Frequently Asked Questions: Capital requirements (CRR/CRD IV) and resolution framework (BRRD/SRM) amendments

Brussels, 23 November 2016

Why is the Commission proposing this package of banking reforms?

Today's banking reform package aims to complete the reforms that the EU implemented in the wake of the financial crisis, which made the financial system more stable and resilient. These reforms were designed to comply with the standards agreed with international partners at the G20. But more had to be done, and work continued at international level to complete the work, taking into account the lessons learned during the financial crisis.

Today's proposals tackle remaining weaknesses and implement some outstanding elements that are essential to ensure the institutions' resilience, which have only recently been finalised by global standard setters (i.e. the Basel Committee on Banking Supervision (BCBS) and the Financial Stability Board (FSB). This was called for also in the ECOFIN Council in its June conclusions, where the Commission was invited to put forward its proposals to further reduce risks in the financial sector no later than by the end of 2016. Such risk reduction measures will not only further strengthen the resilience of the European banking system and increase market confidence, but will also allow further progress in completing the Banking Union.

At the same time, these objectives need to be achieved in a way that is fully supportive of the EU economy and its continued recovery. Banks are a key source of funding for businesses and households. In order for them to better fulfil this function, the regulatory environment should be made more proportionate, where appropriate, to banks' complexity, size, business profile and specificities.

The Commission has carried out a thorough and holistic assessment of the existing financial services framework in order to ensure recent reforms interact smoothly, both with each other and with new policy initiatives as well as with broader reforms in the financial sector. This broad assessment, which includes a public consultation known as the Call for Evidence, also took into account global standards and their impact on the wider economy. The findings have informed some of the measures proposed in this package.

What has been proposed at international level to tackle the remaining weaknesses of the financial system?

The adoption of the so-called Basel III framework at international level did not mark the end of the post-crisis reform. Work continued on several elements which were left outstanding at the time. For example, while Basel III introduced a requirement to calculate and disclose a leverage ratio (LR), it did not introduce a capital requirement based on that leverage ratio. Such a requirement was introduced later to become applicable in 2018. Similarly, although the Basel Committee had agreed on the necessity of introducing liquidity requirements, the Basel III framework actually did not provide detailed rules for those requirements; those were published later (in December 2014).

Moreover, the Basel Committee carried out a fundamental review of the trading book (FRTB) framework to address the flaws of the existing rules unveiled by the financial crisis. Similarly, new standards were adopted with regard to the calculation of capital requirements for the counterparty credit risk, for exposures to qualifying central counterparties (CCPs) and for exposures in the form of equity investments in funds.

To address the “too-big-to-fail” issue, in November 2015 the G20 endorsed the Financial Stability Boards (FSB) Total Loss-Absorbing Capacity (TLAC) standard for global systemically important banks (or 'G-SIBs'). This recommended standard ensures that, if these big banks fail, they will have sufficient funds available for authorities to implement an orderly resolution that minimises the impact on financial stability, ensures that core activities can be maintained and avoids exposing public funds to loss.

The implementation of the TLAC standard into EU law will further strengthen the European resolution framework (comprised of the BRRD and the SRMR) and the ability of relevant authorities to achieve resolution outcomes that are effective in safeguarding financial stability and public funds. In order to maintain coherence between rules applicable to large and smaller banks, the TLAC rule is integrated into the Minimum Requirement for own funds and Eligible Liabilities (MREL), which has already been applied to all EU banks as of 2016.

This Memo provides further detail on all the aforementioned points.

Do standards currently discussed in the Basel committee form part of this proposal?

Today's package includes the elements of the regulatory framework that have already been agreed at international level. Some of the most complex changes to the Basel III framework, most notably those on credit and operational risk, are still being discussed by the Basel Committee and are not included in this year's proposal.

The Commission is participating in the ongoing of the Basel Committee discussions and is fully committed to working on agreed international principles, as today's package demonstrates.

2. BANKING REFORM PACKAGE

Do the new EU rules implement global standards faithfully?

