

**Follow-up to the European Parliament non-legislative resolution of 1 March 2018 on
Banking Union – Annual Report 2017**

2017/2072 (INI)

- 1. Rapporteur:** Sander LOONES (ECR/BE)
- 2. EP reference number:** A8-0019/2018 / P8_TA-PROV(2018)0058
- 3. Date of adoption of the resolution:** 1 March 2018
- 4. Subject:** The resolution concerns the 2017 Annual Report on Banking Union, an own-initiative report of the European Parliament which is the third of its kind. As the previous ones, the resolution takes stock of the main achievements of the Banking Union and, stating that further efforts are necessary, invites the Commission to act on a number of issues. The main topics addressed in the resolution are: stress tests, non-performing loans (NPLs), level III assets¹, banks' exposures to sovereign, Fintech, resolution instruments, backstop to the Single Resolution Fund (SRF) and the creation of a European Deposit Insurance Scheme (EDIS).
- 5. Competent Parliamentary Committee:** Committee on Economic and Monetary Affairs (ECON)
- 6. Brief analysis/ assessment of the resolution and requests made in it:**

The resolution *inter alia* stresses the following points:

On supervision, it:

- calls on the responsible public bodies to use consistent methodologies for the 2018 stress tests;
- recommends that cooperation between the European Banking Authority (EBA) and the Single Supervisory Mechanism (SSM) improves, while acknowledging the SSM's leading role for issues or regulatory gaps in the Banking Union;
- calls for improved cooperation between the European Central Bank (ECB) and the Single Resolution Board (SRB); and for clarification of procedures identifying a bank as "failing or likely to fail";
- calls for an inter-institutional agreement between the ECB and the European Court of Auditors (ECA) to specify exchange of information;
- reiterates its concerns regarding the high level of non-performing loans (NPLs) and calls for a swift implementation of the July 2017 Council action plan, supports Commission action on prudential treatment of NPLs and recalls that any ECB actions on NPLs should not interfere with legislators' prerogatives;
- reiterates concerns on risks related to level III assets and calls for the SSM to make the issue a priority for 2018;

¹ assets which are typically very illiquid and whose valuation cannot be determined by using observable measures such as market prices or models

- considers that the EU regulatory framework on prudential treatment of sovereign debt should be consistent with the international standard; takes note of the Commission's ongoing work on Sovereign Bonds Backed Securities (SBBSs);
- stresses the importance of addressing flaws in internal models and notes the finalisation of Basel III, recalling that its implementation should not result in a significant increase in capital requirements at Union level or harm banks' ability to finance the real economy and should take due account of the European specificities;
- considers that separation between monetary and supervisory policy has worked well, but additional safeguards might be warranted where shared services deal with critical policy-making; supports delegation of decision-making within the ECB to make supervision more effective;
- calls for a uniform reporting system to avoid duplication and alleviate administrative burden on banks and supervisors;
- stresses the urgent need for more proportionality in the supervision of small low-risk institutions and welcomes the Commission's efforts on this;
- recalls the need to harmonise options and discretions;
- calls in relation to FinTech for the right balance between protecting consumers and financial stability and encouraging innovation; calls on authorities to closely monitor and assess cybersecurity risks and on the SSM to make it a high-level priority;
- recalls the importance of preparedness and adequate contingency planning in the context of Brexit;
- calls for coordinated action to address vulnerabilities related to shadow banking;
- and overall assesses the Banking Union (BU) as a positive change for Member States having the euro and encourages non-euro area Member States to join.

On resolution, it:

- welcomes the first application of the new resolution regime in 2017; takes note of the high number of legal applications lodged before the General Court of the EU in relation to this case; asks the Commission to assess whether and how this could endanger the effectiveness of the new resolution regime and render the resolution framework in effect inapplicable;
- calls on the SRB and the Commission to jointly publish a summary of the issues most criticised by the legal applications; considers that the 2017 banking cases raise questions in terms of transparency and communication;
- calls on the co-legislators to take the 2017 banking resolution cases into account as lessons learnt when co-deciding on the Commission proposals on the total loss-absorbing capacity (TLAC), the minimum requirement for own funds and eligible liabilities (MREL) and the moratorium tool;
- calls on the Commission to reconsider its interpretation of the State aid rules;
- reiterates its position that bail-inable instruments should be sold to appropriate investors who can absorb potential losses without threatening their own financial standing;
- and recalls that a fiscal backstop is key to ensuring a credible and efficient resolution framework.

