BRIEFING

Update on recent banking developments

Calendar week 46

This briefing gives an update on recent events and developments in the Banking Union, based on publicly available information. The briefing summarises: 1) the main elements of two papers commissioned by ECON on the effectiveness of relaxing capital and liquidity buffers as crisis measures; 2) the most recent ECB Bank Lending Survey; 3) recent EBA publications (on anti-money laundering, sustainability, MREL-TLAC eligible instruments and the prudential treatment of legacy instruments); 4) the recent ESMA Wirecard report and similarities with the case of Commerzialbank Mattersburg; 5) the European Court of Justice's role in shaping the Banking Union; and 6) the European Court of Auditors report on EU agencies.

1. The effectiveness of relaxing capital and liquidity buffers as crisis response measures

In response to the COVID-19 crisis, the European Central Bank (ECB) Banking Supervisor announced a number of decisions aimed at providing capital reliefs to banks, to ensure that banks keep lending to the real economy (see here for an overview of all such measures taken). More recently, in their macroprudential bulletin, the ECB have been interested in assessing whether capital relief measures have worked in practice, and what factors could constrain the effectiveness of such measures (see Box 1).

The ECON Committee commissioned two papers by external experts specifically looking at whether the relaxation of capital and liquidity buffers has been effective in the current crisis. In their paper, **Jorge Abad and Rafael Repullo** find that EU banks entered the COVID-19 crisis with sufficient capital and liquidity buffers, but with a lack of significant macroprudential buffers (namely the countercyclical capital buffer). They largely attribute this shortcoming to the use of credit-to-GDP as the reference point for decision-making. Thus, when the crisis hit, regulators had to rely on microprudential measures to ensure that banks continue lending to the real economy.

The authors note, however, that banks have so far not drawn down their capital and liquidity buffers. They hypothesise that despite higher demand for credit by firms to cover liquidity needs, there is a lower demand for investment by households and firms due to high uncertainty. On the supply side, financial market pressures may act as impediment to banks drawing down on their capital buffers. Other mitigating factors include banks' reluctance to extend loans that may end up non-performing, and a lack of certainty regarding the time horizon for replenishing buffers. In addition, the actual increase in the liquidity position of banks is to be expected given the monetary policy measures introduced since the crisis. The authors further highlight that *"more lending to support the real economy may come at the expense of greater risk for the banking system"*, as the reduction in capital buffers in a high-risk environment reduces the solvency of banks. The decision to restrict pay-outs is therefore seen as justified by the authors.

Considering these factors, the authors make some key takeaways: that macroprudential tools, as they stand, are insufficient to deal with large macroeconomic shocks; that the new framework for provisioning based

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on expected credit losses adds an additional layer of procyclicality; and that an institutional design in which microprudential supervision is close to the central bank is highly desirable, so that microprudential tools can be quickly deployed for macroprudential purposes.

Consequently, the authors make four policy recommendations. First, the credit-to-GDP gap should be abandoned as the reference point for the countercyclical capital buffer, and that *"solid macro-financial analysis and sound judgement"* be used instead. Second, banking regulation should increase macroprudential buffers - with the suggestion to raise the upper bound of the countercyclical capital buffer (from 2.5% to 4%) and to partially compensate for this by reducing the capital conservation buffer (from 2.5% to 2%). Third, a single statistical framework should be used to calculate risk measures to compute capital requirements and loan loss provisions. Lastly, the authors recommend expanding the current prudential filters separating accounting from regulatory capital to mitigate the procyclical effects of IFRS 9.

The second paper, by **Alexandra Matyunina and Steven Ongena**, focuses more on bank capital regulation. Looking at aggregate bank lending in the euro area, the authors find that total loan volume grew during the first half of 2020. At the same time, the risk-weighted assets of euro area significant institutions remain at the same level as at the beginning of 2020, indicating that credit supply growth has been driven by national guarantee schemes. There is thus no evidence of the utilisation of capital buffers at the aggregate level.

