'. The EBF views the Commission's proposals as merely 'recalibrating provisions where evidence has established that the earlier regulatory response was heavy-handed'. More neutrally, the Association for Financial Markets in Europe (AFME) also supported 'the implementation of these requirements in the EU in a manner that will enable the sector to support economic growth'.

A number of regional credit institutions are concerned regarding the proportionality of these initiatives and advocate 'a more efficient form of regulation, geared towards a bank's business model, size and risk profile' for moderate-size traditional retail banks.

Finance Watch, a not-for-profit association of 48 civil society organisations, voices reservations regarding the Commission's banking reform package, its 'accompanying sotto voce' and its 'lack of ambition'. According to Finance Watch, the regulator's proposals display an 'overriding concern about maintaining or improving the competitiveness of EU banks vis-à-vis overseas rivals'. The association also notes that 'existing peculiarities of the EU implementation, e.g. regarding sovereign risk and mortgage lending', have been maintained.

Legislative process

In the Commission work programme for 2018, both CRD and CRR amending proposals were included as priority pending initiatives aimed at deepening the economic and monetary union. In December 2017, the Parliament and the Council achieved a fast-tracked agreement on the CRR proposal’s provisions setting out transitional arrangements to prevent unwarranted impact of the mandatory application of international financial reporting standard (IFRS) 9 (applicable from 1 January 2018) on EU banks' regulatory capital. The agreement also touched on the treatment of certain banks' large exposures to the public sector. Negotiations on the remainder of the legislative package continued until mid-2018.

Council

Within the Council, the proposals amending the CRR and the CRD have been examined together with the proposals amending the resolution framework, which remain part of the 'banking reform package'. Several compromises were discussed during the Maltese, the Estonian and the Bulgarian Presidencies. An overall agreement on the package was finally reached by the Ecofin Council on 25 May 2018.

Many of the amendments proposed by the Council aim at restoring an appropriate balance between home and host Member States in provisions concerning cross-border groups. To this aim, for example, the Council removed the proposed **waivers** from capital and liquidity requirements within banking groups on a cross-border basis.

The Council confirmed the CRR amendments introducing a binding **leverage ratio** requirement of 3 % of Tier 1 capital and added a surcharge on systemic institutions consistent with the December 2017 Basel III standards. Limited technical amendments on the treatment of export credit exposures and securitisations and on the definition of public development credit institutions were also introduced.

Considering the work in progress at international level, the **NSFR** requirement for the funding risk generated by derivatives was set at the lower level suggested by the BCBS (5 %), accompanied by a review clause in case it is reconsidered. At the same time, the NSFR requirements for short term repos and reverse repos was set at 5 % and 10 % respectively for a four-year phase-in period, with an automatic increase to 10 % and 15 % at the end of the phase-in (unless the Commission proposes otherwise in a separate Level 1 legislative proposal).

While awaiting finalisation of ongoing BCBS work on market risk, the Council agreed on implementing the **FRTB** as a reporting requirement in a first stage. However, a strong commitment in the legal text is introduced for a full and timely implementation of the new market risk capital requirements once the BCBS has finalised the relevant standard.

Several changes were introduced to **Pillar 2**-related provisions to reduce constraints on competent authorities' powers to impose additional requirements under the Pillar 2 framework proposed by the Commission. The Council also laid down amendments to compensate for the demise of macro-prudential tools in Pillar 2, by ensuring that the macro-prudential toolbox set out in CRD IV remains flexible and comprehensive, even if not mandatory, to prevent an excessive build-up of systemic risk. To this aim, for example, provisions on the level of the O-SII buffer cap were revised, including for subsidiaries; and an overall cap of 5 % for the sum of G-SII or O-SII buffer and the systemic risk buffer was established (that competent authorities can exceed with Commission authorisation).

The Council opted to maintain the current frequency of regulatory reporting, but sought **proportionality** by reducing its granularity for small institutions. Ministers agreed to give the EBA a mandate to develop ad hoc reporting templates for small institutions. Regarding disclosure requirements, the Council supported the principle of lighter disclosure for smaller institutions consistent with the Commission's proposal, but the criteria to define those institutions were revised.

Member States had very different views on exemptions from the **scope** of CRD/CRR, however consensus was reached on broadening the list of exempted entities, explicitly excluding certain regional promotional banks, despite some exceeding the threshold qualifying an institution as 'significant' under the SSM regulation.

Several changes to provisions on MREL eligible liabilities were introduced in the **resolution** framework, including a transitional provision 'grandfathering' certain existing liabilities until they mature, to ensure legal certainty.

European Parliament

Within the Parliament, the two legislative proposals amending CRR and CRD have been negotiated in parallel. Parliament's Committee on Economic and Monetary Affairs (ECON) appointed Peter Simon (S&D, Germany) as rapporteur. The ECON committee adopted its reports on the CRR and CRD amending proposals on 19 June 2018.

