

BRIEFING

National options and discretions (NODs) in EU banking regulation

This briefing gives an overview of existing National Options and Discretions (NODs) in EU banking regulation, takes stock of the action undertaken by the Single Supervisory Mechanism to harmonize them - notably the publication on 24 March 2016 of an ECB Regulation and an ECB guide on options and discretions and its successive updates - and points to possible next steps. This briefing is regularly updated.

OVERVIEW AND DEFINITIONS

One purpose of the Capital Requirements Regulation (EU) 575/2013 (CRR) and the Capital Requirements Directive 2013/36/EU ('CRD IV package') was to address the issue of national options and discretions in prudential regulation inherited from the previous frameworks so as to achieve a "Single Rule Book" for all banks in the EU. However the CRD IV package still contains a number of national options and discretions, over 150 according to the

DEFINITIONS

Option: refers to a situation in which competent authorities or Member States are given a choice on how to comply with a given provision selecting from a range of alternatives set forth in Community legislation

Discretion: refers to a situation in which competent authorities or Member States are given a choice whether to apply or not to apply a given provision in EU Law.

ECB assessment (See [Explanatory Memorandum](#) accompanying the public consultation on the draft Regulation and Guide of the European Central Bank on the exercise of options and discretions in Union law). Since the establishment of the Banking Union and the setting-up of the Single Supervisory Mechanism (SSM) such NODs appear even less justified in the euro area. As the [ECB comprehensive assessment of November 2014](#) showed, there were very significant differences in the way the NODs were exercised across the euro area, in particular as regards the use of the transitional provisions of CRR/CRD IV for the computation of CET1 capital, with a material impact on the level playing field. According to the SSM explanatory memorandum, *'[NODs] may have material effects on the overall level of prudence of the framework and on the comparability of capital ratios that make it difficult for markets and the public to gauge the capital strength of banks. (...) [They] also add a layer of complexity and costs which*

is particularly burdensome for firms operating across borders and leaves room for regulatory arbitrage (...) [NODs] can negatively affect the SSM's ability to supervise banks efficiently and from a truly single perspective'.

SSM ACTION

CATEGORISING NODS: FIVE DIMENSIONS	
1. LEGAL BASIS <i>Directive or Regulation</i>	NODs can be enshrined in the Directive (CRD IV) or the regulation (CRR); NODs in the Directive can be transposed diversely by Member States which complicates the task of the SSM
2. LEVEL OF DECISION <i>Member State or Competent Authority</i>	NODs can be available either to the Member State or to the supervisor (i.e. the 'competent authority'). The SSM has no competence over Member States NODs but can act on supervisory NODs in its capacity of competent authority in the Banking Union
3. TIME HORIZON <i>Temporary or permanent</i>	While some NODs are permanent, other NODs are gradually phased-out. They reflect the intention to gradually implement the new capital requirements. The phasing-out pace may vary across MS
4. PERSPECTIVE <i>Macro- or micro-prudential</i>	Macro-prudential NODs concerns the <i>level</i> of the capital requirements (that may vary for financial stability purposes depending on the level of systemic risk in the country) while micro-prudential NODs rather relate to the definitions of the components of the capital ratio and thus the <i>quality</i> of capital
5. SCOPE <i>Horizontal or case-by case</i>	NODs may apply to all banks ('horizontal') or be granted, upon request, to individual banks ('case-by-case'). Typical instances of case-by-case NODs are the various waivers and derogations from the general rule.

If NODs are arguably a problem for the single supervisor, the SSM has also the means to foster a common approach in the Banking Union. The SSM can act when NODs are in the hands of the supervisor and its action is facilitated when these NODs are enshrined in the Regulation, which is directly applicable in the Member States. The majority of NODs in the CRR are granted only to competent authorities. These comprise the main provisions relating to capital adequacy and liquidity requirements, including waivers of application of prudential requirements on a solo basis. Thus the majority of provisions considered material by the ECB (in order to carry out prudential supervision consistently across the Banking Union) are NODs on which it can directly act upon. At the end of 2015, the SSM has thus launched a thorough work on NODs in order to harmonize the ones in its remit wherever possible, which led to the publication of an [ECB Regulation](#) and [guide](#) on 24 March 2016. The ECB Regulation entered into force on 1/10/2016. The ECB guide is a non-binding text, immediately applicable.

