EPFSF Briefing on "Risk Reduction Measures package" 24 April 2018

Key elements

• The Risk Reduction Package is built on the agreed global standards while taking into account the specificities of the European banking sector.

• It contains 4 proposals (November 2016) from the European Commission aiming at reforming important aspects of the Capital Requirements Regulation ('CRR'), Capital Requirements Directive ('CRDIV') as well as the Banking Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism Regulation (SRMR).

• Another significant part of the RRM package was the partial harmonisation of banks creditor hierarchy through the creation of a new class of debt (the senior non-preferred debt) ranking below senior debt, but just above junior debt and which is eligible to meet TLAC/MREL requirements. The text was adopted at the end of 2017 and already implemented by the majority of Member States.

• Overall, this package intends to further reinforce the global financial reform programme in Europe and it deepens the achievements of CRDIV/CRR/BRRD/SRMR, which had already reduced the likelihood that banks would fail by significantly increasing the quantity and quality of capital they hold, and by making them less leveraged and more liquid.

Areas of focus

1. Measures to increase the resilience of EU banking institutions and enhancing financial stability

The proposals incorporate the remaining elements of the regulatory framework agreed recently within the Basel Committee on Banking Supervision (BCBS) and the Financial Stability Board (FSB). They include:

• More risk-sensitive capital requirements, in particular in the area of market risk, counterparty credit risk, and for exposures to central counterparties (CCPs);
• Implementing methodologies that are able to reflect more accurately the actual risks to which banks are exposed;
• A binding Leverage Ratio (LR) to prevent institutions from excessive leverage;
• A binding Net Stable Funding Ratio (NSFR) to address the excessive reliance on short-term wholesale funding and to reduce long-term funding risk.
• A requirement for Global Systemically Important Institutions (G-SIIs) to hold minimum levels of capital and other instruments which bear losses in resolution. This requirement, known as 'Total Loss-Absorbing Capacity' or TLAC), will be integrated into the existing MREL (Minimum Requirement for own funds and Eligible Liabilities) system, which is applicable to all banks, and will strengthen the EU's ability to resolve failing G-SIIs while protecting financial stability and minimising risks for taxpayers. It proposes a harmonised national insolvency ranking of unsecured debt instruments to facilitate banks' issuance of such loss absorbing debt instruments.

2. Measures to improve banks' lending capacity to support the EU economy

In particular, specific measures are proposed to:

• Enhance the capacity of banks to lend to SMEs and to fund infrastructure projects;
• For non-complex, small banks, reduce the administrative burden linked to some rules in the area of remuneration (namely those on deferral and remuneration using instruments, such as shares), which appear disproportionate for these banks;
• Make CRD/CRR rules more proportionate and less burdensome for smaller and less complex institutions where some of the current disclosure, reporting and complex trading book-related requirements appear not to be justified by prudential considerations.

3. Measures to further facilitate the role of banks in achieving deeper and more liquid EU capital markets to support the creation of a Capital Markets Union

Specific adjustments to the proposed measures are envisaged in order to:

• Avoid disproportionate capital requirements for trading book positions, including those related to market-making activities;
• Reduce the costs of issuing/holding certain instruments (covered bonds, high quality securitisation instruments, sovereign debt instruments, derivatives for hedging purposes);
• Avoid potential disincentives for those institutions that act as intermediaries for clients in relation to trades cleared by CCPs.
These legislative proposals will now be submitted to the European Parliament and to the Council for their consideration and adoption.

Legislative process

The timeline of the EU legislative process is as expected relatively long given the extremely complex nature of the file. In the European Parliament the draft reports were published in December 2017 and the ECON amendments tabled in February 2018. These amendments are currently being discussed and the final report should be released relatively soon.

Meanwhile the Council under the Estonian and now the Bulgarian Presidency is also making a lot of progresses in the discussions, reaching agreement on a vast majority of issues. The remaining outstanding issues, including the Fundamental Review of the Trading Book should be adopted in May/June.

Therefore, the start of trilogues should occur before the summer break and continue during the Austrian Presidency of the Council.

Industry position

While respecting internationally agreed standards in the proposed RRM package, the diversity and specificities of the European banking sector also needs to be appropriately catered for; and prudential requirements must not hamper banks' financing capacity, the development of market finance, financial stability and sustainable economic growth in Europe.

The industry broadly supports the objectives of the Risk Reduction Measures package and further advocates that the final design of the prudential and financial stability framework takes account of the bank's need to:

• Finance the European economy and innovation
• Regain a competitive profile in the global financial markets
• Support market liquidity by providing market making activities

- Take full advantage of the EU Single Market and the Banking Union
- Degrease burdensome regulation and supervision

Overall, industry players are quite pleased that many of the tabled amendments and council deals aim to achieve the conflation of the above objectives.

An extra attention should also be put on proportionality for less-significant institutions, based on their size, scope of activities and systemic effect.

Conclusion

Although risk reduction in the Financial Services sector has been a top priority for more than 10 years, there is a danger to pursue a never-ending course of risk reduction, potentially leading to adverse consequences for banks that are financing almost 80% of the EU real economy.

This is precisely why industry players believe that once the objectives are clearly met, the rules should not perpetually evolve in order to allow a relative business operating stability.

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Chairman Financial Industry Members

Peter de Proft, Director General, EFAMA
Rue Montoyer 47, B-1000 Brussels
Tel: +32 2 513 39 69
E-mail: peter.deproft@efama.org

Secretariat

David Reed, EPFSF Director
2/4, Rond-Point Schuman, BE-1040 Brussels
Tel: +32 2 514 68 00
E-mail: secretariat@epfsf.org