European Economic and Social Committee

ECO/424
Banking reform –
Capital requirements and resolution framework amendments

OPINION

European Economic and Social Committee

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
[COM(2016) 850 final – 2016/0360 (COD)]
Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 806/2014 as regards loss-absorbing and recapitalisation capacity for credit institutions and investment firms
[COM(2016) 851 final – 2016/0361 (COD)]
Proposal for a Directive of the European Parliament and of the Council amending Directive 2014/59/EU on loss-absorbing and recapitalisation capacity of credit institutions and investment firms and amending Directive 98/26/EC, Directive 2002/47/EC, Directive 2012/30/EU, Directive 2011/35/EU, Directive 2005/56/EC, Directive 2004/25/EC and Directive 2007/36/EC
[COM(2016) 852 final – 2016/0362 (COD)]
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
[COM(2016) 854 final – 2016/0364 (COD)]

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Consultation	European Parliament, 01/02/2017 Council of the European Union, 02/02/2017 and 20/02/2017 European Commission, 17/02/2017
Legal basis	Articles 114 and 304 of the Treaty on the Functioning of the European Union
Section responsible	Economic and Monetary Union and Economic and Social Cohesion
Adopted in section	08/03/2017
Adopted at plenary	30/03/2017
Plenary session No	524
Outcome of vote (for/against/abstentions)	175/0/1

1. **Conclusions and recommendations**

1.1 The EESC very much welcomes the Commission's package of proposals and hopes that it will contribute effectively to complementing the work done after the crisis to reform the financial sector.

1.2 The Committee welcomes the underlying **holistic and integrated** approach here: a number of major objectives in various fields are unified and reconciled in these proposals, without, however, disregarding the principles. This approach creates the opportunity to make progress in a number of important areas towards a more sustainable common European future and the further completion of the EMU.

1.3 This relates primarily to **objectives in the sphere of banking and finance**. The Committee believes that the proposed measures will undoubtedly help ***strengthen*** Europe's ***prudential and resolution framework*** for banks. This is crucial to the objective of ***reducing risk in the financial sector*** and ***enhancing*** the ***resilience of the institutions***. Financial stability and a sound financial system that contributes to stable and sustainable economic growth are essential. Furthermore, shadow banking should not be left out and allowed to remain unregulated.

1.4 The Committee believes that the risk-reducing nature of these proposals, in particular, will enable ***progress*** to be made not only in further advancing the ***Banking Union***, but also in implementing its third pillar, the ***European Deposit Insurance Scheme***. This is all the more important since a fully-fledged banking union is one of the foundations for the completion of the EMU, the implementation of which should be pursued without delay. Certain specific adjustments in the proposals should facilitate the pursuit of a ***Capital Markets Union***.

1.5 The Committee feels that these proposals will make a positive contribution to the continued ***restoration of client and consumer confidence*** in the financial sector. It is therefore pleased to note that the "too big to fail" issue is being addressed via the TLAC measures and that efforts are being made to make the bail-in rules more effective and efficient. In any case, it is of paramount importance that in the event of a bank crisis there is no question of resorting to public money or taxpayer funds.

1.6 The Committee also welcomes the attention paid to the **financing of the economy**. In the current climate of uncertainty and change and in a period when the level of investment remains insufficient, no opportunity should be missed to create ***new and additional opportunities*** for a ***lasting and sustainable economic recovery*** of the real economy going hand-in-hand with ***growth, more investment and job creation***.

1.7 Banks have an important role to play as intermediaries in capital markets and bank loans will undoubtedly remain in the future the main source of funding for households and SMEs. While the proposals are a step forward towards creating the right conditions in which banks can play this role, the question arises of whether it would not be possible to do more to strengthen and intensify efforts for the benefit of SMEs, which are the backbone of the European economy. More specifically, the EESC calls for the confirmation and further expansion of the "SME supporting factor"[1], whereby banks are required to set aside less capital for loans granted to SMEs. The Committee also advocates a similar approach for the benefit of social economy enterprises.

1.8 The Committee also welcomes the fact that **account has been taken** of a number of **specific features of the EU**, inter alia on the basis of the call for evidence. This is the case, inter alia, with the adjustments to the international agreements, which can be found in these proposals, as part of the global reform of the financial sector. This will benefit the financing of the economy.

