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## Introduction by Director General

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This year, the Commission still continues its work on several initiatives being a direct or indirect response to the financial crisis, such as new capital requirements, crisis management, deposit guarantee schemes, financial conglomerates, credit rating agencies, etc. Most of them were or will be discussed during the EBC meetings this year.

As regards the implementation of international agreements within the G20, notably the Basel III framework (see: previous issue of the Info-letter), a major step in this direction was made in July 2011 when the Commission adopted the CRD IV legislative proposal. The proposal consists of a Directive and also of a Regulation, and this is because the financial crisis highlighted the danger of divergent national rules, and moreover, the EU Single Market needs a single rule book. The overarching goal of the Commission proposal is to strengthen the resilience of the EU banking sector whilst ensuring that banks continue to finance economic activity and growth.

On the day of adoption of the CRD IV, Commissioner Barnier said: "*The initiative is the outcome of a long consultation and preparatory process. It translates the firm will of the Commission to learn from the crisis and fully implement the decisions taken by the G20. This proposal will have a decisive impact on bank activities and behaviour (...)*". In this context, it should be noted that the new rules will be applicable to more than 8000 banks operating in Europe, and amounting for more than half (53%) of global assets. It should also be emphasized that the EU is the first jurisdiction in the world that published a Basel III-based legislative proposal.

During the financial crisis, a number of governments had to take emergency actions to stabilise banks, thus avoiding their failures and preventing serious financial meltdown. However, governments acted under their own national laws since no EU framework for managing banking crises existed at EU level. It became obvious during the crisis that the lack of an EU regime hampers the ability of governments to deal with problems in cross-border banks. Therefore, putting in place a new crisis management / bank resolution framework will be a key issue in the coming months and in the coming years.

Nadia Calviño, Deputy Director General, DG MARKT



## Capital Requirements Directive and Regulation

Following various consultations last year, the Commission conducted its last [public consultation](#) in February-March 2011 (on counterparty credit risk) before the adoption of the legislative proposal. Moreover, there were two meetings of the **CRD Working Group** – on 15 February and 22-23 March 2011. Between January and April 2011, there were also several meetings of the working sub-groups of the CRD Working Group on liquidity, capital definition, leverage ratio, counterparty risk and capital buffers. All those meetings helped to finalise the proposal.

On 20 July 2011, the Commission adopted a [legislative proposal](#) (so-called **CRD IV**) in order to strengthen the regulation of the banking sector. The proposal, which is to replace the current Capital Requirements Directives (2006/48/EC and 2006/49/EC), contains two legal instruments which form a **package** and should be considered together:

- **Directive** – governing the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms;
- **Regulation** – detailing the prudential requirements for credit institutions and investment firms.

The proposal is accompanied by an [impact assessment](#) which demonstrates that this reform will significantly reduce the probability of a systemic banking crisis in the future.

The [Regulation](#) covers the following areas: (i) **capital** – to increase the minimum amount of own funds required to be held by banks as well as the quality of those funds, and to harmonise deductions from own funds; (ii) **liquidity** – to improve short-term resilience of the liquidity risk profile of financial institutions (the exact composition and calibration of the proposed Liquidity Coverage Ratio will be determined after an observation and review period in 2015); (iii) **leverage ratio** – to limit an excessive build-up of leverage on credit institutions' and investment firms' balance sheets (the ratio is to be subject to supervisory review; implications of a leverage ratio will be closely monitored prior to its possible move to a binding requirement in 2018); (iv) **counterparty credit risk** – to encourage banks to clear OTC (over-the-counter) derivatives on central counterparties. The Regulation is directly applicable without the need for national transposition and thus it sets a **single rule book**, i.e. a single set of prudential rules to be applied within the EU Single Market.

The new [Directive](#) covers some areas of the current CRD and also includes the following new elements: (i) **capital buffers** – introducing two capital buffers on top of the minimum capital requirements, i.e. a capital conservation buffer (identical for all banks in the EU) and a countercyclical capital buffer (to be determined at national level); (ii) **sanctions** – to ensure that all supervisors can apply truly dissuasive, effective and proportionate sanctions; (iii) **enhanced supervision** – to reinforce the supervisory regime to require the annual preparation of a supervisory programme for each supervised institution based on a risk assessment, more systematic use of on-site supervisory examinations, more intrusive and forward-looking supervisory assessments, etc; (iv) **enhanced governance** – to strengthen the requirements on corporate governance and introduce new rules aimed at increasing the effectiveness of risk oversight by boards, ensuring effective monitoring by supervisors of risk governance, etc.