Two addendums to the guide were also published:

- On the recognition of institutional protection schemes (IPS):

An IPS is defined in the Capital Requirements Regulation (CRR) as a contractual or statutory liability arrangement of a group of banks which protects the member institutions and in particular ensures their liquidity and solvency. The recognition of an IPS leads to some prudential requirements applied to individual banks being relaxed for the IPS member institutions, which is comparable to the way the entities of a consolidated banking group are treated. Such treatment is justifiable only if the requirements set out in the legislation are met, such as the ability

of the IPS to support its members in difficulty. The addendum sets out the approach to be followed by the ECB when assessing whether those requirements have been met. The final decision will be taken by the ECB on a case-by-case basis, on the basis of the criteria contained in the ECB guide. In cooperation and agreement with the National Competent Authorities (NCAs), the assessment criteria included in the guide will also be used by NCAs for less significant institutions as IPAs typically consist of both banks directly supervised by the ECB and banks supervised by NCAs.

- [On 8 additional NODs:](#)

This addendum refer to capital waivers (Article 7 of the CRR), exclusion of intragroup exposures from the calculation of the leverage ratio (Article 429(7) of the CRR), the use of IFRS for the valuation of assets and off-balance sheet items (Article 24(2) of the CRR), the calculation of risk-weighted exposure amounts of intragroup exposures (Article 113(6) of the CRR), the materiality of collateral outflows from downgrade triggers (Article 30(2) of Commission Delegated Regulation (EU) 2015/61), the cap on inflows (Article 33(2) of Commission Delegated Regulation (EU) 2015/61)), the combination of the functions of Chairman and CEO (Article 88(1)(e) of CRD IV), and the internal adequacy assessment process for credit institutions permanently affiliated to a central body (Article 108(1) of CRD IV).

[A consolidated version of the guide](#) (including the two addendums) was published in November 2016. With the addendum to the guide, the ECB considers that the NODs policy package is, for the time being, concluded.

THE ECB REGULATION

(Regulation (EU) 2016/445 of the ECB on the exercise of options and discretions available in Union law)

Binding, addresses horizontal NODs

- ❑ Published on 24 March 2016, entered into force on 1/10/2016
- ❑ Harmonises the exercise of 35 horizontal options and discretions contained in the CRD IV package and the Liquidity Coverage Ratio (LCR) delegated act;
- ❑ Concerns in particular provisions allowing for a smoother transition towards the new definition of own funds for banks (As regards the deduction of DTAs, the SSM proposes notably to turn 10 year DTAs into 6 year DTAs);
- ❑ Also covers some permanent NODs relating to the qualifying holdings, supervisory reporting, and definition of default, credit risk mitigation measures, large exposures or the liquidity framework.

THE ECB GUIDE

(ECB Guide on options and discretions available in Union law)

Non-binding, addresses case-by-case NODs

- ❑ Published on 24 March 2016; consolidated version in November 2016
- ❑ Provides guidance as regards case-by-case NODs to be used by Joint Supervisory Teams when assessing a request for exemption from a given bank;
- ❑ Regarding the possibility not to deduct holdings in insurance companies for bank-led conglomerates, such possibility is maintained and conditioned to enhanced disclosure;
- ❑ A revised consolidated version of the guide, including the addendum covering 8 additional NODs and the approach for the recognition of IPS was published in November 2016.

IMPACT OF NODS ON CAPITAL LEVELS

According to the impact assessment performed by the SSM and presented in its [explanatory memorandum](#) accompanying the public consultation, the following NODs are the ones with the most significant and quantifiable immediate impact:

- ***Transitional arrangements for the definition of own funds*** -in particular the impact of allowing for a 10 year phase in for the deduction of Deferred Tax Assets instead of 5 years in Basel III, which is of importance in particular in ES, IT, IE and PT ([as shown in the ECB explanatory memorandum, p.9](#)). These temporary NODs are covered in the ECB Regulation; and
- ***The possibility not to deduct holdings in insurance subsidiaries for banks subject to supplementary supervision under the Financial Conglomerate Directive.*** This NOD is addressed in the ECB guide.