1.9 The current proposals constitute a further step – but not the last – in the process of ***reforming*** the ***financial sector*** agreed on in the wake of the ***international*** crisis; the Committee considers that it remains important for ***Europe*** to play a ***leading role*** in this ongoing and future international work. International minimum rules should be provided and European values and interests need to be safeguarded. In any case, it is important not to accept any distortions that would adversely affect European institutions.

1.10 However, when it comes to the impact on the rules of the necessary diversity within the European financial sector, the Committee feels that small and non-complex banks are still not being sufficiently taken into account. The current proposals still take insufficient account of the specific features and possibilities of this type of institution. This concerns in particular the **proportionality principle**. Rather than the current fragmented and limited approach, the Committee believes that a more structured and comprehensive approach is crucial here, to the benefit of more institutions and in more fields. No excessively heavy obligations or burdens should be imposed on this kind of institution.

1.11 It is also in the interest of all players and stakeholders – regulators and supervisors, as well as institutions, –that **clarity and legal certainty** be sought in the development of the new rules, for which, moreover, a sufficient implementation timeframe should be provided. In order to avoid potential negative effects on the financing of the economy, it would be desirable for the legal transition measures concerning the new IFRS[2] 9 to be finalised swiftly. Furthermore, the sector must tackle a raft of challenges, such as those posed by technological and digital developments, low interest rates and a number of other developments that have arisen in the aftermath of the crisis.

Additional conclusions

1.12 With regard to the prudential framework, the Committee welcomes the increased focus on the role of the regulators and supervisors and the options that they are to be given. Rules and supervision are interdependent and must each be able to play their role, inter alia to achieve better harmonisation of rules and practices. And to be able to act efficiently and effectively should the need arise.

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1 SME SF

2 IFRS = International Financial Reporting Standards

1.13 With regard to the resolution framework, the Committee would endorse the integration of the total loss-absorbing capacity (TLAC) framework into the own funds and eligible liabilities (MREL) rules, as well as harmonisation of the national ranking of subordinated debt instruments in insolvency proceedings. This will harmonise the rules and improve the practical applicability of the loss-absorption framework.

2. Background[3]

2.1 On 23 November 2016, the Commission published a series of proposals to reform the regulation of banks. They are intended to implement texts drawn up following work carried out in the Basel Committee on Banking Supervision and the Financial Stability Board, taking account of the results of the Commission's call for evidence, which was aimed at assessing the effectiveness and efficiency of current banking law.

2.2 These legislative proposals[4] aim to modify existing banking law. In particular, this concerns:

2.2.1 the **Capital Requirements Regulation** (CRR) and the **Capital Requirements Directive** (CRD) of 2013. These set out prudential requirements for credit institutions (banks) and investment firms and rules on governance and supervision;

2.2.2 the **Bank Recovery and Resolution Directive** and the **Single Resolution Mechanism Regulation** of 2014. They include the rules on the recovery and resolution of failing institutions and establish the single resolution mechanism.

2.3 The new proposals serve multiple objectives. These include, in essence:

2.3.1 increased resilience of EU financial institutions and greater financial stability,

2.3.2 improving the lending capacity of banks to support the economy in the European Union, and

2.3.3 promoting the role of banks in achieving deeper and more liquid European capital markets, to support the creation of a Capital Markets Union.

2.3.4 At the same time, and that could be pointed out here, the proposals aim for a more sophisticated and comprehensive application of the proportionality principle for the benefit of small and/or non-complex banks.

2.4 Without going into detail, the key elements[5] of the proposals can be summarised as follows:

2.4.1 With respect to the objectives mentioned in point 2.3.1:

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3 This text is based, inter alia, on the information provided by the Commission on the proposals (including a press release and Q & A).