Finally, the proposal is aimed at reducing, to the extent possible, **reliance by credit institutions on external credit ratings** (see also: section on Credit Rating Agencies).

The Commission proposal follows the timelines agreed in the Basel Committee: entry into force of the new legislation on **1 January 2013**, and full implementation on **1 January 2019**. This proposal will now be negotiated in the Council and in the European Parliament.



## Crisis Management / Bank Resolution

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Following the Commission communication of 20 October 2010 on "An EU framework for Crisis Management in the Financial sector" (see: previous issue of the Info-letter), the Commission launched on 6 January 2011 a [public consultation](#) on technical details of a possible EU crisis management framework. A broad range of issues was considered in the [consultation paper](#) – from prevention and early intervention to bank resolution measures and financing arrangements. The consultation was open until 3 March 2011. The Commission received 140 responses from a variety of stakeholders – most of them from industry stakeholders (banks, federations, other financial industry) and national public authorities (from EU and EEA Member States), and also from EU/international organisations (EBA, ECB, IMF), non-financial industry, law firms, academia and private individuals. The [results of the consultation](#) and the [list of answers](#) were published at the Commission's website on 5 May 2011.

In the context of the preparation of a legislative proposal for bank resolution, the Commission will organise two expert meetings of the **Early Intervention Working Group (EIWG)** – on 20 and 27 September. The purpose of the meetings will be, on the one hand, to discuss the technical details of the most complex areas and, on the other hand, to receive input from Member States before policy choices are made on the most sensitive political issues.

The Commission will adopt a **legislative proposal** (accompanied by a detailed **impact assessment**) before the end of 2011.

## Deposit Guarantee Schemes

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In 2011, the negotiations on the DGS proposal were continued by the Hungarian Presidency. There were five meetings of the Council working group on DGS from January until May 2011. Finally, at the COREPER meeting on 17 June 2011, Member States reached a [general approach](#) on the DGS proposal. The Council compromise text includes some major changes on DGS financing compared to the Commission proposal, notably on the target level for ex-ante funds of DGS (0.5% of covered deposits to be reached by 2027 while the Commission proposed 1.5% of eligible deposits to be reached by 2020). Moreover, the Council text stipulates a broader use of DGS funds for bank resolution and early intervention measures, deletes all provisions on mutual borrowing among DGS, and leaves risk-based contributions to the discretion of Member States (European Banking Authority is to issue non-binding guidelines only).

As regards the European Parliament, on 28 February 2011, rapporteur Peter Simon presented its [draft report](#) on the Commission proposal on DGS. The draft report, together with [amendments](#) submitted by other MEPs, was discussed in March and April by the EP Committee on Economic and Monetary Affairs (ECON). On 24 May 2011, the Committee adopted the report by a large majority (34 votes for, 5 votes against, 1 abstention). The [final version of the EP report](#) adopted by ECON was published in mid-June. Overall, the EP report is in line with the Commission legislative on several important issues, notably a short payout deadline (one week) and a relatively high target level for ex-ante funds of DGS (1.5% of covered deposits). The main differences are related to the exemption of voluntary schemes from the scope of the Directive and the use of DGS funds for early intervention (bank rescue measures).

The next steps will take place under the Polish Presidency. Two **trialogue** meetings between the Council, EP and Commission have been scheduled for 14 and 20 September 2011.



## Financial Conglomerates

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**FICOD 1** was adopted by COREPER on 17 June 2011 and by the European Parliament on 5 July 2011. It ensures consolidated banking supervision and insurance group supervision at the ultimate parent level, the level where group wide decisions are taken as well as the level where capital for the whole group is attracted from investors and allocated across the business lines. On top of that "quick fix", published by the Commission in August 2010 as a response to the crisis, the Council and Parliament decide in the dialogues to add:

- non-harmonized investment funds managers (hedge funds) in the scope of conglomerate supervision (harmonized asset managers were already in);
- transparency requirements to include the legal and operational group structure in supervisory and annual reports (equally for banking, insurance or conglomerate groups);
- stress tests on financial conglomerates;
- a provision ensuring that equivalent provisions appearing in two or three directives may be applied once;
- an invitation for the Commission to start the second part of the review (FICOD 2), to consider the supervision of mixed financial holding companies in that review, and pay specific attention to systemically relevant financial conglomerates.

The adopted text can be found [here](#); it will be checked by jurilinguists in September 2011.