Consistent with the position taken during the preparatory phase, the Parliament paid great attention to **proportionality**. Firstly, the absolute threshold to define 'small, non-complex institutions' was raised to €5 billion. Furthermore, the Parliament proposed that supervisory authorities may adjust that threshold by including a relative component calculated on the basis of the economic output (GDP) of the Member State. That would reflect the size and risk profile of an institution in relation to the overall size of the supervisor's Member State's national economy. Additional qualitative criteria to take a bank's business model into account are envisaged. Small and non-complex institutions would benefit from a simplified, less granular version of the NSFR (sNSFR) and less complex standard methods for measuring credit risk. Reduced disclosure requirements are also envisaged for small banks, particularly for those that are not publicly listed. The reporting frequency was not modified, but instead the content of reporting was reduced.

The binding **leverage ratio** was maintained at 3 %, however for global systemically important institutions (G-SIIs) the Parliament provided for an add-on equalling 50 % of the G-SII buffer. The report proposed clarifications on the treatment of public lending by public development banks and provided for additional exemptions.

The Parliament also took account of the work in progress on the **NSFR** within the BCBS and set the required stable funding (RSF) calibration for derivatives at 5 %. While maintaining the factors proposed by the Commission, the Parliament reduced the asymmetric treatment for repos and reverse repos, by lowering the RSF to 0 % for secured reverse-repos and 5 % for unsecured reverse-repos. Covered bonds benefit from preferential treatment.

A consistent phased-in implementation of the current **FRTB** standard was confirmed, with an extended period of implementation from two up to three years. A review clause gives the Commission a mandate to revise those elements that are currently under revision by the BCBS until mid-2019.

Parliament mirrored the ECB proposals on capital and liquidity **waivers** within cross-border groups. For example, it reduced the scope, by providing that capital waivers cannot apply to subsidiaries exceeding the threshold qualifying an institution as 'significant' according to the SSM regulation and that capital waivers cannot exceed 25 % of the subsidiaries' minimum own funds requirements. An EBA report should assess possible benefits and risks and necessary preconditions for cross-border capital waivers and make suggestions if the capital waiver can be increased above 25 %. The Commission was given the power to amend the relevant provisions on the basis of the result of the EBA assessment.

Parliament also proposed a thorough review of the **macro-prudential framework** in accordance with the recommendations of the European Systemic Risk Board (ESRB). Macro-prudential and systemic risks were clearly separated from institution-specific risks, ensuring that the former are covered under Pillar 1. Concurrently, the Parliament proposed that, when carrying out the **SREP**, competent authorities shall monitor institutions' exposures towards shadow banking and financial transactions potentially leading to tax benefits, and notify the Commission. The EBA was mandated to define shadow banking and the mentioned financial transactions.

Another area of major interest for the Parliament was preserving the banking system's ability to support real economy. Accordingly, it increased the threshold of SME exposures subject to the 23.81 % capital discount (**SME supporting factor**) to €3 million. It also suggested a favourable prudential treatment for infrastructure projects with environmental and social sustainability impact. Furthermore, Parliament proposed that salary or pension backed loans would be subject to lower risk weights given their low default risks and their importance to supporting the real economy. To further foster **sustainable finance**, the Parliament required G-SIIs to disclose environmental, social and governance (ESG)-related risks, physical risks and transition risks separately. An EBA report will look into an adapted prudential treatment for assets exposed to activities associated with environmental and social objectives. The EBA will also investigate the introduction of technical criteria for the SREP of risks related to exposures to activities which are associated with ESG objectives.

Interinstitutional discussions (trilogues) on the proposals amending CRR and CRD began in early July 2018. The Euro Summit on 29 June 2018 raised expectations that Council and Parliament will conclude banking reform before the end of the year.

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Capital Requirements Directive: exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures, Legislative Observatory (OEIL), European Parliament.

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ENDNOTES

1 A revised version of the Basel III framework was published in June 2011.

2 Internal models are based on an internal-ratings-based (IRB) approach, developed as part of the Basel II framework in 2004, which allows banks to use 'their own internal measures for key drivers of credit risk as primary inputs to the capital calculation, subject to meeting certain conditions and to explicit supervisory approval'.

3 One of the most costly lessons from the financial crisis were the numerous rescue missions for ailing banks in the EU. Between 2008 and 2011, the Commission approved €4.5 trillion (equivalent to 37 % of EU GDP) of state aid measures to financial institutions. The necessity of these measures stemmed from the fact that many banks proved to be 'too-big-to-fail' (TBTF). 'Too-big-to-fail' also covers 'too-interconnected-to-fail' (TITF), 'too-complex-to-fail' (TCTF), and 'too-systemically-important-to-fail' (TSITF), see European Commission, SWD(2014) 30 and SWD(2013) 156 final, the State Aid Scoreboard, and for the USA, CRS.

4 See also Delegated and Implementing Measures in the Banking Field. Forthcoming Level 2 Acts under CRD IV and CRR, Directorate-General for Internal Policies, European Parliament, 28 February 2017.

5 This section aims to provide a flavour of the debate and is not intended to be an exhaustive account of all different views on the proposal. Additional information can be found in related publications listed under 'EP supporting analysis'.

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