4 See Procedure 2016/0360/COD, Procedure 2016/0361/COD, Procedure 2016/0362/COD and Procedure 2016/0364/COD.

5 The presentation of the proposals that follows is clearly not exhaustive.

2.4.1.1 the imposition of more risk-sensitive capital requirements, in particular in the areas of market risk, counterparty credit risk and exposures to central counterparties;

2.4.1.2 the implementation of methods which better reflect the actual risks to which banks are exposed;

2.4.1.3 the introduction of a binding leverage ratio[6] of at least 3% in order to prevent institutions from taking on excessive leverage;

2.4.1.4 the imposition of a binding Net Stable Funding Ratio[7] to address excessive reliance on short-term wholesale funding and reduce funding risk in the long term;

2.4.1.5 the requirement for global systemically important institutions[8] (G-SIIs[9]) to maintain a minimum level of own funds and other instruments to enable them to absorb losses in the event of resolution. This requirement, known as the total loss absorbing capacity[10], is integrated into the existing MREL[11] system applicable to all banks. This will allow the EU, when the need arises, to resolve failing G-SIIs more effectively and to safeguard financial stability and minimise risks for taxpayers. Moreover, provision is made for harmonisation of the creditor hierarchy, to ensure a level playing field in the event of a bail-in in the resolution of a bank.

2.4.2 With respect to the objectives mentioned in point 2.3.2 (and, to a certain extent, point 2.3.4), the aim is to:

2.4.2.1 enhance the capacity of banks to lend to SMEs and to finance infrastructure projects;

2.4.2.2 reduce the administrative burden for small, non-complex banks in connection with a number of rules regarding remuneration, particularly those relating to deferral and remuneration with instruments such as shares;

2.4.2.3 make the CRR/CRD rules more proportionate and less burdensome for smaller and less complex institutions, since some of the current disclosure, reporting and complex trading book-related requirements appear not to be justified by prudential considerations.

2.4.3 With respect to the objectives mentioned in point 2.3.3, the aim is to:

2.4.3.1 avoid disproportionately high capital requirements for trading book positions, including those related to activities of market makers;

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6 LR

7 NSFR

8 At present, 13 European banking groups would be covered by this measure.

9 The term used in the CRR for Global Systemically Important Banks (G-SIBs)

10 TLAC

11 Minimum requirement for eligible liabilities and own funds

2.4.3.2 reduce the costs of issuing/holding certain instruments (covered bonds, high-quality securitisation instruments, government debt instruments, derivatives used for hedging purposes);

2.4.3.3 avoid disincentives for institutions acting as intermediaries for clients in relation to transactions cleared by central counterparties.

3. Observations and comments

3.1 *General considerations*

3.1.1 These proposals should be wholeheartedly welcomed. They further complement and refine the important work done after the crisis to reform the financial sector. They also take account of the fact that banks in Europe will in future continue to play an important role in society, and in particular in financing the economy. Banks have an important role to play as intermediaries in capital markets, and bank loans will remain the main source of funding for households and firms in Europe, especially SMEs. This must not be jeopardised.

3.1.2 The Committee welcomes the holistic and integrated approach taken in the drafting of these proposals, with account being taken of several important societal goals and desirable developments. Adopting this approach when drafting the current proposals without, however, disregarding the principles is a major achievement. The one must not be at the expense of the other.

3.1.3 In a difficult and complex political, social and economic situation, and with a number of major challenges ahead, unifying and reconciling a number of major objectives in various fields creates considerable potential for progress in various areas towards a more sustainable common European future. This balanced approach will also contribute to the continued restoration of confidence.

3.1.4 The Committee is also pleased that account was taken of the results of the call for evidence[12], as this made it possible, on the one hand, to adopt a more harmonious approach and to involve all stakeholders and, on the other hand, to follow a more sophisticated and varied approach, within the framework of the objectives set.

3.1.5 In the Committee's view, it remains crucial that the banking system is resilient and sufficiently capitalised as a prerequisite and basis for the maintenance of financial stability.

3.1.6 No less important are measures to support the economy and its efficient financing, so that economic growth and job creation can receive the greatest possible support.

12 COM(2016) 855 final

3.1.7 Also, the risk-reducing nature of these proposals makes them likely to contribute to the further realisation of the Banking Union[13] and, in the Committee's view, they constitute a key element that should enable progress to be made on implementing its third pillar, the European Deposit Insurance Scheme. The Banking Union in turn constitutes one of the fundamental pillars of the EMU and its implementation should be pursued promptly. These proposals will also be conducive to establishing the Capital Markets Union[14], representing further added value.