The authors argue that the temporary reduction in capital requirements has mitigated the banks' incentive to deleverage in the crisis. They go on to estimate the impact of these measures on the credit supply, finding that *"for the actual 1,7 pp capital release activated by the ECB and the national authorities at the end of the first quarter this year [not accounting for the release of the capital conservation buffer], it translates into 2,0–2,6% growth in lending to the real economy over the following 12 months."* Moreover, the impact of capital availability will increase if losses start accumulating on the banks' balance sheets.

However, the authors find that while supervisors have alleviated the bank's capital-related concerns as regards to lending decisions, other market discipline constraints remain in place (as alluded to in the paper by Abad & Repullo above). In the current crisis, banks' concerns regarding stock market valuation, a higher risk environment and regulatory and economic uncertainty, are seen as key factors limiting credit supply growth. Moreover, the authors find that the *"dividend payout ban is likely contributing to both the decrease in the banking sector market valuation and the regulatory uncertainty."* They therefore recommend introducing a regulation that would outline the course of supervisory action regarding payout restrictions in pre-crisis situations, with the following distributional guidelines: *''The banks should be allowed to distribute the financial year earnings as scheduled in the form of dividends or share buybacks depending on the banks' preferred payout method; the share buybacks should be limited to the sum of the distributable earnings; the coupons on the instruments qualifying as AT1 capital should not be restricted.''*

It should be noted that the European Parliament has publicly voiced its support for the payout restrictions. In a 27 March statement, Economic and Monetary Affairs (ECON) committee Chair and political coordinators stated that they *"support actions by banking supervisors for the application of strong temporary restrictions for banks on payments of dividends and bonuses, and buying back of own shares."* More recently, Chair Enria stated that the ECB will take further decisions on payout restrictions ''*only when we will have more visibility on the macroeconomic developments ahead of us.*''

Box 1: ECB Macroprudential Bulletin, October 2020

The ECB touched on the issue of capital buffers and their usability in the context of COVID-19 in three articles in their Macroprudential Bulletin:

The first article, by **Behn, Rancoita, and d'Acri**, looks at the main objectives of the capital buffer framework and the possible trade-offs that may arise between these. On the one hand, if banks continue to lend during a crisis, this can lead to a lower capacity to absorb losses and a risk of bank failure or banking crisis. On the other hand, the banking sector can contribute to reducing losses at the start of a crisis by maintaining or expanding the supply of loans. The authors note that although buffers are a tool to be used in a crisis, banks may not be willing to use them due to certain regulatory prudential and market impediments. **The possible stigma attached to breaching buffer requirements may lead banks to set capital ratio targets in order to optimise financing costs, minimise the risk of default, rating downgrades, and supervisory action. This echoes the findings of the abovementioned external papers commissioned by ECON.** The authors note that problems of collective action may arise if individual banks do not consider the social benefit of stabilising the economy through the use of buffers. **Therefore, they stress the importance of clear and convincing communication by prudential authorities to mitigate a number of obstacles to the use of buffers** (also a point raised by the external papers) and find that *"shaping agents' expectations on the path towards replenishing used buffers will also help to enhance their usability"* (in this regard, see the ECB's clarification of the timeline to restore buffers).

Borduk, Budnik & Volk examine the role of capital buffers in containing the reduction of lending to the real economy during the COVID-19 crisis. Using the Banking Euro Area Stress Test (BEAST) model, the authors compare the results when banks use their buffers to when they abstain from doing so. The model also allows for an understanding of the heterogeneous behaviour of the individual banks by studying the interactions between the financial sector and the real economy. **The results show that the use of capital buffers by banks leads to better economic results, without a negative impact on their resilience:**

- *"Using buffers is expected to increase lenfing to the non-financial private sector by more than 3%..."*
- *"The increase in lending supports economic activity, leading to an increase in GDP of 0.3-0.5% in 2022..."*
- *" When banks use their buffers, they are expected to experience lower transitions to default, resulting in a 0.2 percentage point lower NPL ratio in 2022... In turn, and also taking into account positive effects on loss given default, credit losses are expected to be lower."*
- *"Even though the released buffer significantly lowers capital requirements, the CET1 ratio is only around 0.7 percentage points lower when the buffer is used. The decrease in the CET1 ratio is higher for banks with a larger release of capital requirements...''*

Therefore, the authors conclude that enhancing the usability of buffers (as discussed above) will have a material impact on the duration and severity of the recession.

