ECO/509
An inclusive and sustainable Banking Union

OPINION

European Economic and Social Committee

Promoting a more inclusive and sustainable Banking Union by improving the contribution of community banks to local development and building a socially responsible international and European financial system
(own-initiative opinion)

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Plenary Assembly decision	20/02/2020
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Section responsible	Economic and Monetary Union and Economic and Social Cohesion
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1. Conclusions and recommendations

1.1 The rules adopted in recent years at international and European level have not always taken full account of the different models that contribute to the diversity of banks in Europe, and this has had a significant impact on smaller and regional banks, which often take the form of cooperatives, particularly in Member States such as Italy and Spain.

1.2 The different models that give the European banking system its pluralism and diversity have not been affected in the same way by the regulatory measures put in place following the financial crisis. In some cases, the banks that contributed least to the 2008 crisis have been hardest hit by the rules adopted in response to that crisis.

1.3 While acknowledging the progress made by the Commission in taking account of smaller and less complex banking institutions in its recent regulatory measures, the EESC believes it would be useful to further increase the proportionality of banking rules with regard to the characteristics of their addressees, without sacrificing the effectiveness of prudential rules. At the same time, the general principles and objectives underlying the measures taken since the financial crisis should not be jeopardised or undermined, since they have proved to be both necessary and effective. The security, stability and resilience of the financial system are of paramount importance.

1.4 The EESC endorses the recent decision to push back the date for implementing the Basel III accord, and feels that when the time comes, the new provision on capital requirements should be transposed in a way that caters properly for the diversity of banking business models in Europe and their contribution to the diversification and resilience of the Banking Union.

1.5 The EESC calls for greater recognition of the unique role played by regional and community banks, often organised as cooperatives in some Member States such as Italy and Spain, when it comes to families and SMEs at local level; in some cases, they are the main, if not the only, source of access to credit for thousands of European citizens and businesses.

1.6 The EESC also calls for proper recognition of the contribution made by the larger cooperative banks of countries such as Germany, Austria, the Netherlands and France to the European banking system. In cases where they contribute to systemic risks, this must be duly taken into account in regulation and supervision.

1.7 It is also important to point out the key role they play in nourishing economic democracy, promoting the participation of their stakeholders, who are not mere shareholders or clients, but partners who can participate on the basis of *per capita* votes in governance guidelines, which are in fact oriented more towards stakeholder value than shareholder value.

1.8 The EESC believes that European banks, including regional and cooperative banks, will play a key role in economic recovery following the COVID-19 emergency, supporting the economy and employment.

1.9 A diversified banking system, fed into by a range of stakeholders and rooted in regions and local communities, is also an important guarantee for preserving shared, participatory social responsibility of citizens, SMEs and individual economic operators substantially involved in the real economy.

2. General comments

2.1 This own-initiative opinion is the EESC's contribution to a Banking Union able to meet the objectives of sustainable development and social inclusion which are prerequisites for the European Union's future competitiveness given the array of global challenges. In this respect, the EESC would like to convey civil society's interests in achieving an inclusive, diversified and sustainable Banking Union.

2.2 This contribution follows on from a number of other EESC opinions on the role of local and cooperatives banks[1] and is even more important now that we are facing a global health, humanitarian, economic, employment and social crisis triggered by the COVID-19 outbreak.

2.3 The constant increase in European-level banking regulation, which has gradually become more restrictive over the years, has not always managed to allow for the various banking models which contribute to the diversity of banking in Europe or to develop proportionate rules which are also suited to smaller, regional banks.

2.4 The points discussed below primarily refer to community banks, which are often small with a simpler management structure. They also refer to the cooperative banks of various types and sizes in Europe. These banks are small, numerous and only operate locally in some countries such as Italy and Spain. On the other hand, in Member States such as Germany, Austria and the Netherlands they are relevant players, but in so far as they operate as a cooperative, they still share the same distinctive feature of other cooperatives banks, which is the pursuit of stakeholder value rather than (predominantly) shareholder value. When organised in a banking group listed on the stock market, cooperative banks are required to share several features with other listed companies.

2.5 In order to tackle the subject of banking regulation, we must take up the twofold challenge of looking back with a critical eye at the events which shaped Europe's regulatory framework over the years and looking forward with a clear gaze at where we want to go.