The EU has actively contributed to developing global standards in different fora, including the Basel Committee on Banking Supervision (BCBS), always trying to make sure that major specificities and issues of the EU financial markets are properly reflected in the standards. The rules proposed today by the Commission fully respect the balance and level of ambition of the global standards. However, the Commission proposes targeted adjustments to the calibration of some of the new Basel standards, (i.e. the leverage ratio (LR), the net stable funding ratio (NSFR), the market risk rules), to better factor in the specificities of EU institutions and the EU economy. These adjustments are limited in scope or are temporary.

The aim of those adjustments is to support greater lending to the economy and mitigate potential disincentives related to the efficient functioning of capital markets. This is necessary because, in addition to their fundamental role of providing finance to the economy, credit institutions are also important actors on capital markets, either as issuers of financial instruments or as investors in securities and other financial instruments (e.g. covered bonds, securitisations). They also play an important role in facilitating the efficient functioning of those markets by providing essential services, such as underwriting or market making.

Finally some of the adjustments aim to prevent any potential unfavourable treatment for some targeted areas (e.g. trade finance) which are particularly important to cross-border trade.

What are you doing to ensure that the EU prudential rules are fit for purpose?

At the EU level, the Commission has already carried out various initiatives to assess whether the existing prudential framework and the upcoming reviews of global standards were the most adequate instruments to ensure that EU institutions would continue to provide the necessary funding to the economy.

First, in the course of 2015 the Commission launched a public consultation on the impact of the CRR and the CRD IV on the financing of the EU economy (with a particular focus on the financing of micro, small and medium-sized enterprises (SMEs) and of infrastructure) and a Call for Evidence (CfE) covering all legislative proposals made after the crisis in the area of financial services.

In addition, the Commission carried out specific analysis on rules relating to remuneration and on the proportionality of the rules contained in the CRD IV package.[1]

All the initiatives mentioned above have provided clear evidence of the need to update and complete the current rules in order to:

- Reduce further the risks in the banking sector and thereby reduce the reliance on State aid and taxpayers' money in case of a crisis, and
- Enhance the ability of institutions to channel adequate funding to the economy.

How will you make prudential requirements more proportionate for smaller institutions?

The proposals include various amendments, as described under each relevant section, to make the overall prudential framework in the CRR/CRD more proportionate to the size and complexity of institutions.

This addresses the feedback received from stakeholders as a result of the Call for Evidence, especially in relation to administrative costs. Stakeholders claimed that costs resulting from complex prudential rules create a competitive disadvantage for smaller institutions that cannot benefit from economies of scale and are unable to allocate more resources to compliance functions, unlike their larger competitors.

A number of provisions (e.g. reporting on large exposures) in the CRD/CRR review proposals will provide for simplified requirements for smaller institutions, thereby reducing the related administrative costs.

In addition, the CRD/CRR review proposal sets out a mandate to the European Banking Authority (EBA) to develop an IT tool to guide banks in identifying rules relevant to their size and business model.

What are the key elements of your proposal?

The Commission is proposing amendments to the following pieces of legislation:

- The Capital Requirements Regulation (CRR) and Directive (CRD) which were adopted in 2013 and which spell out prudential requirements for institutions[2] and rules on governance and supervision of institutions, respectively;
- The Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism Regulation (SRMR) which were adopted in 2014 and which spell out the rules on the recovery and resolution of failing institutions and establish the Single Resolution Mechanism, respectively.

Today's measures implement international standards into EU law, while taking into account European specificities and avoiding undue impact on the financing of the real economy. In particular, the proposals include the following **key elements*:***

- A **binding 3% leverage ratio (LR)** which will prevent institutions from excessively increasing lending when they do not have enough capital;
- A **binding detailed net stable funding ratio (NSFR)** which will require credit institutions and systemic investment firms to finance their long-term activities (assets and off-balance sheet items) with stable sources of funding (liabilities). This will increase banks' resilience to funding constraints;
- A requirement to have more risk-sensitive own funds (i.e. capital requirements) for institutions that trade in securities and derivatives, following Basel's work on the **'fundamental review of the trading book' (FRTB)**;
- The implementation of **new standards on the total loss-absorbing capacity (TLAC)** of global systemically important institutions (G-SIIs), which will strengthen the EU's ability to resolve failing G-SIIs while minimising risks for taxpayers;
- **Making EU rules more proportionate** and to ease burden for smaller and non-complex banks without compromising their stability;
- **Making it easier for banks to lend to SMEs and fund infrastructure** projects and thereby to support investments.