Lastly, **Andreeva, Bochmann and Couaillier** specifically looks at market pressure, finding that it is indeed an obstacle to the usability of regulatory capital buffers. First, the authors looked at euro area banks' target CET1 ratios, finding that *''targets were lowered temporarily, but not accross the board"*: **only one third of banks (mostly consisting of the largest banking groups) lowered or withdrew their targets,** and in most cases this was a mechanical adjustment or done so only in the short-term. The authors further find that *"despite the supervisory and macroprudential measures introduced, banks remain rather reluctant to dip into their remaining macroprudential buffers"*. A regression analysis confirms that when facing an adverse macro-financial environment, banks target higher capital ratios, which may counterimpact the effectiveness of capital buffer releases. The authors attribute this impediment to buffer usability to market pressure. In a period of low risk appetite and flight to safety, as with the COVID-19 crisis, **banks may refrain from using their capital buffers to (i) avoid increases in credit risk premia** (and for lower rated banks, this could even result in lost market access); **(ii) avoid replenishing capital ratios in a challenging environment**, and possibly triggering regulatory breaches and payout restrictions; and **(iii) avoid a further deterioration of market-based risk metrics.**

2. ECB Bank Lending Survey

The ECB October Bank Lending Survey (BLS) results reveal that credit risk considerations due to the coronavirus pandemic has crept into banks' expectations resulting in a tightening of credit standards on loans to both firms and households in the third quarter of 2020. Among the largest euro area countries, credit standards for all types of loans has tightened in Germany, Spain, France and Italy. This tightening was mainly driven by banks' risk perception and was in line with banks' expectations expressed in the previous survey round and banks expect to tighten them even further in the upcoming fourth quarter. The further tightening of credit standards are reflecting concerns around the recovery, uncertainties around the prolongation of fiscal support measures, deteriorations of the economic outlook and worsened creditworthiness of consumers.

Firms' demand for loans or drawings of credit lines has declined in the third quarter of 2020, while household demand for housing loans and consumer credit has increased. This was mainly driven by several factors: for firms, the needs of emergency liquidity has declined compared to the previous quarter as well as weak demand for fixed investment contributed negatively; for households, the lifting of severe lockdown measures has contributed to consumer sentiment and higher demand for housing loans.

It should be noted that after a significantly lower rejection rate for firms' loan applications, reported by the banks in the second quarter BLS, in the third quarter of 2020 such rate has increased across all loan categories. Nevertheless, currently reported loan rejection rate is still well below the levels that were observed prior to the coronavirus pandemic.

Moreover, the October BLS has also included a number of ad hoc questions related to euro area banks' access to retail and wholesale funding as well as impact of the ECB's quantitative easing tools. Banks have reported that theirs access to funding continued to improve, ECB's quantitative easing tools (such as asset purchase programme (APP), pandemic emergency purchase programme (PEPP) and targeted long-term refinancing operations (TLTRO III)) had positive impact on banks' liquidity position and market financing conditions, however, it had a negative impact on banks' profitability.

3. Overview of some recent EBA publications

Opinion on how to take into account Money Laundering/Terrorist Financing (ML/TF) risks in the Supervisory Review and Evaluation Process (SREP)

Following the European Council's request that the EBA set out how prudential supervisors' factor in ML/TF risks in the supervisory process, including SREP, the EBA published its Opinion on the topic on 4 November. This follows a July 2019 Opinion on communications to supervised entities regarding ML/TF risks in prudential supervision and December 2019 Joint Guidelines on supervisory cooperation in this area.

The EBA reminds prudential supervisors that ML/TF risks are *"not necessarily linked to an institution's size or financial soundness."*. The Opinion outlines the EBA's expectation that prudential supervisors consider ML/TF risks in the following components of the SREP: the monitoring of key indicators; business model analysis; assessment of internal governance and internal controls; assessment of risks to capital; assessment of risks to liquidity and funding. More generally, the Opinion calls for cooperation and exchange of information between prudential and anti-money laundering supervisors, facilitated through the Memorandum of Understanding (MoU) signed between the ECB and national anti-money laundering authorities. The EBA has indicated that more detailed guidance that supervisors should take in incorporating ML/TF risks in the SREP process will be detailed in the revised SREP Guidelines, to be completed by end-2021.