As regards IPS, according to the ECB, they are currently recognised in three Euro Area Member States: Austria, Germany and Spain. About 50 % of all credit institutions in the Euro Area, representing around 10 % of the total assets of the Euro Area banking system.

NEXT STEPS

It is worth noting that the action of the SSM is limited to competent authority NODs and banks under its direct supervision in the Euro Area (i.e. “significant banks”). To address NODs given to Member States (and not the competent authorities) or extend the common interpretation of NODs to less significant banks or foster convergence within the EU as a whole, an amendment of EU law may be necessary. Although margins of manoeuvre appear limited given national sensitivities on many of these NODs -which are often the result of difficult negotiations-, the Commission is open to such review of EU law. In its [Communication of 24 November 2015 'Towards the completion of the Banking Union'](#), it states that '(...) *There is a need to reduce national options and discretions in the application of prudential rules. [Notwithstanding the on-going work by the SSM] there remains scope to eliminate some of the remaining options and discretions through EU regulatory measures. The Commission will work (...) with a view to aligning, as necessary, the use of national options and discretions (...)*'.

The [Council roadmap to complete the Banking Union of 17 June 2016](#) calls on the Commission to table a legislative proposal on NODs by end 2016. The ‘banking package’ published on 23/11/2016 does however not cover these issues, in particular the recently proposed amendment of CRR postpones the review of the large exposures regime (which contains a number of NODs). The table in Annex 1 gives a more detailed overview of existing NODs, SSM action so far and possible next steps.

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OVERVIEW OF EXISTING NODS BY BROAD CATEGORY

CATEGORY (NUMBER ¹)	CONTENT	POTENTIAL IMPACT	SSM ACTION	POSSIBLE NEXT STEPS
1. MEMBER STATES NODS (35) <i>NODs available to Member States and applicable to all banks</i>	<p>Mostly in the Directive; The most important ones are of macro-prudential nature, i.e. they allow MS to vary the level of capital requirements (e.g. additional macro-prudential buffers); A few micro-prudential NODs (relating to information exchange between supervisors, sanctions, reporting requirements for branches and initial capital requirements).</p>	<p>Macro-prudential NODs are the ones with potentially the most significant impact (they reflect the various levels of systemic risk across the EU);</p>	<p>No competence of the SSM to define MS NODs; As regards implementation, the SSM Regulation currently provides for a specific role for the ECB/SSM in monitoring national macro-prudential measures (the SSM can notably set higher buffers than those applied by the national authorities).</p>	<p>Commission Communication of 24 November 2015: <i>'There remains scope to eliminate some of the remaining options and discretions through EU regulatory measure'</i>; The Commission's intention is nonetheless to keep national flexibility for macro-prudential NODs (<i>'Concerning national options and discretions in the application of macro-prudential rules, the Commission will also consider possible revisions to the current regime, while retaining the necessary flexibility to respond to country-specific circumstances'</i>)</p>
2. TEMPORARY SUPERVISORY NODS (15) <i>NODs available to competent authorities, applicable to all banks and temporary (i.e. gradually phased out)</i>	<p>They correspond to the gradual phasing-in of the new capital requirements; Most of these should be fully phased-out by 2018 (e.g. deductions from CET 1 capital of goodwill and unrealised losses); Some transitional options have a longer phasing out period (e.g. the prolonged period until 2023 of the deduction of the stock of Deferred Tax Assets which existed prior to 1 January 2014 - CRR Article 487).</p>	<p>Significant impact; According to the SSM, the impact of the transitional adjustments on available CET1 capital, calculated by comparing banks CET1 capital as per the transitional arrangements at 1 January 2014 with the amount of CET1 they would hold if a fully-loaded CET1 definition were applied, amounted to €126.2 billion (See figure 2 on p.9 of the ECB explanatory memorandum</p>	<p>In its Regulation, the ECB/SSM proposes a common approach for the treatment of all transitional arrangements; It proposes notably a common approach regarding the possibility for banks to phase in the deduction of DTAs relying on future profitability and existing before 1 January 2014 over 10 years instead of the regular 5 year transition allowed in the Basel 3 accord; The common approach consists in turning 10 year DTAs into 6 years DTAs (40</p>	<p>The need for further action on transitional options dealing with different starting points is unclear, as the majority of these are phasing in/phasing out options and will be automatically discontinued from 2018; However for some of the options with longer transitional periods, i.e. grandfathering of capital instruments, the transition period could be reduced.</p>

