

# Amending capital requirements

## The 'CRD V package'

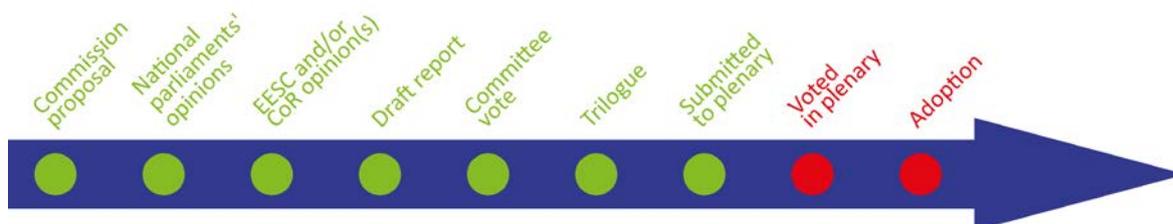
### OVERVIEW

In December 2018, the European Parliament and the Council (the co-legislators) reached a political agreement on the legislative proposals amending the current Capital Requirements Directive and Regulation (the 'CRD-IV package'), which establish the prudential framework for financial institutions operating in the EU. The amendments to the package implement the most recent regulatory standards for banks, set at international level ('Basel III framework'). They also address some regulatory shortcomings and aim to contribute to sustainable bank financing of the economy. Parliament is due to vote on adopting the proposals during the April II plenary session.

**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**

<i>Committee responsible:</i>	Economic and Monetary Affairs (ECON)	COM(2016)850 & 854
<i>Rapporteur:</i>	Peter Simon (S&D, Germany)	23.11.2016
<i>Shadow rapporteurs:</i>	Othmar Karas (EPP, Austria); Ashley Fox (ECR, UK); Caroline Nagtegaal (ALDE, The Netherlands); Matt Carthy (GUE/NGL, Ireland); Sven Giegold (Greens/EFA, Germany); Philippe Lamberts (Greens/EFA, Belgium); 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')
<i>Next steps expected:</i>	First-reading vote in plenary	



## Introduction

In November 2016, the Commission put forward a [proposal for a directive](#) and a [proposal for a regulation](#) amending the legislative cornerstones of the EU's framework on [prudential requirements](#) for banks and financial institutions. Referred to as the '**CRD V package**', the aim of the amending texts is to implement recent international regulatory standards 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 December 2010, the BCBS adopted a set of standards on capital requirements 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 reward well-managed banks. In 2013, the bulk of the Basel III framework was introduced in EU law through 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](#)) and a regulation ([CRR](#)) (see 'Existing situation' below).

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](#), 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 and a [final version](#) of the standard in January 2019. The core features of the standard include a clear distinction between the trading book and the banking book and revised approaches to measuring market risk.

A second strand of international developments concern the resolution framework for financial institutions. In view 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 a document setting out the [key attributes](#) of effective resolution regimes in 2011; these 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, 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](#) (see 'Context') 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 harmonised 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.

The EU resolution framework, consisting of the [BRRD](#) and the [SRMR](#) (see 'Context'), establishes the 'minimum requirement for own funds and eligible liabilities ([MREL](#))', which requires banks to hold a minimum level of instruments able to ensure that losses are absorbed and banks are recapitalised once they are placed in a resolution. The MREL is a bank-specific (Pillar 2) requirement set by resolution authorities when preparing bank [resolution plans](#). However, the BRRD gives the Commission the mandate, if deemed appropriate, to adopt a legislative proposal on revisions to the MREL by 31 December 2016, including the possibility of introducing a common minimum level of MREL and the need to ensure it is consistent with standards developed at international level, including TLAC.

## Parliament's starting position

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. 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. In addition, in its annual report on the [banking union in 2016](#) and [in 2017](#) the Parliament called on the Commission to take the proportionality principle and the European specificities into account.

## 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

(CRR) Introducing a **binding 3 % leverage ratio**. If an entity's assets exceed its capital base, it is leveraged. This is an inherent element of banking. However the financial crisis revealed that institutions were excessively 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). To implement this standard, the CRR amending proposal provides for a binding 3 % leverage ratio for all institutions subject to the CRD. Such a Pillar 1 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 available stable funding (ASF) in relation to the stable funding required (RSF) over a one-year horizon to finance on- and off-balance sheet activities, as of January 2018. ASF and RSF are calibrated by multiplying single components by appropriate factors to reflect their presumed degree of stability and liquidity respectively. The ratio is set at a minimum level of 100 %. The corresponding provisions in the CRR amending proposal reflect the Basel III asymmetric treatment for short-term lending transactions such as [repos and reverse repos](#), which requires banks to hold stable funding sources when lending cash, while not recognising stable funding when borrowing cash.

