



Brussels, 14 June 2016  
(OR. en)

10036/16

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**Interinstitutional File:  
2015/0270 (COD)**

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**LIMITE**

**EF 175  
ECOFIN 573  
CODEC 856**

## **REPORT**

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From: Presidency

To: Delegations

Subject: - Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 806/2014 in order to establish a European Deposit Insurance Scheme (First reading)  
- Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions "Towards the completion of the Banking Union"

= Progress report (State of play)

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### **I. INTRODUCTION**

1. The Commission Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 806/2014 in order to establish a European Deposit Insurance Scheme ("EDIS") was transmitted to the Council on 24 November 2015<sup>1</sup>. At the same time, the Commission published the Communication "Towards the completion of the Banking Union"<sup>2</sup>. This package was presented at the ECOFIN meeting of 8 December 2015.

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<sup>1</sup> Doc. 14649/15.

<sup>2</sup> Doc. 14650/15.

2. Given the importance and the complexity of the subject matters raised in both the above-mentioned proposal and communication, and the fact that the issues addressed are strongly interrelated, Member States agreed that the Council work had to be organised and coordinated at the appropriate level. Therefore, on 13 January 2016, the Committee of Permanent Representatives agreed to establish within the Council the *Ad Hoc Working Party on the Strengthening of the Banking Union* (hereinafter "AHWP")<sup>3</sup>.
3. Under the Dutch Presidency, this AHWP met nine times (20 January, 1 and 16 February, 1 and 16 March, 5 and 29 April, 10 May, 1 June 2016), alternating the examination of the EDIS proposal with discussions on risk reduction measures, based on the aforementioned Commission Communication.
4. The European Economic and Social Committee and the European Central Bank delivered their opinions on the EDIS proposal on 17 March 2016<sup>4</sup> and 20 April 2016<sup>5</sup> respectively.
5. This progress report has been drawn up under the responsibility of the Presidency on the basis of positions expressed by delegations at the aforementioned meetings, and in reply to several calls for written comments. This report cannot be considered as binding on the delegations, but it does represent the Presidency's best assessment of the main outcomes of the discussions, with a view to provide some orientation for the work ahead.
6. The progress report is divided in two parts: section II covers the general considerations and specific issues regarding the EDIS proposal and section III covers the discussions on measures to strengthening the Banking Union.

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3 Doc. 5006/16.

4 Doc. 7332/16.

5 Doc. 8186/16.

## **II. EDIS PROPOSAL**

### **1. GENERAL CONSIDERATIONS**

7. A significant number of Member States consider the implementation of a third pillar of the Banking Union as a priority, and have welcomed the proposal. Some of them have indicated that the substance of the provisions and the timing of the entry into force should be even more ambitious, calling in particular for a faster mutualisation process. Some Member States, however, have strongly objected to the proposal and its timing, contesting the necessity and appropriateness of the proposal. Some of those Member States also indicated that they were therefore not in a position to discuss details of the proposal. A number of others, while generally supporting the proposal, have raised concerns.
8. In addition to a number of specific issues, the main fundamental questions raised during the debate on the proposal have mainly been the following:
  - the link between further progress on risk sharing (including the EDIS and the setting-up of a common backstop for the Single Resolution Fund) and on a number of measures aimed at reducing risks in the banking sector, which are dealt with in more detail in Part III of this report;
  - the absence of a specific impact assessment; several Member States were of the opinion that such an assessment was needed to discuss the necessity, appropriateness and possible structure of EDIS;
  - the suitability of the legal basis.

## 1.1. Absence of specific impact assessment

9. Most of the Member States have been disapproving of the absence of a specific impact assessment accompanying the EDIS proposal. The Commission services have underlined that a fully-fledged impact assessment, covering i.a. mandatory lending, had been delivered in relation to the Directive 2014/49/EU on deposit guarantee schemes ("DGSD") in 2010.<sup>6</sup> In addition, they provided an informal analysis of the economic benefits of the EDIS proposal, the rationale for the different phases of EDIS and the benefits in comparison to purely national DGSs, and the costs and benefits of mandatory lending.
10. According to the analysis presented by the Commission services, the mandatory lending construction would pose significant organisational challenges to the network of DGSs due to the lack of a central body, hence arguing that a central body is necessary to ensure a well-functioning scheme. Moreover, using data on insured bank deposits in Member States, the Commission services assessed how the payout capacity would change by moving from the current system to the EDIS. The Commission services argued that, by pooling *ex ante* contributions in a single Fund, it would be able to absorb larger shocks than any of the national deposit guarantee schemes could. Hence, EDIS would improve the deposit insurance cover for banks and thus increase the level of depositor confidence in all participating Member States, without changing the overall funding level and the costs for banks. Nevertheless, the analysis of the different phases showed that for some countries for some period during the phase-in, it could sometimes have been more beneficial to retain a fully national DGS. Also, the analysis presented showed the most benefits are to be gained in the coinsurance and full insurance phases. The reinsurance phase offers little direct economic benefit.

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<sup>6</sup> Doc. SEC(2010) 834 final.

11. Several Member States have appreciated this input and supported the Commission services' intention to work on targeted topical assessments in the framework of upcoming discussions on specific provisions. Several others, however, have voiced serious concerns both about the approach, including its basic assumptions, and the conclusions drawn so far. These Member States have called for having as much *ex ante* clarity as possible on the overall impact (including any negative effects) of the proposal, also in comparison with possible alternatives to the EDIS, including amended governance arrangements for a mandatory lending scheme. According to some of these Member States, the Commission's procedure does not comply with the requirements under Subsidiarity Protocol and better regulation requirements and have demanded a fully-fledged impact assessment.
12. The Presidency believes that, in order to have a comprehensive and solid basis for the definition of a Council position on the EDIS proposal, additional analyses should be performed by the Commission services, extending the scope to other key elements of the proposal, in particular including possible alternative options to the various elements. Member States therefore have indicated a number of subjects for further analysis regarding the design and effects of EDIS on which further explanation by the Commission is requested. The Commission has indicated its willingness to contribute targeted analyses on the issues as deemed relevant by the AHWP.<sup>7</sup>

## **1.2. Suitability of the legal basis**

13. A significant number of Member States have raised (strong) concerns regarding the suitability of the legal basis of the proposal, Article 114 TFEU, arguing in particular that the obligation upon banks to pay

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<sup>7</sup> As per the presidency note distributed on 4/3/2016 titled "Suggested topics for further analysis of the necessity and effects of EDIS".

contributions to the European Deposit Insurance Fund ("DIF") would be impinging upon the Member States' budgetary sovereignty.

