Subject: EBA Stance on the Risk Reduction Measures Package

Dear Parties to the Trilogue,

The completion of the General Approach by the Council and the Draft Report by the EU Parliament on Risk Reduction Measures marks an important step towards the finalisation of the overall package. In the context of ongoing trilogues between the co-legislators and the EU Commission, I would like to take the opportunity to provide some considerations on the draft revised Capital Requirement Regulation (CRR2), the Capital Requirement Directive (CRD5) and the Bank Recovery and Resolution Directive (BRRD2), including comments on the suggested amendments to the legislative texts as well as comments on the proposed EBA mandates.

It has been the consistent position of the EBA to support a timely adoption of the framework agreed by the Basel Committee for Banking Supervision, whilst carefully assessing the impact on the European banking landscape, and especially on non-internationally active banks that lay outside the direct scope of international standards.

The swift and full implementation of the Fundamental Review of the Trading Book (FRTB) is therefore an essential part of the current package. The EBA is actively contributing – and will continue to do so - to the implementation, as illustrated by our 2017 discussion paper (EBA-DP-2017-04) as well as
through our active involvement at the Basel table where final amendments to the FRTB framework are currently discussed. It remains of utmost importance that banks and supervisors prepare the implementation of the new framework, which represents an improvement to the existing one. I believe that the implementation into EU legislation should move ahead as soon as possible, so that the framework is operational in January 2022, in line with the internationally agreed timeline agreed at the Basel Committee. In this regard, I would highlight that implementing the FRTB only through a reporting framework at this stage would require banks and supervisors to monitor two market risk frameworks simultaneously, one for the Pillar 1 capital requirements and another one just for reporting purposes. Given the significant number of technical issues, one solution that could be considered would be to move ahead already now with the implementation in the Level 1 text, as originally proposed by the Commission, leaving to the EBA in the task to ensure proportionate and technically sound solutions, in line with the final texts to be agreed by the Basel Committee later this year.

Beyond the FRTB, a number of amendments are suggested, which touch upon elements of the Basel III package agreed at the end of 2017. Given that the EBA is currently considering the impact of the Basel III implementation in the EU following a Call for Advice of the Commission, it would be more prudent to await the outcome of this assessment before anticipating some provisions in a selective manner. This relates in particular to changes in the credit risk framework, as it will be important to all the new rules in a coherent manner and with a comprehensive view of their overall impact.

It remains a key European priority to further deepen the Single Market. The progress on the Risk Reduction Measures will help not only to strengthen banks’ resilience but also to address persisting fragmentation in the European banking markets. In that regard, the possible use of cross-border capital waivers (articles 7,8 CRR2) is an important tool to foster enhanced integration, which should go hand in hand with the review of large exposures policies as proposed by the Commission. The exercise of such waiver by the SSM in the banking union would surely be accompanied with the careful balance between interests of home and host authorities. It is clear from a prudential perspective that strict and prudent conditions should apply. By the same token, various amendments to the EU Commission’s proposals risk crystallising, or even increasing, current fragmentation. This relates in particular to the combination of possible provisions for increased national flexibility for small and non-complex banks as well as for the public and promotional banks or networks and IPSs in the definition part of the CRR2. With the use of flexible definitions and across a list of provisions in the CRR2 - ranging from reporting to leverage, net stable funding ratio (NSFR), and market risk purposes (articles 429 2a new, 5a new, 428f, 277, 277a, 279a, 325 – 325 bq CRR2) -, such room for national discretion to exempt or fall back to national practices could open the door to a tiering of the European banking landscape. We must carefully consider the interplay between flexible definitions, exemptions and/or waivers and avoid that regulatory competition and less conservative approaches emerge again, disrupting the integrity of the single rulebook. In all such cases mandates for the EBA to act as a monitoring agent would be very warranted. Building on some amendments already suggested by one or the other co-legislators, drafting suggestions for such mandates are made in the annex.
Concerning the prudential reporting framework, the EBA has always shown the highest sensitivity to the burden on banks as well as on supervisors. It is unfortunate that proposals are made to reintroduce ample room for national flexibility, even though the intent is to alleviate costs and make the best use of existing data collections is well intentioned. It would be a big loss to roll back the benefits of Common Reporting in the EU. COREP has been a major accomplishment. The EBA stands ready to play a role in monitoring the desired flexibility and validating how identical data collected by other means at national level could justify that some banks (or national subsets of institutions) dis-apply some parts of the single reporting framework defined by COREP.

Moreover, I note that harmonised reporting requirements as part of the single rulebook will become irrelevant as competent authorities may have to make recourse to statistical data collections or ad-hoc requests in order to perform their supervisory duties. These national efforts may increase if reporting frequencies under consideration in the CRR2 are too long. If lower frequencies are chosen as way to reduce reporting burden, the requirements should always specify which data have to be collected ‘at least annually’. Finally, mandates on proportionality should entrust the EBA as the authority accountable to streamline, to update as well as to control flexibility under the harmonised European framework.