(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 propose to: (i) establish 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); (ii) make requirements proportionate, to reflect the risks to which banks are exposed more accurately; (iii) strengthen 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 be allowed to apply the treatment of banking book positions to their trading book. Banks with medium-sized market activities (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.

(CRR) Improving the prudential treatment of **large exposures**. 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.

(CRD) Streamlining the **Pillar 2** capital requirements. The CRD amending proposal clarifies the conditions for imposing Pillar 2 additional requirements (see 'Existing situation') on banks. The proposal emphasises the institution-specific nature of Pillar 2 add-ons that makes them unsuitable for macro-prudential purposes, for which other specific tools are set out. The 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'). It also 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**. At the moment, 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 'where the same 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 set out 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 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](#). 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 to the CRR and the CRD aimed at enhancing proportionality and reducing compliance costs for institutions.

(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 requirement for G-SIIs to hold harmonised minimum levels of capital and other instruments (eligible liabilities) suitable to 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 concerning eligible liabilities is added to the CRR following

the chapters governing own funds. While the TLAC requirement concerns G-SIIs only, the rules on eligible liabilities apply to all institutions. A bank-specific add-on for G-SIIs and the MREL for non-G-SIIs (Pillar 2 requirements) are introduced through targeted amendments to the BRRD and SRMR.

## 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<sup>1</sup>

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 considered priority pending initiatives aimed at deepening economic and monetary union. They were also included in the [joint declaration on the EU's legislative priorities for 2018 to 2019](#). 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 an 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 the end of 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'. An [overall agreement](#) on the package was reached by the Ecofin Council on 25 May 2018.

Many of the amendments proposed by the Council were aimed at restoring an appropriate balance between home and host Member States in provisions concerning cross-border groups. To this end, 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** calibration (see 'The changes the proposal would bring') 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 calibration 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, the legal text includes a strong commitment to 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 the 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 end, 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 were 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 that would reflect the size and risk profile of an institution in relation to the overall size of its Member State's national economy. Additional qualitative criteria to take a bank's business model into account were 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 were also envisaged for small banks, particularly for those that are not listed. The reporting frequency was not modified, but instead the content of reporting was reduced.

The binding **leverage ratio** was maintained at 3 %, however the requirement should be fulfilled by at least 50 % of CET1 capital. Similar to Council, 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. Parliament also proposed to change the calculation method for the leverage ratio used by large institutions, by referencing averages of observations over the reporting period instead of observations at the end of the quarter. This was aimed at tackling so-called 'window-dressing behaviour', which refers to possible attempts by institutions to reduce the size of their balance sheets at the reporting date in order to improve their leverage ratio. 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 %. In addition, it reduced the asymmetric treatment for repos and reverse repos, by lowering the RSF calibration to 0 % and 5 % for secured and unsecured reverse-repos respectively. Covered bonds would 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.

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 would be 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 would be mandated to define shadow banking and the financial transactions concerned.

Another area of major interest for the Parliament was preserving the banking system's ability to support the 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**, Parliament required G-SIIs to disclose environmental, social and governance (ESG)-related risks, physical risks and transition risks separately. An EBA report would look into an adapted prudential treatment for assets exposed to activities associated with environmental and social objectives. The EBA would also investigate the introduction of technical criteria for management and supervision (SREP) of risks related to exposures to activities associated with ESG objectives.

To tackle [disincentives for banks to reduce their stocks of non-performing loans \(NPLs\)](#) through massive sales potentially causing economic losses and capital shortfalls, Parliament proposed an amendment aimed at mitigating the effect of exceptional NPL disposals on the loss given default ([LGD](#)) parameter used in internal rating-based (IRB) models to calculate credit risk. Adjustments would be applicable for a limited period of time.