14. The Council Legal Service opinion of 12 April 2016<sup>8</sup> addressed the question whether Article 114 TFEU is a suitable legal basis for establishing a set of uniform rules and a centralised decision-making procedure, as well as for creating the DIF and raising contributions from the institutions covered by the proposal. The same opinion included also considerations on a possible recourse to the intergovernmental method.

15. Considering the divergence of the Member States' positions in respect of the option to set up an Intergovernmental Conference to deal with the DIF funding, the Presidency holds the view that – similarly to the negotiations on the Single Resolution Mechanism (SRM) – the possibility of having a well-framed Intergovernmental Agreement (IGA) should be explored.

## **2. STATE OF PLAY ON SPECIFIC ISSUES**

16. The Dutch Presidency has commenced by discussing specific elements of the Commission proposal to identify the sensitive issues and topics, which could be subject to a further discussion. On the basis of these discussions and the guidance provided by MS on the sensitivities, the Dutch Presidency progressed with a more detailed examination of some elements of the proposal, starting on the provisions related to “steady state” (i.e. the final stage of full EDIS mutualisation) rather than on the intermediate stages (co-insurance and re-insurance). The idea of the Presidency was that if we can agree on the steady state and all the horizontal issues (governance etc.), it would be easier to agree on the intermediate steps.

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<sup>8</sup> Doc. 7862/16.

17. On the basis of comments received from delegations, the Presidency identified a number of key topics and concrete options on how to handle them in the framework of the AHWP. Some Member States expressed the view that in the absence of an impact assessment or further thorough analysis, none of the specific elements of the EDIS proposal and their potential effect could be thoroughly assessed. Therefore the topics and options have been discussed on a preliminary basis.
18. The Dutch Presidency has classified the key topics into three main categories:
  - Provisions that have been amended in a Presidency working document , sent to AHWP members for the meeting on June 1 2016, following an in-depth discussion of the Commission proposal.
  - Provisions for which the way forward is provisionally acceptable to a large number of MS, though not all, but deserving either further refinement in the drafting or further consideration of some specific elements of the text.
  - Provisions which require a more fundamental debate in the AHWP.The state of play of the discussions for each of these categories is presented below.
19. Notwithstanding the above classification, the Presidency, based on written suggestions by delegations, has suggested a number of technical adjustments to the Commission proposal in the above mentioned working document.

### **3. PROVISIONS AMENDED BY THE PRESIDENCY**

#### **3.1. Irrevocable payment commitments (Article 3)**

20. Some Member States have indicated that they would like irrevocable payment commitments (IPCs) to be taken into account as financial means that institutions transfer to the DIF in order to reach its target level. This option had not been included in its proposal by the Commission, which expressed reservations with respect to operational issues it might raise in ensuring timely delivery of the collateral.
21. As a compromise, the Presidency proposed amendments to Articles 3 and 74b of the proposal in order to include IPCs in the available financial means of the DIF, while delegating powers to the Commission to further specify the requirements applying to the IPCs and to ensure a consistent application within the EDIS framework. This approach was accepted by a majority of the AHWP.

#### **3.2. Derogation from the funding path (Article 41j)**

22. Although the Commission proposal allows for the possibility to derogate, on a temporary basis, from the funding path of the EDIS upon Commission's approval, a number of Member States have called for these provisions to be further specified, particularly to clarify the conditions and circumstances for the derogation.
23. So as to maintain the coverage of the EDIS, the Presidency has proposed to make the derogation automatic when a payout event has occurred up to one year before the date on which a specified funding level should have been reached, while ensuring that the DGS complies again with the

funding path requirements at the latest two years after that date. The competence of the Commission to approve a longer derogation period for certain duly justified reasons has been left intact, in order to enable tailor made solutions in addition to the automatic derogation.

24. The Presidency's approach has been provisionally accepted by some Member States, whereas others have expressed the view that the funding path depends on the overall structure of EDIS and can therefore not be discussed separately. Further refinement is needed on this topic.

### **3.3. Appeal mechanism (Article 85)**

25. The SRM Regulation establishes an Appeal Panel and opens up the possibility to appeal some decisions of the Board under the SRM framework. However, some Member States have called for the scope of the appeal mechanism to be broadened to EDIS related decisions that could be subject to an appeal to be specified in Article 85.

26. On these grounds, the Presidency has presented an amendment clarifying that some provisions could be subject to an appeal, and namely those relating to: disqualifications (41i), the determination of the amount of funding (41m), the repayment of funding and determination of excess loss (41o), the monitoring of insolvency procedure (41q), *ex ante* contributions (74c) and *ex post* contributions (74d).

27. The suggested amendments have been accepted by some Member States, whereas others have pointed to the necessity of further legal and technical analysis.

## 4. PROVISIONS REQUIRING FURTHER REFINEMENT/CLARIFICATION

### 4.1. Scope of the EDIS (Articles 1 and 2)

28. One of the material topics of the legislative proposal concerns the scope of the EDIS. Member States have indicated that it should be more clearly specified, especially with regard to third country branches, as well as certain entities other than credit institutions (i.e. entities that are currently excluded from the scope of the CRDIV (article 2(5)) and hence from the scope of the SSM) that might be covered by participating DGS.