3. CAPITAL and LIQUIDITY REQUIREMENTS

3.1 Leverage Ratio (LR)

What is the leverage ratio and what are you proposing?

Leverage is an inherent part of banking activity: as soon as an entity's assets exceed its capital base it is leveraged. The financial crisis highlighted that credit institutions and investment firms were highly leveraged, i.e. they took on more and more on- and off-balance sheet items with relatively limited additional capital based on risk weights applied to assets. The Commission's goal has never been to eliminate leverage completely, but rather to reduce excessive leverage that can be detrimental to financial stability.

The leverage ratio (LR) is an additional prudential measure to enhance financial stability by determining capital requirements on the basis of non-risk weighted assets so as to prevent the building up of excessive leverage during economic upswings and to act as a backstop to internal model based capital requirements.

It is essentially the amount of regulatory capital of an institution divided by its (gross) total assets. There are some nuances to this essential because the leverage ratio also includes off-balance sheet positions; for derivatives, the value used for the leverage ratio is not the accounting value but a modified "prudential" value.

New provisions are introduced and adjustments are made to several articles in the CRR in order to introduce a binding leverage ratio requirement for all institutions subject to the CRD. The leverage ratio requirement complements the current requirements in the CRD and the CRR to calculate the leverage ratio, to report it to supervisors and, since January 2015, to disclose it publicly.

The leverage ratio requirement is set at 3% of Tier 1 capital and institutions must meet in addition to/in parallel with their risk-based capital requirements. The 3% calibration is in line with the internationally-agreed level. This requirement applies to all credit institutions and investment firms that fall under the scope of the CRR.

What are the proposed adjustments to the leverage ratio?

The adjustments to the leverage ratio exposure measure that were already included in the current [delegated act on the leverage ratio] have been maintained. Since a 3% leverage ratio requirement would constrain certain business models and lines of business more than others, further adjustments are warranted.

Institutions may reduce the leverage ratio exposure measure by the amount of pass-through promotional loans and officially guaranteed export credits. In order not to disincentive client clearing by institutions, institutions are allowed to reduce the exposure measure by the initial margin received from clients for derivatives cleared through qualifying central counterparties. Public development banks may reduce their exposure measure by the amount of lending they provide to finance public sector investments.

The proposed adjustments to the leverage ratio mainly concern public development banks and promotional banks which fall outside the Basel scope of large, international active banks and are therefore in line with the leverage ratio agreed by the Basel Committee.

Does the proposal contain a leverage ratio buffer for G-SIBs?

No. International discussions are ongoing on a possible leverage ratio surcharge for G-SIBs. Once a final international agreement on the leverage ratio buffer will be reached, it should be considered for inclusion in the CRR.

3.2 Net Stable Funding Ratio (NSFR)

What is the NSFR and why do we need to introduce a binding stable funding ratio?

Before the financial crisis, institutions made use of excessive amounts of short-term wholesale funding to finance their long term activities, meaning that extensive long-term assets growth was not accompanied by a similar increase in stable funding sources. When short-term funding became unavailable, institutions were either forced to request emergency liquidity assistance from central banks or engage in 'fire sales' of assets with the ultimate consequence of driving a number of them into insolvency. Some credit institutions also had to be bailed-out by their governments.

Having learnt the lessons from the financial crisis, the Basel Committee therefore decided to introduce a new standard on stable funding as part of liquidity rules. The Basel Committee completed its work and published the NSFR standard in October 2014. In December 2015, the EBA submitted a report to the Commission on whether and how it would be appropriate to ensure that institutions use stable sources of funding and on the impact of such a requirement. It recommends aligning closely the rules of calculation of the EU NSFR with the BCBS' standards but adopting some adjustments to the Basel standards to take specific account of some European specificities.

To ensure banks have stable funding, the CRR already introduces a reporting obligation and a general requirement that long-term assets have to be adequately met with a diversity of stable funding instruments (liabilities) under both normal and stressed conditions. These general requirements together with market discipline mitigates some of the risks related to insufficiently stable funding, but do not prevent institutions from relying on too-high amounts of short-term wholesale funding.