2.6 As regards looking back, it should be pointed out that the current framework is largely a response to the 2008 crisis. The European legislator aimed to recast the rules so as to remedy the shortcomings revealed by the crisis and, most importantly, to ensure that banks would be better equipped and more resilient in the event of future crises.

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1 The EESC has already issued several opinions on the Banking Union (*Role of cooperative and savings banks in territorial cohesion*) but the recommendations made in them have yet to be taken up. In 2014, in response to the proposal for a regulation on structural measures improving the resilience of EU credit institutions (COM(2014) 43 final – 2014/0020 (COD)), the EESC put forward recommendations on support for local economies and the need for banking regulations which complied with the principle of proportionality. In 2018, the EESC published a study entitled *Europe's cooperative banking models* (ISBN: 978-92-830-4024-8, Catalogue number: QE-01-18-233-EN-N) describing the state of play and the outlook for the cooperative banking system in Europe.

2.7 While the purposes of the reforms implemented were and remain laudable, there can be no doubt that the approach taken to date by the banking regulator has had an asymmetrical impact on the various branches of the banking system.

2.8 The different models that give the European banking system its pluralism and diversity have not been affected in the same way by the reforms implemented. In some cases, the business models that contributed least to the 2008 crisis, such as local banks, which are often small and, in some Member States, cooperatives, have been harder hit by the rules.

2.9 Partly due to regulation which imposed an increasingly untenable burden in a number of respects, local small to medium-sized banks came under increasing regulatory pressure to form larger groups and merge or be forced out of the market, with a resulting loss of diversity within the European banking system.

3. Regional banks and banking regulation: general considerations

3.1 The various standards adopted in recent years in order to implement international agreements and European legislation have penalised small and medium-sized banks, particularly cooperative, regional and mutual banks, for three reasons:

a. compliance costs due to extensive, complex, highly detailed and constantly changing regulation;
b. limited acknowledgement of the fact that local banks have a different systemic impact in terms of risk;
c. the fact that big systemic banks are at an advantage when it comes to the costs of financing.

3.2 The EESC therefore considers that the legislator should act promptly to ensure that banking regulation is more **structurally proportionate and fitted** to the regulated entities. The legislator should aim to achieve three objectives:

a. reduce artificial distortions in competition brought about by regulations which are not proportionate or fitted to the characteristics, including the defining business objectives, of the regulated entities;
b. ensure that the European banking industry is diversified and thus better able to cope with future financial and economic crises;
c. promote (rather than reduce) credit support for SMEs, a key sector of Europe's economy.

3.3 The EESC endorses the recent decision to push back the date for implementing the Basel III accord, and feels strongly that when the time comes, it should be transposed into EU law in a way which caters properly for the diversity of banking business models operating in Europe.

3.4 With a view to the transposition of the new reforms set out in the Basel accord, the EESC feels that it would be useful to list and endorse the seven principles set out in June 2019 by the European Systemic Risk Board (ESRB), which were devised prior to the ESRB's launch of the consultative assessment[2].

a. ***Adaptability***: financial regulation should be able to evolve with the financial system and not become an obstacle to innovation. This entails not creating material barriers to entry by new banks and not discouraging new business models or the safeguarding of alternative banking models which have established their place, such as the cooperative model.

b. ***Diversity***: the diversity of financial institutions and business practices should be preserved, as this diversity is an effective safeguard against systemic instability. It is important to avoid excessive homogenisation of the regulated businesses and activities: the ability to develop "antibodies" and diversified forms of reaction/resilience to adverse economic cycles, for instance, boosts the overall stability of the financial industry and, more generally, the economy.

c. ***Proportionality***: the burden of regulation should be proportionate to the importance of the market imperfection at stake and the systemic relevance of the regulated entities.

d. ***Resolvability***: regulation should ensure that unviable institutions can exit the system without endangering systemic stability. However, policies must be adopted which allow for the internal structure and complexity of the institutions concerned.

e. ***Systemic perspective***: financial regulation should aim to ensure the continuous provision of critical financial services to society. A regulatory framework that favours the concentration of activities in a limited number of financial institutions can be more vulnerable as it depends on the survival of the handful of institutions.

f. ***Information availability***: the information flows from banks to regulatory authorities stipulated by sector regulations should make it possible to rapidly identify contagion channels and pockets of vulnerability.

g. ***Non-regulatory discipline***: the presence of regulatory discipline should not rule out solutions which have been tried and tested outside strictly regulatory environments.