#### *4.1.1. Third country branches*

29. In the DGSD framework, the issue of third country branches is dealt with through a Member State option: although an equivalence test is mandatory, Member States only have the option to oblige the third country branch to join a national DGS if the third country protection scheme is not considered as equivalent.

30. In order to ensure a workable system in the framework of the EDIS, the Presidency has proposed to give the Commission the competence of performing the mandatory equivalence check. On this basis, competent authorities would decide on the necessity to require a third country branch to join a national DGS. This would ensure that Member States exercise the option to require DGS coverage of third country branches in a more consistent manner. Third country branches which are required to join a national DGS could then be covered by the EDIS.

31. However, such a solution would not ensure a proper alignment between the EDIS and the SSM scopes, as third country branches are supervised by their national supervisory authorities. It therefore needs further discussion.

#### *4.1.2 Entities other than credit institutions covered by participating DGSS*

32. The misalignment between the EDIS and the SSM/CRR scopes is also a major issue as it regards entities other than credit institutions, such as credit unions, that might be covered by participating DGSSs. Some Member States have raised strong concerns over the fact that depositors of the entities that do not apply current CRR/CRD rules (while they are subject to the national regime and in a few MS to rules based on CRR/CRD) would then not be protected by the European regime. Several Member States, however, have raised concerns as Credit Unions are not always regulated and supervised under CRR/CRD and the Single Supervisory Mechanism. For these Member States a full alignment of scopes is desirable. Nevertheless, Member States have showed openness to explore the inclusion of those entities in the scope of EDIS with a solution in the context of the proportionate provisions to be applied to that set of entities in the context of the upcoming CRR/CRD review. The AHWP should come back to this issue once there is more clarity on the CRR/CRD review.

#### **4.2. Disqualification and fines** (Articles 41i, 41j, 41l, 41m, 50a)

33. The Commission proposal has introduced a number of safeguards to prevent moral hazard and in particular the incorrect or unwarranted access to EDIS funds from participating DGSSs.

34. However, whereas Member States generally saw the need for safeguards many expressed several concerns about the procedure proposed. First, the legality of the procedure has been questioned. It has also been indicated that disqualification could have a negative impact on financial stability. Several Member States consider that the conditions for exclusion and fines should be clarified and that exclusion might be a disproportionate penalty. In particular, some Member States have called for the possibility to apply other (administrative) sanctions before reverting to disqualification, and for the possibility of a remedy period.

35. As a way forward, the Presidency has proposed to establish a staggered intervention ladder regarding compliance with DGSD and EDIS rules in which depositor protection is the key objective and disqualification would only be possible as a final step. The central idea behind the staggered intervention ladder is that even in case of non-compliance by a DGS, financing should be made available but only in the form of a loan subject to certain conditions. In addition, the DGSs would be subject to a continuous monitoring by the Commission and the Board, with regular evaluations of DGSs on their ability to meet their key obligations to be defined in the EDIS proposal itself. The interaction between the disqualification provisions and the funding path is further specified in 41j.

36. Under the staggered intervention ladder, if a DGS does not meet its key obligations, the Board and the Commission would have several options at their disposal: as a first step, the Board will issue a recommendation that includes remedial actions. Consequently, the Commission may "instruct" the DGS to ensure compliance within 3 months, or transform the EDIS funding into a loan in case of a payout event ex post. Also, in the case of lasting non-compliance and insincere cooperation, the DGS could be disqualified from the EDIS. Disqualification does not have to be permanent though. The DGS should, in principle, be able to (re)qualify for coverage by EDIS once it meets all requirements. Criteria will have to be developed for this process.

37. In response to the request of some MS for more differentiation in the intervention ladder, a preliminary assessment of the possibility to apply fines was conducted, which concluded that these are not feasible from a legal perspective. Also, some Member States voiced concerns regarding a monitoring by the Commission, given Member States competence to supervise DGSSs.

#### **4.3. Options and discretions within DGSD**

38. Another question addressed by the AHWP is whether the 41 options and national discretions ("ONDs") embedded in the DGSD - concerning, e.g., the Fund target level, the calculation of contributions, and certain types of eligible deposits - should be applied in the same manner (or at least further specified) in the context of the EDIS proposal.

39. From a legal point of view, the harmonisation of ONDs related to participating DGS could be achieved in two ways: (i) by modifying the DGSD through a separate legislative act; or (ii) by further specifying certain ONDs contained in the DGSD only for the purposes of the EDIS, in the context of the Banking Union, following the SRM precedent in its relation with the BRRD. It should be noted, however, that there are legal limitations to the application of the latter approach, namely in relation to the scope and membership of DGSSs.

40. The results of a survey launched by the Presidency have indicated that Member States consider a harmonisation at Banking Union level as acceptable and important, particularly for key elements in the EDIS such as the payout procedure and the coverage provided.

41. Furthermore, views have diverged on the desirability of a harmonisation at EU-28 level. Some Member States, particularly those whose currency is not the euro, have underlined that ONDs were included in the DGSD with the purpose to reflect national specificities and that they should hence remain available.
42. The Presidency has concluded that, in addition to the ONDs addressed already by the Commission proposal (on contributions and available means as well as on the phase-in), some additional ONDs (on coverage and payout procedure) could be specified for the participating Member States through the EDIS text and with respect to the EDIS fund.
43. The Presidency has then proposed a method which specifies the relationship between the EDIS and the participating DGS, particularly in terms of financial flows, without directly affecting the ONDs of the participating DGS, which would remain entitled to take national measures (e.g. the extension of the coverage of temporary high balances), insofar as these would be financed exclusively by national means not related to the EDIS.
44. Many Member States have expressed openness towards further developing the solution put forward by the Presidency, with some concerned that such a two-tier system might add complexity to the system and lead to an un-level playing field in terms of depositors' protection and cost neutrality.
45. In this context, the Presidency proposes to continue working on the basis of the approach put forward, which could be applied to a number of ONDs, while giving separate consideration to the ONDs related to scope and membership as well as to those related to "alternative measures" in the context of insolvency procedures by participating DGS, as specified in DGSD 11(6). For those alternative measures, a way forward could be to allow for a deposit book transfer of only covered deposits as also suggested in the ECB opinion on the proposal.