The Commission is now proposing to introduce a harmonised binding requirement for stable funding (Net Stable Funding Ratio or NSFR) at EU level. The NSFR is the ratio of an institution's available stable funding relative to the required stable funding it needs over a one-year horizon. This will ensure that credit institutions and systemic investment firms have a sustainable stable funding structure while preventing excessive maturity mismatches between assets and liabilities and overreliance on short-term wholesale funding.

The amount of available stable funding is calculated by multiplying an institution's liabilities and regulatory capital by appropriate factors that reflect their degree of reliability over one year. The amount of required stable funding is calculated by multiplying an institution's assets and off-balance sheet exposures by appropriate factors that reflect their liquidity characteristics and residual maturities over one year. The NSFR is expressed as a percentage and set at a minimum level of 100%, which indicates that an institution holds sufficient stable funding to meet its funding needs during a one-year period under both normal and stressed conditions.

Is the Commission faithfully implementing the Basel standard on NSFR?

Yes. However, some adjustments recommended by the EBA's NSFR report proved to be necessary in order to ensure that the NSFR does not hinder the financing of the European real economy. They relate mainly to specific treatments for:

i) Pass-through models in general and covered bonds issuance in particular, whose funding risk can be considered as low when assets and liabilities are matched funded;

ii) Trade finance activities, whose short-term transactions are less likely to be rolled-over than other type of loans to non-financial counterparties;

iii) Centralised regulated savings, whose scheme of transfer renders the client deposits (liabilities) and claims on the state-controlled fund (assets) interdependent;

iv) Residential guaranteed loans, whose specific characteristics make them similar to mortgage loans;

v) Credit unions, whose statutory constraints on investment of their excess of liquidity entail a funding risk similar to that of non-financial corporates for the institution receiving the deposits; and

The proposed specific treatments broadly reflect the preferential treatment granted to these activities in the EU LCR compared to the Basel LCR. As the NSFR complements the LCR, these two ratios shall indeed be consistent in their definition and calibration.

Other adjustments to the Basel standard relate to the treatment of derivative transactions, of short-term transactions with financial institutions and of High Quality Liquid Assets (HQLA) in order not to hinder the good functioning of EU capital marketsand to preserve the liquidity of sovereign bond markets. A delegated act is proposed in order to review the treatment of derivative transactions 3 years after the application of the NSFR.

What happens if a credit institution or systemic investment firm does not comply with the NSFR requirement?

If its NSFR falls below the 100% level, the institution shall take the measures laid down in the CRR for a timely restoration to the minimum level. Competent authorities shall assess the reasons for non-compliance with the NSFR requirement before deciding on any potential supervisory measures.

Are there any transitional provisions for the introduction of the detailed binding NSFR at EU level?

The NSFR will apply at a level of 100% to credit institutions and systemic investment firms two years after the date of entry into force of the proposed Regulation. In the meantime, the EBA will develop draft implementing standards to harmonise NSFR reporting requirements and institutions will need to prepare for these new reporting requirements.

3.3 Market Risk – trading book

Which positions are subject to capital requirements for market risk?

Instruments that banks hold for trading, such as shares, bonds, or derivatives, are usually subject to volatility, which has a daily impact on banks' profits and losses. Sudden drops in the value of these instruments may damage the solvency position of banks. This justifies a specific prudential regime for these instruments (the so-called 'trading book'), which is different from that applicable to other instruments, such as loans (the so-called 'banking book').

In addition to trading book positions, banking book positions subject to foreign exchange risk or commodity risk are also subject to market risk capital requirements for the same reason.

Why is the Commission proposing to change the rules for calculating the capital requirements for market risk?

During the financial crisis, the level of capital required against trading book positions proved insufficient to absorb losses when they materialised. This revealed a number of weaknesses in the design of the prudential framework for the trading book, which had to be addressed. A first set of revisions was implemented just after the crisis (the so-called Basel 2.5 / CRD III package), with the aim of tightening up the way in which banks assess the risks connected with their trading book.

Some of the structural weaknesses of the framework however remained unaddressed. In 2009, the Basel Committee on Banking Supervision started working on what is known as the **"Fundamental Review of the Trading Book" (FRTB)** to tackle these remaining problems.