With reference to **FICOD 2**, as announced at the Commission's Conglomerates Conference on 7 June 2010, the Commission started investigating the follow up to Basel Joint Forum's report on the Differentiated Nature and Scope of Regulation (DNSR). Among other things, the DNSR report recommended including the full spectrum of risks in the supervisory framework, as well as the supervision of so-called 'non-operating holding companies' (NOHC). To support this follow up, in April 2011, the Commission invited the Joint Committee's subcommittee on financial conglomerates with a [Call for Advice](#) to investigate the European specificities of these issues.

Timing of FICOD 2 will follow the Joint Forum's publications of their revised principles following up the DNSR report, as this exercise relates to several globally operating conglomerates. Policy developments should align to recommendations of the relevant G20 bodies as much as possible, expected to be published in 2012.

New developments will be communicated via the [Conglomerates newsletter](#).

## Credit Rating Agencies

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On 11 May 2011, the European Parliament and the Council adopted an amendment to the CRA Regulation – so-called **CRA II** ([Regulation 513/2011](#)) amending Regulation 1060/2009 on credit rating agencies (CRA I). The new regulation entered into force on 1 June 2011 and entrusted the European Securities and Market Authority (**ESMA**) with **direct supervisory powers over all credit rating agencies established in the EU**. Since 1 July 2011 ESMA has been in charge for any new registration applications and for the supervision of all registered CRA.



Developments related to the sovereign debt crisis in the euro area, and some open issues that had not been fully solved in the CRA Regulation, made it necessary to re-examine certain aspects of rating activities. For this purpose, the Commission conducted a [public consultation](#) from 5 November 2010 until 7 January 2011, and received 93 responses. This consultation covered such issues as overreliance on external ratings, sovereign debt ratings, competition in the rating industry, civil liability of CRA, and conflicts of interest due to the "issuers pays" model (see: [summary of the responses](#) to public consultation).

In addition, on 6 July 2011, the Commission organised a [roundtable](#) on credit rating agencies. The purpose of the roundtable was to gather views from various shareholders in order to shape future policy in the field of CRA complementing existing EU regulation. It was attended by approximately 60 participants, representing all relevant stakeholder groups.

In order to reduce the risk of **overreliance of banks on external credit ratings**, a number of measures have been proposed in the CRD IV proposal (see: section on CRD/Regulation). In line with the [FSB principles](#) for reducing reliance on CRA ratings, the Commission proposed that banks' investment decisions should never rely solely and mechanically on ratings. Strengthening banks' internal risk management should reduce the risk of "cliff" effects. In addition, the Commission proposal promotes the use of banks' internal ratings and requires the European Banking Authority to survey to what extent banks rely on external ratings.

Regarding the remaining topics which require some enhancements of the current CRA Regulation the Commission intends to issue a legislative proposal this autumn (**CRA III**).

## Expert Groups

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### Insolvency Law Expert Group

The ILEG, the expert group that assist the Commission in developing an EU crisis management regime in the banking and financial sector, held a meeting on 11 April 2011. During the meeting, the group had its first discussion on a possible harmonised framework of bank insolvency law. This discussion falls in the preparatory work for a Commission report – scheduled for the end of 2011 – that will examine the need for a harmonised special insolvency regime for banks, as well as the need for further measures for the resolution of systemic institutions, other than banks, such as insurances, financial markets infrastructures, central counterparties, etc.

More information on the ILEG (including agendas and minutes of its meetings) is available at: [http://ec.europa.eu/internal\\_market/bank/crisis\\_management/index\\_en.htm#ileg](http://ec.europa.eu/internal_market/bank/crisis_management/index_en.htm#ileg).

### Group of Experts in Banking Issues

The GEBI held two meetings this year – on 14 February and 1 June 2011. During the first one, the Commission updated participants about Basel III / CRD IV. There were also presentations and discussion on the forthcoming Commission proposal on crisis management. During the second meeting, the Commission outlined the main contours of the forthcoming proposal on capital requirements (CRD IV) and explained the rationale for the use of both a Regulation and a Directive (see: section on CRD/Regulation). There were also presentations and discussion on FICOD (see: previous section) and the role of transparency in the financial sector.

More information on the GEBI (including agendas and minutes of its meetings) is available at: [http://ec.europa.eu/internal\\_market/bank/group\\_of\\_experts/index\\_en.htm](http://ec.europa.eu/internal_market/bank/group_of_experts/index_en.htm).