#### **4.4. Coverage and eligibility of deposits for the purpose of EDIS** (Articles 41c, 41g)

46. Although the issue of the coverage level of EDIS is one of the fundamental issues to be further discussed in the framework of the overall EDIS setup (see part 3 below), the Presidency has put forward a proposal regarding how DGSD rules on coverage should apply to the European fund, in accordance with the general principles agreed for harmonising DGSD options and discretions for the purpose of EDIS (as described in the point 2.3 above).
47. In particular, the Presidency suggested to clarify i) the coverage/insurance level of the EDIS with respect to participating DGS (up to an aggregate amount of deposits for each depositor of EUR 100 000), ii) the treatment of entitlement by two or more persons to a business deposit, and iii) the coverage of temporary high balances.
48. While most delegations accepted the approach proposed by the Presidency on the first two issues, the question of temporary high balances requires further analysis. Indeed, the proposal to set the amount at a level of EUR 500 000 has not been fully supported. Several Member States indicated that this amount should reflect better the standard of living in their countries. As a result, some Member States, which implemented higher amounts at national level, fear that the Presidency proposal would have a negative impact on the protection of their depositors, while others fear that the suggested coverage level is too high.
49. Furthermore, many Member States stated that national discretion is not only manifested through differences in coverage level or coverage period. Equally important, the provisions refer to national law for specific situations to be covered, which is regulated in very different fields of national legislation (e.g. social law, civil law, labour law) and therefore difficult to harmonise. The Presidency concluded that further discussion is needed. While a coverage level calibrated on the mean or median

amounts could be justifiable, an alternative way forward could be to harmonise only a minimum amount of loss coverage of temporary high balances through EDIS (and hence allowing Member States to finance any top-ups through financial means remaining on the national level).

#### **4.5. Contributions** (Articles 74c, 74d)

50. A large number of Member States asked to include the methodology to calculate the contributions by banks in the level 1 text, instead of a delegated act as proposed in the Commission text. A preliminary discussion has highlighted that MS were generally uncomfortable with the process of compensating banks with funds already paid into the national DGS, and would prefer a direct transfer from the available funds in the national DGS to the DIF. Also, the preliminary discussion highlighted that further work is needed on the risk contribution methodology. Especially, further discussion is needed in order understand the impact on individual banks and Member States. To allow for a more fundamental discussion (see below), the Presidency has therefore asked the Commission to provide more detailed information about the proposed methodology as well as the financial consequences.

#### **4.6. Governance and decision-making process under the EDIS**

(Articles 43 to 59)

51. The new governance structure of the Single Resolution Board under the EDIS (participants, voting procedures, tasks of the Board) has generally been welcomed by Member States, though some Member States expressed concerns on specific aspects of the governance provisions. Other Member States stated that governance process can only be assessed, once the final structure of EDIS is clear. Some Member States raised the general question of a conflict of interest within SRB.

52. In particular, the threshold for the involvement of the Board's plenary session (set at 25% of the use of the DIF in the Commission proposal) was discussed, some Member States considering the threshold as too high, others seeing it as unnecessary.

53. The voting modalities have also raised some debate: some Member States preferring the rules as adopted in the SRM Regulation, others opposing the requirement that decisions should be taken with the support of members representing at least 30% of the contributions once the target level has been reached.
54. At a general level, the current the initial Commission proposal was a good solution on all governance provisions, but could benefit from an article by article discussion.

## **5. PROVISIONS REQUIRING FUNDAMENTAL DISCUSSION**

55. A number of key topics of the EDIS proposal have not yet been discussed in detail. Given the fundamental differences of approaches expressed by Member States towards those issues, the Presidency has considered that it would not be in a position to provide any concrete suggestion on the way forward before the AHWP has held a thorough exchange of views on each of the subjects.
56. The topics that have been identified as deserving further fundamental discussions, as well as the main areas of concern highlighted by Member States, include:
  - The accession and departure of MS to EDIS, and the conditions under which such an accession and departure may take place;
  - The pace and process of mutualisation, including the build-up of national and common means;
  - Monitoring and exercising insolvency process by Board;
  - Calculation of ex ante contributions and the specification of a methodology for calculating risk based contributions;
  - The use of common means for alternative measures and the interaction with the principle of cost neutrality for participating DGSSs.

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### **III. MEASURES TO STRENGTHEN THE BANKING UNION**

#### **1. CURRENT ACHIEVEMENTS**

57. During the discussion in the AHWP, MS recalled that many measures have already been adopted and implemented at unprecedented speed. These include two important pillars of the Banking Union that have already been established.
58. The first pillar started following a **comprehensive assessment** - consisting of an asset quality review and stress test - of all significant credit institutions of the Banking Union, resulting in increased transparency, confidence and substantial capital adjustments by those credit institutions. The Single Supervisory Mechanism (**SSM**) became operational in November 2014 and is already delivering on its goal to achieve strong, independent and uniform prudential supervision within the Banking Union. For example, important steps have been taken towards a harmonised and unbiased supervision by conducting the **Supervisory Review and Evaluation Process (SREP)** according to a common methodology for directly supervised entities, ensuring consistency, avoiding supervisory forbearance and accounting for institutions' specificities.