Previously, Chair Enria of the ECB Supervisory Board stated in a letter dated 22 April that *"In the 2019 SREP, we enhanced our approach to identifying and reflecting AML/CFT concerns in prudential supervision ... This methodology will be revisited to incorporate insights gained from practical experience and the expected amendments to the EBA's SREP Guidelines regarding AML/CFT risks, as well as the AML/CFT-related elements in the new Capital Requirements Directive (CRD V) ... Taken together, all this gives me confidence that the SREP process will be able to take better account of AML/CFT concerns in the future, leading to additional synergies with the competent authorities in this field."*

Discussion paper on management and supervision of Environmental, Social and Governance (ESG) risks for credit institutions and investment firms

As part of the launch of a public consultation on incorporating ESG risks into risk management and supervision on 3 November, the EBA published a discussion report on the topic. The feedback on the discussion paper will feed through to the EBA's final report, expected to be delivered in June 2021[1]. The

[1] Article 98(8) Capital Requirement Directive V and Article 35 Investment Firm Directive mandate the EBA to develop a report assessing the potential inclusion of ESG risks in the review and evaluation performed by competent authorities and elaborating on the arrangements, processes, mechanisms and strategies to be implemented by institutions to identify, assess and manage ESG risks.

paper identifies common definitions of ESG risks,[2] provides an overview of evaluation methods, and outlines recommendations for the incorporation of these risks into business strategies, governance and risk management, as well as supervision.

The consultation paper recommends that supervisors proportionally incorporate ESG factors into the business model analysis, and notes that the *''the existing assessment under supervisory reviews might not sufficiently enable supervisors to understand the longer term impact of ESG risks, its breadth and magnitude, on future financial positions and related long-term vulnerabilities.''* It therefore recommends evaluating whether institutions sufficiently test the resilience of the business model against a longer-term time horizon. Moreover, the paper suggests that supervisors should incorporate ESG risk considerations into internal governance assessments. Lastly, the EBA notes that ESG risks materialise in the form of existing prudential risks and should therefore be considered by supervisors as sources of financial risk. To facilitate the integration of ESG risks into the supervisory framework, the EBA suggests that *''on the basis of the outcome of this discussion paper and as embedded in Article 98(8), the EBA can capture these risks in dedicated guidelines and, based on the recognised materiality of the ESG risks, these risks should be introduced in the [Capital Requirements Directive] and [Investment Firm Directive].''*

Report on the monitoring of TLAC-/MREL-eligible liabilities instruments of EU Institutions

On 29 October, the EBA published its first monitoring Report[3] on minimum requirement for own funds and eligible liabilities (MREL) and total loss absorbing capacity (TLAC) instruments. The Report presents the EBA's current policy views and areas for further work, but is not able to analyse the compliance of any given instrument. The EBA analysed 27 transactions issued in 14 jurisdictions for a total amount of approximately EUR 22.75 billion, which is composed of EUR 21 billion senior non-preferred issuances and EUR 1.75 billion senior holding company issuances - the only two types of issuances looked at in the report.

Overall, the EBA finds that ''*European banks have not waited for the adoption of the new banking package to start issuing MREL and TLAC instruments*.'' Moreover, it observes that market participants have used relatively simple and standardised provisions, conducive to providing legal certainty and reliability at the point of resolution. However, the EBA cautions that this may no longer hold since *''the uncertainty of the legal requirements has been dissipated with the publication of CRR2/BRRD2.''* To determine the quality of the instruments, the EBA looked at availability, subordination, capacity for loss absorption, maturity and other aspects including governing tax, regulatory calls and tax issues. In total, the EBA makes 15 recommendations.