3.1.8 These proposals are a further step on the road to restoring confidence in the financial sector and the banks, but not the last. The Committee hopes that future steps will be taken in the same spirit. This applies in particular to issues currently being discussed[15], inter alia in connection with the finalisation of the Basel III framework[16], and where results are expected within a relatively short timeframe. At all events, the important thing is to further reduce risk in the sector without disproportionately affecting the European banking sector.

3.1.9 In addition, it is also important to bear in mind the international context, particularly as some agreements on the global reform of the financial sector appear to be interpreted differently and/or less strictly by non-European partners. The comprehensive reform agenda agreed at G20 level after the financial crisis must not be compromised or lead to excessive differences or fragmentation globally, to the detriment of EU-established institutions.

3.1.10 It is important that these proposals provide the financial sector and stakeholders with sufficient clarity and certainty. A correctly remunerated, diversified sector, operating in a single European area, must also be in a position to tackle other challenges, such as those linked to technological and digital developments, low interest rates and a number of other problems that have arisen in the aftermath of the crisis, such as non-performing loans[17] in some countries.

3.1.11 Finally, the Committee reiterates its previously expressed view that shadow banking should not be left out and allowed to remain unregulated. The potential risks of this should be brought under control and supervision, in order to strengthen financial stability. At the same time, a level playing field must be ensured for and between all those who are active in the financial environment.

3.2 *The prudential framework and the relevant proposed measures*

3.2.1 The Committee welcomes the attention paid to the prudential framework and the steps being taken to further complement and strengthen it by means of the various ratios and other measures provided for in the current proposals. These proposals can expect a warm reception, particularly

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13 OJ C 177, 18.05.2016, p.21

14 OJ C 133, 14.04.2016, p.17

15 This includes work relating to operational and credit risk and the internal models of the banks. Another ongoing process under the Basel framework is the development of sovereign risk standards. This should also be a particular focus at international and European levels.

16 Also known as Basel IV measures.

17 OJ C 133, 14.04.2016, p.17.

as a nuanced approach is being taken, ensuring, for example, that the financing of the economy is not unduly hampered.

3.2.2 The Committee welcomes the increased attention for the role of the regulators and supervisors in this environment, and the intention to give them additional opportunities and to achieve more and better harmonisation of rules and practices. This is important not only in order to avoid excessive disparities in the treatment of banks, but also from the point of view of broader application of the principle of proportionality.

3.3 ***The resolution framework***

3.3.1 In line with its previous opinions, the Committee is pleased to see that the "too big to fail" issue has been addressed in the new proposals. The introduction of TLAC for European G-SIIs within the framework of MREL, with a generally applicable[18] and an individualised[19] part, simultaneously allows a harmonised and a tailor-made approach.

3.3.2 But this must be taken further. As previously stated[20], the agenda for the coming years must also (continue to) focus on full implementation of Basel III, on the Financial Stability Board (FSB) and on finding a solution for "too-big-to-fail" banks in line with international agreements (G-20). The goal must remain to strengthen the stability and resilience of the financial sector and, at the same time, to prevent any future recurrence of the need to draw on public funds in order to rescue banks. Furthermore, in order to facilitate the implementation of the resolution mechanism, further work should be done on exploring how the high level of bank sovereign debt holdings can be reduced[21]. This would also be conducive to completing the implementation of the Banking Union[22].

3.3.3 The Committee also particularly welcomes the Commission proposal to increase the harmonisation of the hierarchy of creditors in the application of the bail-in regime by creating a new asset class, in order to provide for a level playing field between the different Member States[23].

3.4 ***The measures for improving the financing of the real economy and SMEs in particular***

3.4.1 Of course, it is very positive that the various planned measures have been scrutinised from the perspective of their effect on the financing of the real economy. And that the necessary steps have been taken to improve the lending capacity of banks.