4. Proposals for transposing the new rules into the regulatory framework of the Banking Union

4.1 There is reason to suppose that the European Commission will review its legislative programme during the 2019-2024 European legislature in the wake of the COVID-19 emergency. Until such time as the new programme is known, the EESC considers that the following key principles should steer the regulatory adaptation of the European banking system.

4.2 The Basel accord (concluded in December 2017) needs to be transposed taking greater advantage of the margins for interpretation and discretion than happened with the Basel II and Basel III frameworks. In general terms, it is fair to recognise that the European Commission has taken some steps in the right direction to simplify the rules with regard to smaller and non-complex banking institutions in several areas such as reporting requirements, supervision and

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2 Reports of the Advisory Scientific Committee – *Regulatory Complexity and the Quest for Robust Regulation*, No 8, June 2019.

capital requirements (SME supporting factor). It is, however, necessary to continue further in that direction by, as far as possible, adapting the rules to the different business models, without sacrificing the effectiveness of prudential regulation.

4.3 In particular, the EESC recognises the unique role played by regional and community banks, often taking the form of cooperatives in some Member States such as Italy and Spain, when it comes to SMEs and families. The EESC also recognises the contribution made by the larger cooperative banks of countries such as Germany, Austria and the Netherlands to the European banking system. In cases where they contribute to systemic risks, this must be duly taken into account in regulation and supervision.

4.4 It would be beneficial for Europe's economy and banking system if we could push past the equation (laid down in Article 40 of Regulation 468/2014) whereby banks which are part of a "significant" banking group themselves become "significant" despite remaining relatively small in terms of size, role and exposure to so-called systemic risks, in order to recognise the forms of proportionality brought in in May 2019 by the CRD V and the CRR II (known as the banking package). Article 84(4) of the CRD V and Article 4(1) (145) of the CRR II introduce the concept of "small and non-complex institution" for which some requirements should be scaled back, particularly as regards disclosure.

4.5 The EESC considers that the definition of "small and non-complex institution" lays the groundwork for a systematic approach to proportionality. Simplified requirements for a small and non-complex institution should not be restricted to disclosure requirements. It should be possible to extend this simplification to other prudential and supervision requirements. For instance, a small and non-complex institution should not be supervised as a "significant" institution when it is affiliated with a "significant" group for which such supervision is required by national law. Such a situation could in reality trigger a sort of double supervision of minor banks carried out at different levels, with a significant adverse impact in terms of both compliance costs for banks and regulatory costs for banking authorities.

4.6 The EESC also calls for the revision of the rules and mechanisms governing the resolution and liquidation of banks, the method used to calculate the MREL[3], and the alternative steps which can be taken by specific deposit guarantee funds[4] set up by some regional or cooperative bank systems based on the European Court of Justice *Tercas* ruling of 19 March 2019[5].

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3 MREL (Minimum Requirement for own funds and Eligible Liabilities) is a requirement introduced by the Bank Recovery and Resolution Directive (BRRD) which aims to ensure that the bail-in mechanism works efficiently by increasing the bank's loss absorption capacity.

4 One such fund aiming to **safeguard deposits** is operated by the *Banche Cooperative Italiane consorziate* (BCC-CR). It is a good example of a mechanism set up to safeguard deposits which is fully financed by the banks' own resources, with a mutual and cooperative mechanism. The fund intervenes in the event of the **compulsory liquidation** of the member banks and, in the case of subsidiaries of community cooperative credit banks which are affiliated and operate in Italy, when their state's guarantee scheme has intervened; in the event of the **resolution** of member banks; in operations entailing the **disposal** of activities, deposit liabilities, businesses, parts, assets and grouped legal transactions; and to overcome the status of **failure or risk of failure** of a member.

5 This ruling effectively annuls the Commission's decision whereby support by a private-law consortium for one of its members constituted state aid.

4.7 The new primary regulations and the rules on supervision of sustainable finance must not result in further compliance costs with consequent unsustainable supervision models for small and cooperative banks.