59. The second pillar, the Single Resolution Mechanism (**SRM**), has resolution powers and is fully operational since January 2016 when the first contributions were transferred to the Single Resolution Fund (SRF) following the ratification of the Intergovernmental Agreement by all Member States participating in the Banking Union. The SRB is ensuring consistency of approaches for resolution activities (both resolution planning and preparation of resolution schemes) in various ways. First, it engaged, in collaboration with NRAs, in the preparation of two manuals dealing with resolution planning and crisis management, respectively. Second, it defined a common stance on relevant resolution policy issues (e.g. the determination of minimum requirements for own funds and eligible liabilities) through discussions in Committees and the Plenary. Third, it coordinates the Internal Resolution Teams (IRTS) which carry out the resolution planning activity drawing on SRB and NRAs expertise. The SRB is well advanced in pursuing the target of having a resolution plan for the major banks in the Banking Union by the end of 2016. The SRB also promotes consistency of resolution activities conducted by NRAs for the Less Significant Institutions under their direct responsibility mainly through the assessment of draft resolution decisions (e.g. resolution plans) that NRAs are obliged to notify to the SRB.

60. As for the SRF, participating Member States have agreed on 8 December 2015 to a harmonised **Loan Facility Agreement** (LFA) with the Single Resolution Board (SRB), providing national credit lines to the SRB to support the national compartments of the SRF in case of possible funding shortfalls in that compartment following resolution cases of banks of the MS concerned.

61. Moreover, in December 2013 the Council adopted a statement on the **SRM backstop**, indicating that a common backstop will be developed during the transition period, and will be fully operational at the latest by the end of the transitional period (i.e. by 1 January 2024) and that progress shall be reviewed soon after the entry into force of the SRF. The Council reiterated its commitments in December 2015 and also specified that “the common backstop will be fiscally neutral over the medium-term and will ensure equivalent treatment across all participating Member States, as well as incurring no costs for Member States not participating in the Banking Union”.
62. Furthermore, underpinning the two pillars mentioned above, almost all members of the Banking Union have **transposed and implemented** all the relevant legal provisions into national law of the **single rule book**, ensuring more consistent regulation and high-quality supervision across the EU by:
  - a) Stronger prudential requirements for banks that have been introduced under **CRDIV/CRR**. This has enhanced the capacity of banks to absorb adverse economic and financial shocks by increasing the quality and quantity of capital, expanding risk coverage and improving governance and transparency.
  - b) A new recovery and resolution framework for banks has been established under the **Bank Recovery and Resolution Directive** (BRRD). This framework aims to harness financial stability and protect taxpayers by applying the new bail-in rules that minimise the use of public funds when banks are failing or likely to fail and by managing bank crises in a more timely and orderly manner.
  - c) The functioning of **national Deposit Guarantee Schemes** (DGSS) has been enhanced by the Deposit Guarantee Scheme Directive (DGSD),

which harmonises coverage, strengthens and harmonises funding arrangements and ensures an expedient pay-out procedure.

## 2. REMAINING CHALLENGES

63. MS recalled that the Banking Union was established primarily in response to the financial crisis and the sovereign debt crisis in particular in the euro area. The crisis was to a large extent driven by negative feedback loops between banks and their respective sovereign; breaking the vicious link between banks and their respective national sovereigns has therefore become a key objective of the Banking Union.
64. The above achievements, as well as the ECB's measures and national measures, made a significant contribution to reversing the fragmentation of financial markets, mitigating moral hazard and reducing the risk for the involvement of the public sector.
65. While acknowledging that the current achievements are unprecedented and the establishment of the Banking Union is well advanced in a number of areas, both in terms of risk reduction and risk sharing, MS agreed that the overall construction and the resilience of the Banking Union could be further enhanced through an inclusive and comprehensive process of further risk reduction and risk sharing. During the discussion in the AHWP, a number of remaining **challenges** were put forward by different MS (in no **particular order**):
  - a) Several MS considered that in the current situation, national DGSs are still **vulnerable** to large **local shocks** and wider systemic contagion effects. This situation would undermine the homogeneity of protection for deposits and contribute to a lack of confidence in the safety of bank deposits among depositors. Several MS therefore urged to advance rapidly with EDIS.

- b) A number of MS indicated that shift from bail-out to **bail-in** and the minimisation of the use of public funds need to be ensured through effective implementation and application of the bail-in rules and by ensuring that sufficient resources are available for bail-in. In this regard, some MS underlined the importance of a uniform approach and legislative proposal for rules on the creditor hierarchy and subordination to improve bail-in and reduce legal risks regarding the no creditor worse off principle.
- c) Some MS considered that remaining differences in national legislation and implementation could create an **unlevel playing field**. According to a few MS, there is also a potential risk that certain **national policy measures / channels** could have significant **impact** on the respective banks' balance sheets, while potential costs are borne by all Banking Union Member States.
- d) EU banks remain significantly exposed to their national sovereigns. While several MS vocally called for caution, some MS underlined the need to review the regulatory treatment of **sovereign exposures**.
- e) While some MS already recalled that the SSM and SRM regulation as well as the Dublin Declaration recognises that the **governance arrangements** of the SSM and the SRM leave room for simplification subject to changes in primary law, some MS pointed out that the SSM and SRM have been established recently and therefore might need more time to fully establish itself.

f) Several MS considered that the extensive menu of prudential and crisis management measures that have already been agreed cannot eliminate entirely the risk that in extraordinary situations and as a last resort public funding – while being fiscally neutral over the medium term – may be temporarily required to enhance the borrowing capacity of the SRF. While it has been agreed that the SRF should have a **common backstop** to be available as a last resort by the end of the transitional period at the latest, work on this matter has not yet started. A few MS also noted that 11 MS have not yet signed the FLA with the SRB. In line with the ECOFIN declaration of 8 December 2015 to establish the bridge financing arrangements by 1 January 2016, those MS are expected to sign the FLA swiftly. Some other Member States noted however that as the size of the national compartments will fall with progressive mutualisation of contributions, those credit lines would be supporting a declining share of the total SRF over time. In view of this, those MS asked to start discussing the operational details of the common backstop as soon as possible.

g) A number of MS pointed out that a number of remaining **Basel reforms** already agreed on (i.e. the leverage ratio and net stable funding ratio) would need to be implemented in the EU in order to further enhance financial stability.