Moreover, the Report reflects on areas for future work, including the increase in ESG issuances for MREL purposes, and the need to provide more guidance in this area. Based on the analysis on issuances conducted thus far, the Report identifies ''*a possible perception by investors that green assets and green capital could be segregated from the rest of the assets and capital of the institution and possible challenges around the 'no creditor worse off' principle if the resolution authority decides to bail in the instrument while the green assets are still performing. Guaranteeing that there is no direct link between the green assets and the notes is needed to ensure that the issued capital is available to absorb losses incurred on not only green and social assets but all*

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[2] The EBA defines ESG risks as *"the risks of any negative financial impact to the institution stemming from the current or prospective impacts of ESG factors on its counterparties"*, with ESG factors being *''environmental, social or governance characteristics that may have a positive or negative impact on the financial performance or solvency of an entity, sovereign or individual"*. The EBA also identified three transmission channels: physical, transition, and liability risks. COVID-19 is also identified as a good case study for the interplay of ESG factors and their impact on the financial system. As for the assessment of ESG risks, the EBA notes that methods for the assessment of environmental risks are more sophisticated than those for social or governance risks. The paper finds that ''*further development of the EU Taxonomy Regulation, will gradually allow institutions and supervisor to exploit social and governance indicators, and integrate them, respectively into the management and supervision of ESG risks.''*

[3] This report was published in accordance with Article 80(1) Capital Requirements Regulation (CRR) which states that "*EBA shall monitor the quality of own funds and eligible liabilities instruments issued by institutions across the Union and shall notify the Commission immediately where there is significant evidence that those instruments do not meet the respective eligibility criteria set out in this Regulation*".

types of assets if needed." It also points to other areas of concern, including the degree of clarity of associated risk factors; the definitions used for green assets and bonds; and reputational and conduct risk concerns.

Opinion on the prudential treatment of legacy instruments

The Capital Requirements Regulation (CRR) introduced grandfathering provisions for certain capital instruments that, at the time, did not meet with the definition of own funds - the so called "legacy instruments". The beneficial treatment provided by grandfathering provisions will end on 31 December 2021. On 21 October, the EBA published an Opinion on the prudential treatment of these legacy instruments going forward.

The EBA finds that legacy instruments may pose infections risks, or the disqualification of other layers of own funds or eligible liabilities, through clauses that may contradict either the principle of the flexibility of distribution payments, or the eligibility criterion of subordination. Possible options to address this risk include for the institution themselves to (i) call, redeem, repurchase or buy back the instrument; (ii) amend the relevant terms and conditions; and (iii) as a last resort, keep the instruments in the balance sheet as a non-regulatory instrument (meaning that it would be excluded from own funds and TLAC/MREL eligible instruments while remaining on the balance sheet). The EBA believes that this third *option "might be reasonable, taking into account all the relevant circumstances, to allow a certain level of flexibility and tolerance under strict conditions, for a limited number of cases, where neither of the other two options can be pursued by institutions and where this is duly demonstrated by the institutions concerned to the competent authority"* and that this is in the spirit of the CRR.

Going forward, the EBA will monitor how the transposition of specific provisions of the Bank Resolution and Recovery Directive (BRRD) into national law may alleviate infection risk, and to monitor the situation of legacy instruments until the end of the grandfathering period.

4. ESMA Wirecard report - and similarities at Commerzialbank Mattersburg

ESMA's First Peer Review

The European Securities and Markets Authority (ESMA), the EU's securities markets regulator, published the results of its Fast Track Peer Review (Peer Review) on 3 November, which assessed the events leading to the collapse of Wirecard AG and the response by the German supervisor BaFin and the Financial Reporting Enforcement Panel (FREP).

The Peer Review, prepared in response to a request received from the European Commission, identifies a number of deficiencies, inefficiencies and procedural impediments, namely deficiencies in BaFin's internal control system regarding conflicts of interest of its employees vis-à-vis issuers, a risk of influence by the Ministry of Finance, insufficient market monitoring by both BaFin and FREP, and insufficient examination procedures of Wirecard's financial reports by FREP. The Peer Review also mentions that a strong confidentiality regime, by which both institutions are bound, may have hindered the exchange of relevant information between them and with other relevant bodies.

Commerzialbank Mattersburg - an insolvency comparable to Wirecard?

In the wake of the uncovering of a massive balance sheet fraud, the Austrian Financial Market Authority (FMA) in July prohibited with immediate effect a comparatively small bank, Commerzialbank Mattersburg, from continuing any of its business operations by way of an administrative emergency decision. That emergency decision effectively stopped all withdrawals and transfers, and triggered the deposit guarantee scheme to step-in for the pay-out of all covered deposits held by that bank.