4.8 The EESC endorses the proposals made by the European Parliament's Committee on Economic and Monetary Affairs in 2019 with regard to the opportunity to introduce a "green and social supporting factor" to reduce capital absorption for financing granted by banks to social economy enterprises and to enterprises genuinely involved in sustainable and inclusive development programmes. Keeping in mind the necessity of resilience and stability of the financial sector, the opportunity of developing a green and social supporting factor should hence be properly examined and assessed.

4.9 The EESC believes that the new Banking Union regulation must roll out instruments to recognise that bank investments in activities with a positive social and environmental impact must be encouraged, including through preferential treatment with regard to the prudential backstops requested by the EBA.

4.10 This regulatory sensitivity would also be bolstered by data showing that investments by social economy enterprises are low risk in nature; these enterprises had an almost irrelevant impact on the European banking system in terms of NPL.

4.11 The co-legislators reached a compromise in the Spring of 2019, tasking the EBA (Article 501 of Regulation 575/2013, CRR), after consulting the European Systemic Risk Board (ESRB), with assessing, on the basis of available data and the findings of the Commission High-Level Expert Group on Sustainable Finance, whether a dedicated prudential treatment of exposures related to assets or activities associated substantially with environmental and/or social objectives would be justified. This EESC trusts that this assessment will be both careful and positive.

5. Bank groups and supervision

5.1 With regard to the establishment of cooperative bank groups stipulated by European regulation, whereby community and regional banks group together, in particular in certain countries such as Italy and Spain, in order to gain greater critical mass for their activities, regional banks should be able to ensure the appropriate management of the capital absorption of shares in the capital of the respective parent banks, so as to avoid excessive compression of the capital used for credit.

5.2 Currently, the legal framework provided for by European regulation on bank groups follows three articles of the CRR:

a. Article 10: bank groups established by banks permanently affiliated to a central body, with cross-guarantees and powers of direction and coordination (Italy, the Netherlands, Finland, Portugal and Luxembourg);
b. Article 113(6): groups with powers of direction and coordination under the parent bank or highly integrated systems (France);
c. Article 113(7): institutional protection schemes (IPS): Germany, Austria, Spain, the province of Bolzano in Italy.

5.3 In practice, these three set-ups are not able to recognise certain aspects which are defining features of the operations of those cooperative banks which have been required to join cooperative bank groups or institutional protection schemes following the formation of the Banking Union.

5.4 The requirement for cooperative banks to comply with mutual rules, to develop operational arrangements limited to the regions in which they are established, their democratic governance, the absence of individual profit-making objectives, the limits set for the distribution of profit and the indivisibility of capital cannot be reconciled with the current regulatory framework.

5.5 This could weaken their long-standing and effective role as regional development banks with a proven anti-cyclical function.

6. Post-COVID-19 framework

6.1 The impact of the COVID-19 pandemic is now dramatically apparent. We will have to get accustomed to living with much higher levels of public debt and, in order to ensure that resources get where they need to go on time, the entire financial system will have to be mobilised as part of a shared general effort involving public authorities and private players.

6.2 Considering the COVD-19 aftermath, it has been authoritatively observed that European banks will have to become "a vehicle for public policy" to support the economy and employment after this health emergency. As a consequence, "neither regulation nor collateral rules should stand in the way of creating all the space needed in bank balance sheets for this purpose"[6].

6.3 It is too soon to say how the COVID-19 crisis will affect the economy and what its ultimate impact on banks will be, but we do need to consider matters in light of the current and future framework.

a. From a regulatory perspective, the main objective after the 2008 financial crisis was the reduction of risk in banks' balance sheets. After the COVID-19 outbreak and for a currently undetermined period, however, banks' balance sheets will swell with the risks taken by the states and the real economy.
b. The SSM, the EBA and the ESMA have adopted a series of measures using the room for manoeuvre granted to them by the regulatory framework with a view to suspending certain tasks or scaling back certain prudential requirements.
c. If the economic and financial effects of the crisis are still visible to a significant extent in banks' balance sheets in future, this impact will have to be taken into account when implementing the Basel accord of December 2017 in the EU.

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6 See, for example, the arguments of former ECB president Mario Draghi in the *Financial Times,* 26 March 2020.

d. The Basel Committee's decision to postpone implementing the December 2017 accord is undoubtedly appropriate and necessary to enable banks to cope with the fallout of the pandemic, both in order to take into account the impact of the COVID-19 crisis on banks' financial situation and to cater better for the diversity of banking in Europe.

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