¹ There is no official definition and enumeration of options and discretions in prudential legislation. The ECB has identified over 150 options and discretions in CRR/CRD IV including some laid down in the LCR Delegated Act for the purposes of exercising its supervisory tasks. It has proposed a policy approach for around 120 of them (among which 35 are handled in the ECB Regulation). The breakdown by category in the table above is to be taken as indicative only.

		for a detailed breakdown) The possibility for banks to phase in the deduction of DTAs relying on future profitability and existing before 1 January 2014 over 10 years instead of the regular 5 year transition allowed in the Basel 3 accord accounts for most of the impact of transitional arrangements.	% deduction is required in 2016 with a full deduction occurring in 2019), except for banks under restructuring plans (for which a decision on whether to accelerate or to keep the current pace will be made in 2020).	
3. PERMANENT SUPERVISORY NODS (35) <i>NODs available to competent authorities, applicable to all banks and permanent</i>	These concern a variety of issues such as qualifying holdings, supervisory reporting, and definition of default or credit risk mitigation measures; A distinct and important subset of competent authority options applicable to all banks are the Large Exposures exemptions in CRR Article 400(2).	Not mentioned in the ECB/SSM impact assessment as having a significant impact	<u>In its Regulation</u> , the SSM proposes a common approach for some of these NODs, notably those relating to the large exposures regime.	<u>Commission Communication of 24 November 2015</u> : <i>'There remains scope to eliminate some of the remaining options and discretions through EU regulatory measure'</i> (eg he discretions relating to the large exposures regime could be further harmonised at the occasion of the large exposures review, which has been postponed by the November 2016 banking package)

<p>4. INDIVIDUAL SUPERVISORY NODS (65)</p> <p><i>NODs available to competent authorities, applicable upon request to individual banks, on a case-by-case basis by the supervisor</i></p> <p><i>These NODs have been handled in three waves:</i></p> <ul style="list-style-type: none"> - <i>1st package: the ECB guide on options and discretions available in Union law, published on 24 March 2016;</i> - <i>The draft ECB guide on the approach for the recognition of institutional protection schemes (IPS) for prudential purposes, which has been open for public consultation from 19/02/2016 until 15/04/2016;</i> - <i>The draft addendum to the ECB guide covering 8 additional NODs, open for public consultation from 18/05/2016 until 21/06/2016.</i> 	<p>They reflect specific arrangements in Member States, such as Institutional Protection Schemes (IPS), decentralised banking models, the banc-assurance business model, certain holding structures, non-joint stock companies etc... (E.g. bank-led financial conglomerates may be allowed not to deduct holdings in insurance companies but risk-weight them instead -from 100 % to 370%- providing that a number of conditions are met- Article 49 CRR).</p>	<p>May have a significant impact when granted, e.g. notably the possibility not to deduct holdings in insurance subsidiaries (according to the ECB/SSM such exemption is among the NODs having the most significant impact on capital requirements). Because of the individual nature of these NODS, the overall impact is nonetheless difficult to predict.</p>	<p>In its guide and the successive addendums, the ECB/SSM has prepared supervisory guidance on approving these case-by-case options taking into account EBA guidelines and ITS and RTS adopted as level 2 measures (for example the RTSs on own funds); As regards the possibility not to deduct holdings in insurance undertakings, the proposal is to allow non-deduction while enhancing disclosure requirements.</p>	<p>In its report on the Banking Union-Annual report 2015, the European Parliament <i>'emphasises the need for the review of national options and discretions to guarantee a level playing field across the Banking Union, including between conglomerates and non-conglomerated institutions which have holdings in insurance undertakings'</i>;</p>
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