### **3. MEASURES TO STRENGTHEN THE BANKING UNION**

66. In order to address the remaining challenges mentioned above and building on the Commission's Communication, MS have put forward a number of risk reduction and risk sharing measures that are considered to be relevant with a view to strengthening the Banking Union as well advancing the single market for financial services.

67. Without prejudice to further debate on the relevance, prioritisation, desirability and technical details of each measure, a distinction could be made at this stage based on procedural grounds; some measures could be addressed by the ongoing work of various institutions / bodies (4.1) or are expected to be included in future work of the Commission (4.2), while other measures would still need require further work or guidance by the Council (4.3).

### **3.1 Ongoing work**

68. Currently, several institutions and bodies are working on measures that are considered to be relevant in the context of the Banking Union, while noting that several measures are also relevant to the EU28. In this regard, the AHWP has taken note of the following ongoing efforts at BU, EU28 and international level.

#### *3.1.1. At Banking Union level*

69. In the Council, the **AHWP** is currently examining the proposal on **EDIS**, which has been proposed by the Commission as the third pillar of the Banking Union in order to increase the resilience of the Banking Union against future financial crises by reducing the vulnerability of national deposit guarantee schemes to large local shocks and wider systemic contagion effects and by ensuring the homogeneity of the protection of depositors in the Banking Union. The presidency has commenced the work by discussing specific elements of the Commission proposal to identify the sensitive issues and topics, which could be subject to a further discussion. On the basis of these discussions and the guidance provided by MS on the sensitivities, the Presidency progressed with a more detailed examination of some elements of the proposal, starting on the provisions related to “steady state” (i.e. the final stage of full EDIS mutualisation) rather than on the intermediate stages (co-insurance and re-insurance). The current state of play and outcome to date by the AHWP has been reflected in a

progress report drawn up under the responsibility of the Presidency. The EP is planning to establish its negotiating position on the EDIS proposal by the end of 2016.

70. One participating **MS** is in the process of transposing the **BRRD**. Once all participating Member States have fully transposed the BRRD, Member States consider the way forward and timing regarding the work on the **common backstop**.
71. The **SSM** is ensuring the consistent **application of high supervisory standards** to all credit institutions across the SSM by making the best possible use of the instruments granted to the ECB. This also applies to the supervision of **Less Significant Institutions** (LSIs) for which there is an ongoing process for day-to-day cooperation between the ECB and the National Competent Authorities (NCAs) as well as project based initiatives mostly concerning the development of joint supervisory standards and methodologies related to LSIs to ensure that the single rulebook for financial services is applied consistently in all Member States concerned.
72. The **SSM** has identified 122 **options and discretions (ONDs) in the CRR/CRDIV** which are currently under consideration with a view to ensuring a harmonised application. As regards a large number of priority provisions applicable to significant institutions, the ECB's Governing Council has adopted legal instruments (ECB regulation and guide) on 14 March 2016, where the guide has already entered into force and the regulation is expected to enter into force on 1 October 2016. A second phase has been launched in 2016 aiming at completing mapping and policy work on 8 additional ONDs. If deemed appropriate, specification for some of these ONDs under this project will be developed after the assessment of future cases which will allow the SSM to gain experience on their application, or after the adoption of regulatory framework by the EBA or the Commission. As regards the **Less Significant Institutions**, the ECB is examining in the course of 2016 to which extent the new framework for ONDs should apply and how this could be implemented in close cooperation with NCAs. However, it should be noted that several ONDs in the regulatory framework are outside the remit of the supervisory authority and can only be exercised by MS.

73. The **SSM** is **continuously monitoring** the need for remedial action following the Comprehensive Assessment in 2014 to ensure a **prudent valuation of assets**, including those valued on a fair value basis using unobservable inputs (so-called level 3 assets in the fair value hierarchy). For Significant Institutions (SIs) subject to direct ECB supervision, there is an assessment of risks related to material holdings of level 3 fair value assets in the annual Supervisory Review and Evaluation Process (SREP) and monitoring which is taken into account on a case-by-case basis by the Joint Supervisory Teams in their ongoing supervision.

74. The **SSM** and **SRB** have considered the impact of the **accounting standards** from a supervisory and resolution perspective. The SSM has been granted the power to require directly supervised individual banks to exercise IFRS for prudential and reporting purposes. While the SSM may exercise this power if deemed necessary, it has not exercised this requirement so far. Following the public consultation on the ONDs Guide on the 18 May it will be decided whether the SSM will impose such a requirement. As regards the valuation for the purposes of resolution, it should be noted that the SRB considers that such valuation can currently be carried out in the context of different accounting regimes, the international financial reporting standards (IFRS) and national generally agreed accounting principles (GAAP). The arrangements may be evaluated in respect in the light of any possible new developments in the Banking Union. In this regard, it should be noted that some MS consider that the same accounting rules would need to be applied by banks for prudential purposes.

### *3.1.2. At EU-28 level*

75. The **EBA** has drafted regulatory technical standards (RTS) on the harmonised setting of the minimum requirements of own funds and eligible liabilities (**MREL**), after which the Commission proposed to amend the draft RTS proposed on 17 December 2015. The EBA has rejected

certain amendments in February 2016. The **Commission** has adopted an amended RTS by means of a delegated act on 23 May 2016, which is currently being considered by the co-legislators.