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18 Pillar 1 MREL requirement

19 Pillar 2 MREL add-on requirement

20 OJ C 451, 16.12.2014, p. 10.

21 See, inter alia, https://ec.europa.eu/epsc/publications/five-presidents-report-series/further-risk-reduction-banking-union_en

22 OJ C 271, 19.9.2013, p. 8.

23 See EESC opinion ECO/429 Banking reform – Creditor hierarchy in insolvency. Not yet published.

3.4.2 The Committee is particularly pleased that a great deal of attention has been paid to lending to SMEs, which remain the backbone of the European economy. They ensure investment and jobs.

3.4.3 That applies in particular to the consolidation and further expansion of the SME supporting factor. The Committee urges that the possibility be carefully examined of applying this factor more broadly, in the interests of maximising lending and of SMEs. In the same vein, the Committee requests that the Commission make extra efforts to strengthen the economies of the Member States that are most weakened by the economic crisis.

3.4.4 The Committee also believes that concurrent efforts should be made for the benefit of the social economy and those that operate in it. In particular, work could be carried out on a "supporting factor for social enterprises".

3.5 ***Further development of a Capital Markets Union***

3.5.1 Although not their main component, the Committee welcomes the focus in the current proposals on the further development of the Capital Markets Union.

3.5.2 In line with its previous opinions on this subject[24], the Committee believes that the regulatory and supervisory framework should help to fully develop the strengths of capital markets and to keep their weaknesses in check, such as excessive or disproportionate risk-taking. The new system should be resilient to the adverse effects of any new crises. That also requires greater convergence and cooperation in the area of micro- and macro-prudential supervision, at both EU and national levels.

3.6 ***Proportionality and reduction of administrative costs***

3.6.1 First, the EESC wishes to reaffirm the fundamental importance of the need for a diversified banking landscape[25]. This is not only conducive to stability, but is also the best way of meeting the needs of all, whether savers, investors, consumers or entrepreneurs.

3.6.2 The Committee is very pleased that the principle of proportionality, which it has in the past identified as the main problem for small and non-complex banks[26], is the subject of a number of provisions in the current proposals.

3.6.3 The Committee is of the view that the situation of these banks has not been sufficiently taken into account. The current proposals take insufficient account of the specific nature and possibilities of this type of institution.

3.6.4 Rather than the current fragmented and limited approach, the Committee believes that a more structured and comprehensive approach to the proportionality principle is crucial here.

24 OJ C 133, 14.04.2016, p. 17.

25 OJ C 251, 31.7.2015, p. 7.

26 OJ C 251, 31.7.2015, p. 7.

3.6.5 More specifically, the principle of proportionality should not only be based on the size of the institutions concerned but also take into account: i) the specific features of the various business models, ii) the various institutional forms these banks have adopted and iii) the specific objectives pursued by the various financial institutions operating in the market.

3.6.6 No excessively heavy obligations or burdens should be imposed on these institutions. However, more flexibility would be appropriate with regard to certain specific aspects such as reporting obligations. Careful consideration should be given to additional provisions that aim to reduce their administrative burden.

3.6.7 Furthermore, there should be a level playing field for all such institutions regardless of their legal form.

3.6.8 More generally, with due regard to the principles outlined, and provided that the regulators and supervisors are able, where necessary, to act quickly and appropriately, the Committee would like to see the proportionality principle applied to the full extent, both in terms of the number of institutions that can benefit from it, and of the areas and matters to which it is applied.

4. Specific comments

4.1 Considering the importance of the real and effective application of the proposed measures, the financial institutions must be allowed sufficient time for the implementation of the new rules. This requires rapid drafting of the technical and implementing standards by the European Banking Authority, or an implementation period that starts to run only once all the details of the rules have been drawn up by these authorities.

4.2 In order to prevent and counteract the possible negative impact on the financing of the real economy that may result from the new IFRS 9 coming into force[27], the Committee advocates that the legislative transition measures envisaged relating to this new international accounting standard be finalised swiftly.

Brussels, 30 March 2017

Georges DASSIS
The president of the European Economic and Social Committee

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27 Commission Regulation (EU) 2016/2067 of 22 November 2016 amending Regulation (EC) No 1126/2008 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council as regards International Financial Reporting Standard (IFRS) 9 (OJ L 323, 29.11.2011, p. 1).