Commerzialbank Mattersburg, founded in 1995, was a bank with just eight branches, approximately 15 thousand clients, and an alleged balance sheet size of approximately EUR 800 million in 2018.

According to the press, the appointed insolvency administrator reported in a creditor board meeting at court level that the excess of liabilities over assets sums up to a staggering amount of EUR 705 million, explaining that the shortfall is mainly due to fictitious assets in the bank's accounts that amount to around EUR 690 million.

As in the Wirecard case, the magnitude of the shortfall - huge in comparison to the size of the balance sheet - again leads to the question why the external auditor that checked the accounts of Commerzialbank Mattersburg has not noticed that the accounts were manipulated.

As reported by a banking expert that is likewise cited in the press, the banking supervisor in charge of Commerzialbank Mattersburg might also have noticed a number of warning signals way earlier. That report, which is based on the analysis of the bank's annual financial statements from 2008 until 2018 and which compares the development of key financial parameters with that of a peer group, apparently points to an unusual fast increase in the size of the bank's balance sheet, an anomalous credit-deposit ratio, an unusual high ratio of (fictitious) claims towards other banks, and implausibility regarding the margins achieved and the interest earned, among other things.

In their analysis of the wider supervisory implications of the Wirecard case, Langenbucher, Leuz, Krahnen and Pelizzon (2020) recommend a reform of external audits in order to strengthen auditor accountability: they highlight that there is a common refrain to accounting scandals, namely that statutory auditors tirelessly argue that their role is not to detect fraud - in view of that perception, the authors recommend that the law should unmistakably state that auditors' professional scepticism and reasonable checks to uncover accounting manipulations and accounting fraud are an integral part of an external audit.

A thematic digest containing the summaries of three papers by external experts commissioned by ECON on the Wirecard case can be found here.

5. The European Court of Justice: shaping the Banking Union?

Both the Single Resolution Board and the ECB Supervisory Board decisions' are subject to the jurisdiction of the European Court of Justice (ECJ). ECJ has taken a number of decisions regarding banking supervision and resolution (for an overview see Federico Della Negra and René Smits) and such decisions contribute to shaping supervision and resolution in the Banking Union. Two particular decisions are highlighted below as their impacts might be more visible in the coming months - the decision addressing Landesbank Baden-Württemberg (LBW) that declared partially illegal the Commission Delegated Regulation (EU) 2015/63) on contributions to the Single Resolution Fund, and the so called Tercas case, addressing the role of deposit guarantee schemes in resolution.

The Landesbank Baden-Württemberg decision

Decisions by the Single Resolution Board on contributions to the Single Resolution Fund (SRF) have been questioned before the Courts for some time now (see above referred overview). Each institution's contribution to the SRF depends and is based on its relative risk profile (thus, depending on the risk profile of every other institution; data on each institution's risk profile is sensitive and proprietary, thus preventing the SRB from making it available to the banking system overall). On 23 September 2020 the ECJ decided against the SRB in three pending cases (Landesbank Baden-Württemberg (LBW), Portigon and Hypo

Vorarlberg Bank[4 5]). In these cases, the Court decided to annul the 2017 SRB decisions setting out the firms' contributions to the SRF on the grounds that the institutions (and the Court itself) are unable to assess the SRB decisions due to insufficient reasoning. In addition, the Court argues in the LBW case that *"it follows from the foregoing that the SRB cannot replace the contested decision without again infringing the obligation to state reasons and the applicant's right to effective judicial protection before the legal framework, in particular Delegated Regulation 2015/63, is amended."* In its LBW decision, the Court declared that the Delegated Regulation 2015/63 partially illegal. The European Court of Auditors has criticised the methodology back in 2017[6] on arguments that resemble those of the ECJ (opacity).

Besides possible effects on past decisions, the LBW Court decision can have a bearing in any future SRB decision namely any decision on its 2021 contributions (the SRB is nevertheless collecting the relevant data for the 2021 contribution cycle whilst recognised having taken note of the Court decision). In a hearing in ECON, Elke Konig said to be working with the Commission on a possible appeal (which would have no suspensive effects on the Courts' decision).