On the deposit guarantee scheme, it:

- recalls that the Banking Union remains incomplete without a third pillar;
- and takes the view that further harmonisation of the rules applying to deposit guarantee schemes is necessary in order to achieve a level playing field within the Banking Union.

7. Response to requests and overview of action taken, or intended to be taken, by the Commission:

The resolution acknowledges the major steps taken in several critical areas of the Banking Union and the European banking sector, whilst calling for the completion of the Banking Union and highlighting some improvements that should be made on the supervision and resolution framework.

With regard to the need to use consistent methodologies for the **2018 stress test**, the Commission supports the common methodology developed by the EBA in agreement with competent authorities, the European Systemic Risk Board (ESRB) and the ECB for the upcoming EBA stress tests. The commonly agreed macroeconomic scenarios provided by the ECB and the ESRB in cooperation with the EBA, competent authorities, and national central banks are important to enable competent authorities to undertake a rigorous assessment of banks' resilience under stress in a consistent and comparable way. The Commission will take note of the results expected to be published by 2 November 2018, which are designed to serve as an input to the Supervisory Review and Evaluation Process (SREP).

As reflected in the Commission report on the ECB/ SSM², the actions in 2017 concerning several failing banks showed that **the cooperation between the ECB and the Single Resolution Board (SRB)** worked well. Negotiations on the memorandum of understanding between the ECB and the SRB in order to close existing gaps and improve the effectiveness of resolution actions are well advanced. The revised version of the memorandum of understanding should ensure quicker exchange of information, including more automatism in the provision of information, especially regarding banks the business model and strategy of which pose a medium or a high level of risk to their viability. The Commission believes that having a representative of the SRB as a permanent observer in the ECB/ SSM should be carefully weighed against the importance of the ECB's independence. Adequate cooperation arrangements have so far been sufficient to ensure the necessary coordination between the ECB and the SRB.

As stated in its report on the ECB/ SSM, the Commission supports the Parliament's call for an interinstitutional **agreement between the ECB and the ECA** to specify the modalities of information exchange in view of permitting the ECA access to all information necessary for performing its audit mandate. The Commission's SSM report highlights that there is an overall positive **interaction between the ECB and the EBA**, and would welcome even stronger cooperation in certain areas.

Regarding **NPLs**, a comprehensive package was adopted on 14 March 2018. It includes a staff working document providing non-binding technical guidance (a so-called blueprint) for how national asset management companies can be set up in compliance with existing EU banking and State aid rules. It contains also a proposal for a Directive, which aims to further develop secondary markets for non-performing loans (NPLs) and to enhance the protection of secured creditors by providing them with an efficient method of value recovery from secured loans through an accelerated extrajudicial collateral enforcement. The same package enhances the prudential tools needed to effectively address NPLs, by amending the Capital Requirement

² Report from the Commission to the European Parliament and the Council on the Single Supervisory Mechanism established pursuant to Regulation (EU) No 1024/2013, COM(2017) 591 final

Regulation, with regard to the introduction of minimum levels of provisioning which banks must make for future NPLs arising from newly originated loans.

The Commission takes note of Parliament's concerns as regards the draft addendum to the ECB/ SSM guidance on NPLs. The ECB/ SSM, as a supervisory authority, should assess the specific risks of each institution under its supervision, including their level of NPLs. An ECB/ SSM addendum should have the role of providing transparency on how the ECB/ SSM would carry out such case-by case assessment and cannot substitute legislation by imposing general requirements horizontally applicable to all credit institutions.

On risks related to **level III assets**³, the Commission understands that the SSM has already been taking supervisory actions at least in relation to those significant banks under ECB supervision that have the highest amount of level III assets relative to the size of their total assets. The Commission notes that the prudential framework for the treatment of such assets will be reinforced through the proposed implementation of the Fundamental Review of the Trading Book that is currently discussed by the European Parliament and the Council.