With this in mind, the EP’s amendment (article 101a CRR2) tasking the EBA to investigate the features and feasibility of implementation of an integrated, standardised reporting system with central coordination of all data requests to institutions to avoid duplications and facilitate the exchange of information between competent authorities is a very promising contribution that I would strongly support. Such coordination hub role would foster coherence and convergence of all reporting requirements in the prudential and resolution areas. Regarding the scope of the integrated framework, there would be immediate benefit to start with prudential and resolution data. In the long-term, a feasibility study together with the relevant statistical authorities should map the further development and the inclusion of statistical data. In line with some amendments suggested by co-legislators drafting suggestions for EBA tasks are included in the annex.

When it comes to Own Funds, the current regulatory framework for Own Funds has definitely proven to be an effective regime and no fundamental change should be made to the substance of this framework. I support the clarifications brought to the list of all the forms of capital instruments that qualify as CET1 instruments (article 26 CRR2) in line with our Opinion on Own Funds in the context of the CRR review (EBA-OP-2017-07). In the same vein, I welcome the introduction of an anti-circumvention principle as recommended in the EBA Opinion, as this would further reinforce the existing framework.

In the CRR currently in force, the principle that substance should prevail over form has been clearly established. Hence I note that changes to the current eligibility criteria for CET1 instruments (articles 28,29 CRR2) should be avoided. The same applies to the current regime for deductions from CET1 items (article 36 CRR2) and deductions where consolidation and supplementary supervision are applied (article 49(1)CRR2). This would definitely be detrimental to the recent strengthening of the definition of capital and to its convergent application by all supervisory authorities in the EU.
To avoid a weakening in the capital position of our banks, there remains the need to keep stringent provisions on specific treatments: prudential filters on unrealised gains measured at fair value should be reintroduced as such components may disappear quickly from own funds and introduce undue volatility as a result of market fluctuations (EBA/Op/2013/03). Software treatment should not be hastily changed given that deduction as presently applied still reflects the likely absence of value of software in resolution and even more in liquidation. Such treatment should not be lifted without an in depth analysis, also to assess if and to which extent the situation has changed due to the digital revolution. Finally, I would be very concerned if the current treatment of insurance participations (article 49(1) CRR2), which is already laxer than under international standards, would be relaxed further.

Liquidity is a recent, but major, enhancement of the prudential framework, which takes into account the lessons learned from the financial crisis. Given the novelty of the framework, flexibility has been embedded in the rules so as to learn about the implementation on the ground. However, any extension of the list of interdependent assets and liabilities (article 428f CRR2) in the NSFR would be detrimental to the soundness of the system and raise significant level playing field issues. Prior consultation of the EBA by competent authorities and a monitoring mandate for the EBA would be considered extremely useful. The annex contains drafting suggestions building on current amendments.

In relation to TLAC and MREL, the clarity and predictability of the text is of paramount importance. We observe that many interpretative issues arise, especially when it comes to the amount and quality of MREL and TLAC required from institutions as well as subordination requirements. Clearer deadlines, amounts and subordination requirements, within and across banking groups should be set to ensure a robust application of the framework and address level playing field issues, which are already material as the EBA monitoring on MREL decisions recently showed. BRRD2 mandates for standards on reporting and disclosure should be aligned with similar provisions in the CRR2 to reduce compliance costs for banks, support transparency in policy choices and facilitate a good external monitoring. Drafting suggestions for improving the EBA mandates on MREL are made in the annex.

Finally, we have noted and appreciated that a significant number of mandates are given to the EBA, which will ensure greater clarity and harmonisation in the Risk Reduction Measures framework. We would however kindly ask co-legislators to consider being on the cautious side regarding two aspects in particular. In order to match ambitions and outcomes regarding the new Ethical, Social and Green (ESG) Factors we suggest concentrating the report in a first step on the evaluation of the technical criteria of ESG factors for the SREP only. In that report, the EBA could furthermore advise banks to develop tools in this area. Moreover, this mandate may be linked to article 88 (1) CRD5 and the assessment of conflicts of interest. Specific suggestions are presented in the annex accordingly. In general, a period of not less than 12 months should be considered to complete an assigned mandate in order to provide high quality work, especially noting that full consultations with stakeholders will be needed. Furthermore, we stand ready to have a dedicated discussion, where EBA can provide more detailed technical considerations on the content and timeline of specific mandates during the finalisation of the package.
We are looking forward to further support the co-legislators’ needs in view of the adoption of the legislation and to provide technical details which were not included in this letter.

Yours sincerely,

[Signature]

Andrea Enria

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Encl: Annex – EBA Stance on the Risk Reduction Measures Package