76. The **Commission** will monitor the consistent and rigorous **application** of the BRRD, including the **bail-in rules**. To the extent that public funds or funding from the SRF, national resolution funds or deposit guarantee schemes are used, the Commission will ensure compliance with the **EU State Aid** and Fund Aid rules. Such rules ensure that the use of public funds or funding from the SRF, national resolution funds or deposit guarantee schemes is minimised through appropriate burden sharing measures, that aided banks can regain viability within a reasonable timeframe and that competition in the single market is not distorted.
77. The **Commission** is also regularly assessing the level of Deferred Tax Credits (**DTCs**) after working arrangements have been made with MS concerned, aiming at reducing the stock and preventing the build-up of new DTCs.
78. While several MS questioned the continuing relevance of the proposal on **Bank Structural Reform** (BSR) in the context of strengthening the Banking Union, it has been noted that the **European Parliament** is in the process of establishing its negotiating position on the proposal. As the Council has adopted its negotiating position in June 2015, an agreement within the EP would allow the co-legislators to trilogue start negotiations.
79. At the level of the EFC, the High Level Working Group on the Regulatory Treatment of Sovereign Exposures (RTSE) is currently examining policy options for the regulatory treatment of **sovereign risk** in Europe.

### 3.1.3. At international level

80. The **Basel Committee** is reviewing several banking related regulatory issues, notably the standards on capital requirements for credit and operation risk, including the existing regulatory treatment of bank's exposures to **sovereign risk**. A consultation paper on the issue is expected early **2017**.
81. The **Financial Stability Board** has included the topic of **misconduct risk** in two work streams: the Compensation Monitoring Contact Group is focusing on the role of compensation tools with a view of presenting a report by August 2016; and a new FSB working group will exchange good practice on the use of governance frameworks, which may result in a supervisory toolkit or guidelines, sharing of national experiences around enforcement and possibly recommendations on remunerations. These work streams should ensure that relevant authorities are endowed with adequate instruments to address misconduct and its associated risks.

### 3.2. Work by the Commission

82. Further to the ongoing work mentioned above, several measures are expected to be proposed by the Commission in the short and medium term. Some of this work applies to the EU28 and might not require further guidance by the Council, other work is specifically aimed at the Eurozone / Banking Union on the request by some MS.

### 3.2.1. Measures announced for the EU28

83. Before the end of **2016**, the Commission would propose amendments to the legislative framework to ensure the availability of sufficient adequate *bail-inable* liabilities by implementing the Total Loss Absorbing Capacity (**TLAC**) standard and reviewing the minimum requirement of own funds and eligible liabilities (**MREL**), as appropriate and to address possible legal uncertainty. In this regard, it has been noted that the EBA is due to deliver an interim report in July and a final report on MREL implementation by 31 October.
84. Before the **end of 2016**, the Commission may propose amendments to the CRR/CRD-IV as part of an overall review exercise, allowing the following issues to be addressed:
  - a) Harmonising or further specifying **ONDs** that have been **granted to MS** where relevant for the functioning of the Banking Union and the integrity of the Single Market where appropriate. In view of some MS, this work could also contribute to the objective of improving **liquidity and capital flows** within cross-border banking groups while respecting financial stability concerns. To this effect, specific CRR/CRD-IV provisions may be addressed that currently restrict the circulation of capital throughout Member States, e.g. potential legal obstacles to the free movement of funds between institutions within a single liquidity sub-group.

b) Implementing and finalising the **Basel reforms** which have been completed or are expected to be completed by the end of 2016<sup>9</sup> and would need to be implemented before 1 January 2018, including, for example:

- o the introduction of a **leverage ratio** (in this regard, some MS have invited the Commission to set the leverage ratio higher than 3% for systemic banks) and
- o the introduction of the **net stable funding ratio** (NSFR). The standards have already been published by the Basel Committee in October 2014, apart from the treatment of derivatives.

85. Before the **end 2016**, a legislative proposal for minimum harmonisation in the field of **insolvency law** in the context of the Capital Markets Union (CMU), with the main objective of saving businesses in formal or out-of-court restructuring, while also increasing the effectiveness of insolvency procedures (e.g. higher recovery rates), touching upon formal insolvency law where appropriate.

86. In **2018** the Commission would review the BRRD and SRM (end 2018). As for the appropriateness of **governance arrangements of the SRM**, the Commission would assess if there is a need that the functions allocated by the SRM Regulation to the Board, to the Council and to the Commission, will be exercised exclusively by an **independent Union institution** and, if so, whether any changes of the relevant provisions are necessary including at the level of primary law.

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9 As regards measures to ensure the consistency of **risk weighted assets** (RWAs), it should be noted that amendments to the CRR are expected at later stage.

87. In relation to the **SSM**, it should be recalled that recital 85 of the SSM Regulation (EU) 1024/2013 indicates that "the TFEU could be amended to make the ordinary legislative procedure applicable and to eliminate some of the legal constraints it currently place on the design of the SSM (e.g. [...] and go even further in the internal **separation of decision making** on monetary policy and on supervision)". Referring to the SSM Regulation, MS also stated at the Informal Ecofin on 12 April 2013 that they are "ready to work constructively on a proposal for treaty change" and that the ECB regulation should be appropriately adjusted, if necessary, should article 127 paragraph 6 TFEU or other relevant treaty provisions be amended.

### *3.2.2. Measures raised by Member States*

88. Work by the Commission would improve **data availability and quality** with a view to the ambitions of the members of the **Eurogroup** regarding the **reform of national insolvency regimes** in line with common principles and in coherence with parallel work streams led by EU institutions in the framework of the Commission's Action Plan on building a Capital Markets Union. On 22 April, the Eurogroup mandated the EWG to engage with this work as a **matter of priority** and agreed to revert to the matter in **autumn 2016**. To the extent that the work concerns the CMU and non-euro MS, the topic would also need to be discussed at the EU28 level.

89. Following discussions in the AHWP, the Commission has offered to conduct further analysis on a **moratorium tool** and its possible harmonised introduction and application across the Union. Further **preparatory technical work** would be undertaken by the Commission Expert Group on Banking Payments and Insurance (CEGBPI) in the course of **2016**. The aim of the work is to assess whether, where and how the current legal framework could be amended given the strong divergences in the

availability and application (scope, duration, authorities involved, intervention phase etc) of the moratorium tool by MS.