The Tercas case

On 19 April 2019, the General Court annulled a European Commission State aid decision[7] that ordered the Italian state to recover illegal aid granted to Banca Tercas by *Fondo Interbancario di Tutela dei Depositi* ('the FITD'), the Italian deposit guarantee scheme. In 2012 Banco Tercas was put under special administration as a result of irregularities identified by Banca d'Italia. In that context, in 2013, it received an offer by Banca Popolare di Bari ('BPB'), to subscribe Tercas capital. BPB attached a number of conditions to that offer, namely, that FITD would cover Tercas's deficit[8]. Both Banca d'Italia and FITD approved the operation, which was deemed less costly than reimbursing Terca's deposits.

The General Court considered that the Commission failed to provide sufficient evidence to support its assessment[9] that State aid[10] had been given to Tercas, i.e. it failed to demonstrate that FITD acted under a

[4] The decisions relate to contributions for the 2017 collection period. The Court annuled SRB decision on grounds of lack of reasoning (the SRB not offered "an adequate statement of reasons" to the banks for its calculations) and lack of adequately authentication of an electronic document setting out the amount of contributions. The Court also considered unlawful Articles 4 to 7 and 9 of Delegated Regulation 2015/63 and Annex I for infringing the principle of effective judicial protection (the Court accepts the argument that such provisions create "*a complex system for determining contributions, characterised by a number of opportunities to exercise discretion and complete opacity and on the basis of which the SRB is not in a position to give verifiable and reviewable reasons for the individual burdens imposed on institutions.*"

[5] In the first decision listed, the Court adds that "*SRB's decision determining the ex ante contributions to the SRF for 2016 was annulled (judgments of 28 November 2019, Banco Cooperativo Español v SRB, T-323/16, EU:T:2019:822; of 28 November 2019, Hypo Vorarlberg Bank v SRB, T-377/16, T-645/16 and T-809/16, EU:T:2019:823; and of 28 November 2019, Portigon v SRB, T-365/16, EU:T:2019:824).*". It is, therefore, not the first instance where the SRB fails to convince the ECJ of the lawfulness of its decisions. In that same decision, the Court also dwells on whether the Delegated Regulation confers the SRB discretionary powers that would be contrary to the Meroni doctrine, and concludes that "*theoretically*" that is not the case and the Delegated Regulation does not grant SRB discretion.

[6] See European Court of Auditors annual report on EU agencies for the financial year 2017 (available here): "*Furthermore, the Court notes that the methodology to calculate contributions laid down in the legal framework is very complex, resulting in a risk to accuracy. Moreover, the Board cannot release details on the risk-assessed contribution calculations per Credit Institution as they are interlinked and include confidential information about other Credit Institutions. This affects the transparency of these calculations.*". Similar concerns were expressed by the Court in its 2018 report. The 2019 ECA report broadly expresses similar concerns. Assessing SRB contingent liabilities at the end of 2018, the ECA found no evidence contradicting the SRB assessment that a possible outflow of resources was remote. No report is yet available for the 2019 accounts.

[7] Commission Decision (EU) 2016/1208 of 23 December 2015 on State aid granted by Italy to the bank Tercas (Case SA.39451 (2015/C) (ex 2015/NN)) (OJ 2016 L 203, p. 1). The text of the decision can also be found here.

[8] In fact, the intervention of BPB was more complex and involved (a) reduction of capital to zero, wiping out existing shareholders, (b) issuance of new shares for subscription by BPB (EUR 230 million), (c) EUR 265 million from FITD to cover Terca's losses, (d) two guarantees by FITD (EUR 35 and 30 millions) (see points 16 to 26 of the Court decision).

[9] The Court refers to "(...) *Commission had to have sufficient evidence to conclude that those measures were taken under the actual influence or control of the public authorities and that, accordingly, they were, in fact, imputable to the State* (...) *the Commission has failed to prove that other Italian public authorities were involved in the adoption of the measures at issue...* "

[10] The Court considers that State aid under article 107/1 of the Treaty must satisfy two cumulative conditions: "*it must be imputable to the State and be granted through State resources*". The Court considered the Commission has failed to provide evidence that the FITD acted under a public mandate or under the control of public authorities and that the funds rendered to Tercas were under

public mandate or under the control of public authorities or that the funds rendered to Tercas were under public control. The Court argued that FITD acted in the private interest of banks and using money provided by banks to avoid (the most expensive option of) paying out Tercas' deposits (further details can be found in the Court decision, points 62 to 132)[11]. A Commission Q&A released at the time of its state-aid decision argued differently.