## Political agreement

The **Euro Summit** on 29 June 2018 [raised](#) expectations that Council and Parliament would conclude banking reform before the end of the year. Interinstitutional discussions (trilogues) on the proposals amending the CRR and CRD began in July 2018 and went on until early December, when co-legislators reached a [provisional agreement](#) on the entire 'banking reform package', including the proposals on the CRR and CRD. The agreement was endorsed by the ECOFIN Council in its meeting on 4 December 2018. Technical work followed to fine-tune the compromises reached. On 15 February 2019, Coreper [endorsed](#) the final agreement on the banking reform package reached between the Romanian Presidency of the Council and the Parliament. The ECON committee approved it on 26 February 2018.

In the first place, the **agreement** on [amending the CRR](#) and [CRD](#) aims to strengthen bank capital requirements, so as to reduce incentives for EU financial institutions to take excessive risks, while preserving a level playing field with competitors from other jurisdictions. In this vein, the binding **leverage ratio** was confirmed at 3 % of Tier1 capital as proposed by the BCBS standard. However, to avoid disproportionate impacts on certain business models or lines of business, targeted exemptions from the total exposure measure were introduced in line with the Parliament's position (i.e. for public lending by public development banks and officially guaranteed export credits, some exposures of building societies, infra-IPS exposures, and exposures of central securities depositories authorised as credit institutions). Additionally, as a macroeconomic tool to strengthen intra-bank lending in exceptional circumstances, competent authorities can temporarily exclude certain central bank exposures from the total exposure measure, while offsetting the impact of the exclusion by re-calibrating the leverage ratio requirement. The compromise also retains the calculation methodology proposed by the Parliament to tackle 'window-dressing behaviour', yet, considering the [BCBS work in progress](#) on this subject, it only features as a reporting and disclosure obligation, complemented by Pillar 2 measures where necessary. G-SIIs shall maintain an additional leverage ratio buffer equal to 50 % of the G-SII buffer. As for the **NSFR**, the agreement basically reflects the BCBS approach. However, to ensure that EU banks are not disadvantaged vis-à-vis their competitors around the globe and to prevent unintended consequences on EU financial markets, targeted amendments proposed by Parliament have been introduced, concerning the RSF calibration for certain transactions, such as trade financing, factoring and reverse repos. For the latter, in particular, lower factors (0 % and 5 % for secured and unsecured reverse repos respectively) are envisaged for a three-year period; after that period, the BCBS factors would automatically apply, unless the Commission makes a new legislative proposal. Still in line with the Parliament's proposals, the EBA is mandated to issue reports on holdings in securities to hedge derivatives and on the liquidity of precious metals for NSFR purposes. Pending the finalisation of ongoing BCBS work on market risk, the co-legislators agreed on implementing the **FRTB** as a reporting requirement solely and agreed with the Commission that the final standards should be implemented as soon as they are finalised at international level.

As strongly recommended by Parliament, co-legislators agreed that prudential requirements must be **proportionate** to the size and risk profile of banks. To this aim, an explicit definition of 'small, non-complex institutions' based on quantitative and qualitative criteria was introduced. Member States may lower the €5 billion total asset value threshold, but competent authorities will still be able to decide that an institution is not to be considered as small non-complex on the basis of a case by case analysis. Smaller institutions will benefit from reduced reporting and disclosure requirements in order to lower compliance costs. On regulatory reporting in particular, the EBA is mandated to develop targeted reporting standards for small, non-complex institutions with the objective of lowering their reporting costs by at least 10 % and, ideally, up to 20 %. Furthermore, the EBA will conduct a study to assess the feasibility of an [integrated reporting framework](#) for all EU banks that could lead to further developments

if the results of the study were positive. As proposed by Parliament, small non-complex institutions will benefit from a simplified version of the NSFR (sNSFR), that is easier to calculate and less granular, but more conservatively calibrated. Supervisory authorities will be able to require those institutions to apply the fully-fledged NSFR on a case by case basis. In the same vein, the co-legislators agreed that institutions with monthly trading activities not exceeding €50 million and 5 % of their total assets could use banking book instead of trading book rules. Banks with trading activities not exceeding €500 million and 10 % of their total assets can use a simplified standardised approach.

To take into account the evolution of the banking sector in an ever more digital environment, the final compromise reached by co-legislators reflects a Parliament amendment aimed at excluding investments in **software** from [intangible assets deducted](#) from own funds, provided they are prudently valued and able to absorb losses in the event of resolution, insolvency or liquidation of an institution.