### 3.3. Further measures

90. Building on the measures mentioned above, the AHWP has discussed a number of areas where legislative proposals are not foreseen, but where **further measures** might be **warranted** in the context of the Banking Union as well as the EU28. At the current stage of the discussion in the AHWP, a distinction could be made between (i) measures which could potentially be addressed in the context of a European Deposit Insurance Scheme EDIS, (ii) other measures that need further political guidance.
91. It was noted that discussions in this respect, while particularly relevant to the Banking Union, should take place at the level of EU28 to ensure that the Banking Union remains open to all Member State with a view to ensuring consistency with the Single Market.

#### *3.3.1. Potentially to be addressed in the framework of a EDIS*

92. The framework of a European Deposit Insurance Scheme would allow for specifying a number of **options and discretions** for the Banking Union under the Deposit Guarantee Scheme Directive (DGSD), notably in order to clarify the relationship between a European Deposit Insurance Scheme and national DGSS as well as to ensure a level playing field and the smooth functioning of a European Deposit Insurance scheme. As the proposed method of specifying ONDs for the purposes of a European Deposit Insurance Scheme does not necessarily prevent the application of ONDs by MS and/or national authorities in a national context, a large number of MS supported the approach in view of ensuring that the right incentives are provided to enhance the level playing field within the Banking Union while ensuring a level playing field within the EU 28 and to prevent moral hazard in the context of a European Deposit Insurance Scheme.

93. Where appropriate, it has been suggested by a few MS that the **supervisory treatment of Less Significant Institutions** could be further specified in relation to a European Deposit Insurance Scheme. Although other MS expressed caution, it was suggested that practices could potentially be strengthened and harmonised by balance sheet assessments for LSIs. In this regard, it has been noted that significant institutions have been subject to a comprehensive assessment conducted by the SSM before the introduction of the first and second pillars, to build up confidence in European banking supervision and reduce risk, thereby facilitating the establishment of the SRF.

94. A few MS indicated that, where deemed necessary, measures, including precise **safeguards** could be further specified to address the possible risk of specific national measures with a significant impact on banks' balance sheets. To this effect, a few MS suggested to amend the SRM Regulation and / or other appropriate legal texts. Several other MS expressed reservations about such an approach without having more clarity about the national measures concerned, their possible risks and the details of the possible safeguards concerned.

### *3.3.2. Further political guidance needed*

95. As regards a **European Deposit Insurance Scheme** and with a view to establishing a fully-fledged Banking Union, several MS indicated that political guidance is warranted on the possible design (including the three phases, re-insurance, co-insurance and full insurance) and timing (and possible conditionality) of the adoption and entry into force of the build-up of such a scheme in relation to the other risk reducing and risk sharing measures to strengthen the Banking Union. In this regard, several MS also asked for political guidance as regards the necessity for and the possible content of an **Intergovernmental Agreement**, although some other MS believe that the discussion of this issue is premature.

96. The last paragraph of the Statement on Banking Union and bridge financing arrangements for the Single Resolution Fund that ECOFIN Ministers issued on 8 December 2015 indicates that "once the SRF enters into force and when participating Member States have ratified the IGA and fully transposed the BRRD, Member States will take stock of the establishment of the bridge financing arrangements and consider the way forward and timing regarding the work on the **common backstop**, to ensure that it will be fully operational at the latest by the end of the transitional period. Member States will also reflect further in 2016 on measures needed to continue deepening the Banking Union". As the remaining condition is expected to be fulfilled by June 2016, MS will then take stock of the establishment of the bridge financing arrangement and political guidance is then warranted on the way forward and timing regarding the work on the common backstop. In this respect, a few MS also underlined that a common backstop to A European Deposit Insurance Scheme is essential to ensure a uniform level of confidence in deposit protection under all circumstances. While these MS indicated that guidance is warranted on the need to ensure that a common backstop would also covers a European Deposit Insurance Scheme, while others indicated strong opposition.

97. The EFC High Level Working Group (HLWG) on the Regulatory Treatment of Sovereign Exposures (RTSE) is currently examining policy options by taking a holistic view to address banks' **sovereign exposure** in Europe. The options should contribute to breaking the link between banks and sovereigns, taking into account potential costs and benefits, the broader impact on financial markets, public debt management, financial stability and the real economy. Based on the preliminary results of the work by the HLWG, several policy options, including issues in relation to transition, were also discussed during the informal Ecofin in April. A wide range of views was expressed on the preferred policy option(s) and the way forward. A large number of MS expressed the view that any potential modification in the EU should go hand-in-hand with the Basel process whose outcomes should therefore be awaited. Several of these MS expressed caution given the possible negative implications of any imprudent review of the existing framework. In this regard, some MS were particularly concerned about the consistency of the single market if changes would be limited to the Banking Union or Euro area only. Other MS pointed to the currency risk inherent in policy options for non Euro Area members, notably in case of options that address concentration risk. Several other MS however stressed the need for strengthening the regulatory treatment of sovereign exposures. Some of these MS underlined the potential need for a specific treatment if necessary, especially if the Basel Committee does not deliver a timely and substantial reform, considering the related financial stability risks and the enhanced level of cross-border spillovers and risk sharing that is in particular inherent to the Banking Union or Euro area and its institutional setup. In this respect, these MS proposed to address credit and concentration risk at the same time. Given the different views expressed and considering that discussions in the Basel Committee are currently still ongoing, political guidance is warranted on the way forward.

98. During the AHWP, it was noted that the issue of **sovereign debt restructuring** is currently not specifically being discussed at international and European level. While a large number of MS considered that further discussion on the topic is unnecessary and potentially harmful, a few MS wanted to obtain further political guidance in this area.

#### **IV. CONCLUSIONS**

99. The Dutch Presidency invites the Council to take note of this Report, with a view to further progressing work under the incoming Slovak Presidency.

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