The Commission is said to have appealed the decision on grounds that it "*appears to depart from the standard established by the case law*." (the case law being, broadly speaking, that recourse to a deposit guarantee scheme is considered state aid).

The Court decision leads to questioning whether and to what extent "voluntary" guarantee schemes or additional intervention instruments permitted under a number of guarantee schemes in accordance with the DGS Directive, should qualify as State aid. A qualification as state aid would trigger, according to the 2013 Banking Communication, "burden sharing arrangements", i.e. loss absorption by equity holders and creditors[12]. The decision can also pave the way for furthering the discussion on the role of DGSs in resolution.

6. The European Court of Auditors special report on EU agencies

A recent special report by the European Court of Auditors (ECA) on EU agencies notes a number of issues affecting EU agencies as a whole - including the European Supervisory Authorities (ESAs; the ESMA, the EIOPA and the EBA) and the Single Resolution Board (SRB). Of particular relevance to the ESAs and the SRB, the Court notes:

- risks in terms of litigation and reputational damage steaming from having recourse to external contractors instead of own personnel (ESMA, EBA, EIOPA and SRB); contracting external providers is often linked to agencies having insufficient human resources (or being unable to contract and retain sufficient expertise);
- the need to shorten the planning cycles (budgeting and implementation) for EU agencies, in particular those operating in volatile conditions/markets (SRB);
- when discussing composition of the boards of agencies, the ECA notes that the boards of the three ESAs are composed of representatives of national supervisory authorities, which may hamper appropriate peer review (ECA points out to national supervisors "*reluctance to sanction their peers*");
- limited performance oversight by Parliament and Council of agencies, and public control over the fully self-financed agencies (SRB being one of such agencies[13]) ranks even more poorly. For ESMA, ECA notes the recent implementation of activity-based budgeting (namely for assessing the fees to be charged to industry - credit rating agencies and transaction reporting). The ECA also points to agencies having limited visibility of budgetary discussions between Parliament and Council which may hinder their operational planning;

public control. The Court argued that FITD acted in the private interest of banks and using money provided by banks to avoid (the most expensive option of) paying out Tercas' deposits (further details can be found in the Court decision, points 62 to 132). A Commission Q&A released at the time of its decision finds otherwise.

[11] « *Or, le fait qu'un secteur mette en place un système privé d'assistance mutuelle ne constitue pas en soi un indice de l'implication de l'État. (...) les interventions de soutien, telles que celles en cause en espèce, ont une finalité différente de celle des remboursements des dépôts en cas de liquidation administrative forcée et ne constituent pas la mise en œuvre d'un mandat publique*". (points 97 and 106 of the Court decision).

[12] As noted in the 2015 State aid Commission decision "although Banca Tercas' existing shareholders were fully written down at the time, subordinated creditors did not make any contribution to the cost of restructuring, as is required under **burden-sharing principles"**

[13] The SRB offered a reply to ECA in this point: "The SRB understands that ECA's reference to the limited public control over the fullyfinanced agencies is made as regards their budget implementation whereas public control on the overall performance of the SRB is governed by various provisions of the SRMR, in particular Article 45 and Article 46, and the Agreement on accountability and oversight between the European Parliament and the SRB."

- the involvement[14] of the agencies in the revision of their founding regulations and other key legislation in their area of operation is generally limited; their knowledge is not best put to use when drafting and discussing new legislative proposals.

As an additional point of interest, the ECA signals limited public information available on agencies' contribution to EU policy and cooperation.

Some of these findings echo concerns of the ESAs and the SRB, namely on resource allocation and budgeting. Others - like the composition of the boards - may contribute to the debate around reinforcing accountability of such agencies.

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[14] We understand the Court's remark as referring to "formal involvement" of the agencies in law making. In fact, the ESAs are usually informally involved by the Commission and even Parliament in discussing relevant legislative proposals.