Another important aim of the legislative package settled by the Council and the Parliament is to further enhance the capacity of banks to lend to the real economy. In this perspective, in line with the Parliament's approach, the size limit on SME loans that will benefit from a capital charge reduction of 23.81 % by applying the **SME supporting factor** was increased up to €2.5 million; the share of exposures exceeding that threshold will benefit from a 15 % reduction. Capital charges are reduced by 25 % by applying an **infrastructure-supporting factor** to exposures to infrastructure projects complying with a set of criteria able to reduce their risk profile and enhance predictability of cash flows. Those criteria include an obligation that the source of repayment of the exposure shall be represented for at least two thirds of its amount by the income generated by the project being financed. This lower threshold compared to the Commission's proposal allows more projects to benefit from the favourable treatment. A non-binding assessment of projects' sustainability will also be required, as wished by the Parliament. By three years after the entry into force of the amended CRR, the Commission will report on the impact of the capital relief on lending to infrastructure project entities and submit that report to the European Parliament and to the Council, together with a legislative proposal, if appropriate. As regards **pension and salary-backed loans**, there was an agreement to provide for lower risk weight under the standardised approach, as proposed by Parliament, with additional safeguards and risk mitigation criteria. The final agreement also reflects Parliament's proposals aimed at fostering **sustainable finance**.

In order to avoid negative impacts on banks' lending capacity of losses stemming from **massive disposals of NPLs**, the agreement reached by co-legislators confirmed the possibility for banks to partly or fully offset the effect of such disposals on realised LGDs, provided certain conditions are met and within a pre-determined timeframe. To this end, a definition of 'massive disposal' was introduced.

Co-legislators agreed that the Commission's objective to confine bank-specific capital requirements (**Pillar 2**) to microprudential purposes should be coupled with a more thorough reform of the macroprudential framework outlined in the CRR/CRD. Therefore they concurred on a large number of amendments to the Commission's proposal. In particular, as regards the degree of flexibility that supervisory and macroprudential authorities should be given, it was agreed that narrower availability of Pillar 2 tools to tackle macroprudential or systemic risks should be counterbalanced by more flexibility to resort to macroprudential tools implemented through national (not fully harmonised) measures. The macroprudential framework will be periodically assessed by the Commission and subject to a comprehensive report based on the terms proposed by Parliament.

The agreed banking package sets out a framework for cooperation and information-sharing among the various authorities involved in the supervision and resolution of cross-border banking groups. The agreed measures preserve the balance achieved by the Council position between the powers of **home and host supervisors** in order to facilitate cross-border flows of capital and liquidity, while ensuring an adequate level of protection for depositors, creditors and financial stability.

As wished by Parliament, the agreement also introduces amendments to improve cooperation between competent authorities on matters relating to **anti-money laundering** (AML) activities. In particular, it brings in cooperation and exchange of information requirements between prudential supervisors, anti-money laundering authorities and financial intelligence units (FIUs). The texts stipulate that the application of a banking license must include a description of the arrangements, processes and

mechanisms to manage anti-money laundering and terrorist financing risks. Additionally, the AML dimension will be considered in the SREP, including a notification to the EBA and the AML authorities when weaknesses in the governance model, business activities or business model are identified.

As regards the **scope** of the CRR/CRD, co-legislators decided to retain the Council's approach. To avoid the negative consequences of a sudden change in regulation when implementing the new **TLAC and MREL standards**, co-legislators agreed that [subordinated debt](#) issued before the entry into force of the amended CRR would not qualify as own funds instruments or eligible liabilities. Furthermore, as per one of Parliament's proposals, safeguards were introduced for retail investors subscribing newly issued subordinated TLAC/MREL instruments. Parliament is due to **vote** on adopting the proposals during its April II plenary session.

## EP SUPPORTING ANALYSIS

C. Stamegna, [Minimum loss coverage for non-performing loans](#), European Parliamentary Research Service, European Parliament, 7 March 2019.

[Banking reform package](#), Initial Appraisal of the Commission Impact Assessment, European Parliamentary Research Service, European Parliament, August 2017.

M. Magnus, A. Margerit, B. Mesnard and A. Korpas, [Upgrading the Basel standards: from Basel III to Basel IV?](#), Economic Governance Support Unit, European Parliament, October 2017.

A. Stuchlik, [The cost of banking – Recent trends in capital requirements](#), European Parliamentary Research Service, European Parliament, 26 July 2016.

## OTHER SOURCES

[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.

[Capital Requirements Regulation: leverage ratio, 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](#), Legislative Observatory (OEIL), European Parliament.

## ENDNOTES

<sup>1</sup> 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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