On **exposures to sovereigns** the Commission shares the Parliament's view on the multiple and international facets of the problem, requiring coordination at the global level. Discussions in Basel have shown that there is no consensus to reform the regulatory treatment of sovereign exposures (RTSE) at present; thus it would be inappropriate to make progress on risk sharing dependent on such a reform. Moreover, as presented in the Reflection Paper on the deepening of the Economic and Monetary Union (EMU) of May 2017, the Commission is of the view that, to avoid any potential risk to financial stability, changes to the RTSE should only be considered after the completion of the Banking Union (with a functioning backstop to the Single Resolution Fund and a common deposit insurance), and sufficient progress of the Capital Markets Union. Any political decision would also have to go hand in hand with a decision on the introduction of a European safe asset.

Without entailing debt mutualisation between Member States, **Sovereign Bond-Backed Securities (SBBS)** could help enhance cross-border risk sharing in the EMU. By pooling and possibly tranching sovereign bonds from different Member States, SBBS could support further diversification of sovereign bond portfolios in the banking sector and further weaken the link between banks and their respective sovereigns. As announced in the President's Letter of Intent, the Commission will present an enabling regulatory framework for SBBS in spring 2018.

Regarding **FinTech**, the Commission fully agrees with the need to ensure a level playing field between all market participants, based on the "same activity, same rule" principle. In line with the European Parliament's call, the Commission adopted on 8 March 2018 a Communication⁴ on FinTech in the form of an Action Plan. This Action Plan aims to support the uptake of innovative solutions and services in the financial sector across the EU while maintaining financial stability and ensuring a high level of consumer protection. In this respect, this Communication includes a number of initiatives to strengthen the cyber resilience of the EU financial sector as requested by the European Parliament in its resolution.

As regards the principle of **separation between the monetary policy function and the supervisory function of the ECB**, the Commission shares Parliament's views that additional safeguards could be warranted where shared services provide advice that is key for the ECB's policy decision-making. The Commission also agrees with the Parliament in its call for more involvement of ECB staff in on-site inspections. Both issues were flagged by the Commission in its report on the ECB/ SSM.

³ See footnote 1.

⁴ COM(2018) 109 final – FinTech Action plan: for a more competitive and innovative European financial sector

The Commission supports the call to reduce **national options and discretions** and reflected this as much as possible in the proposals amending the Capital Requirements Regulation and Directive (CRR/ CRD) ("banking package proposals"). Moreover, the ECB has dedicated remarkable efforts to harmonising the exercise of options and discretions, which is to be praised.

As stated in the report on the ECB/ SSM, the Commission also welcomes the progress made by the ECB in the area of **delegation of decision-making**. This new framework should accelerate the decision-making and reduce backlogs in certain areas such as fit and proper assessments.

The Commission agrees that **reporting requirements** need to be streamlined to avoid duplication and unnecessary regulatory burden for market participants and supervisory authorities, whilst ensuring that there is sufficient information available for authorities to identify and address emerging risks. Furthermore, the Commission has consistently promoted and applied **proportionality** in its legislative proposals.

The Commission has initiated preparatory work on the **implementation of the agreement on the finalisation of the Basel III framework**. As a first step, it is reaching out to stakeholders in order to identify the possible impact of implementing the revised international standards in the EU. The Commission will carry out a thorough impact assessment and take due account of all specificities of the European banking sector before making any legislative proposal.

In relation to **shadow banking**, EU legislation adopted since the financial crisis has expanded to cover extensive areas of the financial sector. Remaining gaps in regulation should be clearly identified and their impact on financial stability assessed.

The Commission agrees that the current **moratorium tool** that can be applied during the resolution phase provided for in the currently applicable Bank Recovery and Resolution Directive (BRRD) (Article 69) could be insufficient in some specific circumstances to enable the relevant authority to perform its duties effectively. Also for this reason the Commission put forward a proposal on 23 November 2017 which introduces a pre-resolution moratorium that could be used with respect to institutions which meet early intervention conditions to avoid a further deterioration of their financial situation or for the purposes of declaring the bank failing or likely to fail, as well as an additional resolution moratorium to be used in specific circumstances. It should not interfere with the deadlines set for Deposit Guarantee Schemes to repay depositors.

The Commission agrees that it is important to ensure full clarity on the conditions for application of the provision on **precautionary recapitalisation**, and is taking stock of the lesson learnt from recent application of the measure to ensure that its implementation in practice, including the use of asset quality review and the determination of the institution's solvency, is clear and consistent with the role of this tool within the overall resolution framework.

Regarding the first application of the new resolution regime in 2017 and the related **legal actions pending in the General Court**, the Commission notes that this does not impair the effectiveness of the resolution framework, which is designed to enable swift action for the maintenance of financial stability, while at the same time allowing for ex-post judicial review and the protection of the rights of investors and creditors. Summaries of the applications are published in the Official Journal and no further publicity can be given to the pleadings as long as the cases are pending.

The Commission will explore jointly with the SRB lessons to be learnt from these experiences and the related litigation. The Commission will also assess how to best use this insight when preparing legislative proposals in the future.

On **transparency and communication**, the Commission recalls that any citizen of the Union has a right to request access to documents under Regulation (UE) No 1049/2001. Similarly,

Annex II of the Framework Agreement on relations between the European Parliament and the Commission governs the forwarding to the European Parliament of confidential information from the Commission in connection with the exercise of the European Parliament's prerogatives and competences. Yet, the provisions in force oblige the Commission to refuse access to documents where disclosure would undermine the protection of the public interest as regards the financial, monetary or economic policy of the Union or a Member States and where disclosure would undermine the protection of commercial interests of a natural or legal person, or the protection of court proceedings and legal advice, unless there is an overriding public interest.

Concerning alleged differences with respect to certain rules applying in **insolvency and in resolution**, such as the amount of bail-in or burden sharing, the Commission notes that the public interest test allows a distinction between credit institutions that should be subject to insolvency and those subject to resolution.

The Commission recalls that preventive and alternative measures can be implemented under the Deposit Guarantee Scheme Directive in order to prevent the failure of a credit institution, such as national measures which do not fall under the State aid rules of the Treaty (e.g. if the national measure is implemented on market terms) or which constitute precautionary recapitalisation within the meaning of Article 32(4)(d)(iii) of the BRRD. Also, the Member State may decide that the deposit guarantee scheme can be used to provide State Aid in resolution and in liquidation if the relevant conditions in the BRRD and the Deposit Guarantee Schemes Directive (DGSD), as well as those in the State Aid framework, are met. Where State Aid is granted in the context of national insolvency proceedings, the bank must exit the market. In this context, the deposit guarantee scheme may provide State aid to facilitate such market exit (i.e. liquidation aid to close a bank), provided that the conditions under State aid rules as well as those in the DGSD are met.

Given that the financial sector is still fragile, the **2013 Banking Communication** continues to provide for the possibility to use State aid to restructure or organise the orderly market exit of large and small banks but with tightened authorisation conditions (notably requiring contributions from shareholders and subordinated debt holders) to reduce the amount of State aid. The Commission continuously monitors, based on sector developments and experience gained in State aid cases, whether it needs to update the relevant State aid rules.

The Commission agrees on the importance of allocating liabilities to the appropriate categories of investors, and highlights in this respect the crucial role of the rules on transparency of information on financial products, particularly those contained in the Markets in Financial Instruments Directive (MiFID).

The Commission takes note of the call to **reduce national options and discretions** in the DGSD to promote consistency across Member States, and will take this into account for the report on the DGSD that is due by July 2019.

The establishment of a **European Deposit Insurance Scheme** (EDIS), proposed in 2015, is essential to ensure that the Banking Union functions at its best. The Commission adopted in October 2017 a Communication⁵ putting forward some ideas to facilitate the debate, and encourages the European Parliament and the Council to accelerate the negotiation process in order to adopt the proposal by 2018.

The Commission agrees that a **common fiscal backstop** is needed to reinforce the overall credibility of the bank resolution framework within the Banking Union. The Commission

⁵ Communication to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions on completing the Banking Union, COM(2017) 592 final.

has for this reason put forward a proposal on 6 December 2017 for the incorporation of the European Stability Mechanism (ESM) into the Union framework as the European Monetary Fund (EMF), with a backstop function. In the past the Commission had already identified a credit line from the ESM as the most effective way of providing for a backstop. The integration of the ESM into the Union framework as the EMF provides the appropriate environment for creation of a common backstop.