This proposal transposes the conclusions of the FRTB into EU law which addresses the weaknesses of the current market risk capital requirements by:

- Establishing clearer and more easily enforceable rules on the scope of application to prevent regulatory arbitrage (i.e. trying to pick the most favourable capital treatment between the trading book and the banking book);
- Improving risk-capture, making requirements proportionate to reflect more accurately the actual risks to which banks are exposed;
- Strengthening the conditions to use internal models to enhance consistency and risk-weight comparability across banks.

Does the Commission's proposal deviate from the new standards adopted in Basel in January 2016?

The Basel Committee's conclusions on theFRTB to improve the design of the prudential framework for market risks were welcomed by both the supervisory authorities and the banking industry when the standards were developed. For this reason, the Commission adheres to the main objectives of the FRTB with the intention to address the full range of potential risks embedded in banks' trading activities.

However, while the introduction of the FRTB conclusions will generally enhance the calculation of the market risk capital requirements, an implementation without adjustments could have a disproportionate impact on certain segments of the EU financial markets. In particular, it would undermine their capacity to finance the EU economy and limit the ability of end-users, such as corporates, to hedge their risks.

This is why the Commission proposes a number of targeted measures for the implementation of the new Basel standards into EU law:

- Reflecting some EU specificities, such as simple, transparent and standardised (STS) securitisations, covered bonds and the treatment of sovereign exposures to ensure the consistency of our regulatory framework and support the objectives of the Capital Markets Union (CMU);
- Phasing-in the overall level of the requirement, to prevent a disproportionate immediate impact on banks' capital requirements.

Will banks with small and medium-sized trading book portfolios be subject to the new capital requirements for market risk?

The new Basel standards for market risk capital requirements do not entail proportionality in the application. This might raise some concerns for banks with less sophisticated business models and for those with limited trading activities.

Therefore, implementing the FRTB conclusions for all banks as they currently stand could raise proportionality concerns. For banks with small and medium-sized trading books, the benefits of the new rules in terms of risk sensitivity and accuracy appear outweighed by the operational complexity associated with the implementation and maintenance of the new market risk framework.

As a consequence, this proposal sets out a proportionate approach for market risks capital requirements:

- Banks with small trading books (under EUR 50 million and less than 5% of the institution's total assets) can still benefit from a derogation, which allows them to apply the treatment of banking book positions to their trading book.
- Banks with medium-sized activities subject to the market risk capital requirements (under EUR 300 million and less than 10% of the institution's total assets) may use the simplified standardised approach, which corresponds to the existing standardised approach.

When will the revised market risk capital requirements enter into force in the EU?

Banks will have to apply the new rules two years after the entry into force of this proposal. Until then, banks shall still calculate the market risk capital requirements according to the existing rules under the CRR.

From the abovementioned date of application, the new rules will be phased-in for a period of three years during which banks will be allowed to multiply their own fund requirements for market risks by 65%. This multiplier will not apply to the own funds requirements for market risks when banks use the simplified standardised approach to calculate them.

During the phase-in period, the EBA will be mandated to report to the Commission on the appropriateness of the calibration of the new Basel standards for market risk capital requirements and the Commission will decide whether the calibration of these standards in the EU will be fully aligned to it.

3.4 Large exposures

What is the current limit to "large exposures" and what are you proposing?

The so-called "***large exposures***" are the exposures of an institution to a single client or a group of connected clients, representing more than 10% of its eligible capital (therefore "large" compared to an institution's overall capital resources). According to the Capital Requirement Regulation (CRR), a large exposure cannot exceed 25% of the institution' eligible capital (or €150 million, whichever is higher if the client is a credit institution). The purpose of this limit is to protect institutions from significant losses caused by the sudden default of an individual counterparty or a group of connected counterparties.

However, the current capital base (the 'eligible capital') for calculating the limit only captures a small part of the overall large exposures that institutions have. Moreover, it is not sufficiently prudent to contain the possible loss by an institution in case of the sudden failure of a single counterparty or a group of counterparties, and this may endanger the institution's survival.

In line with Basel standards published in 2014, the EU large exposures framework is amended to improve the quality of capital that can be taken into account to calculate the large exposures limit (only Tier 1 capital), to introduce the lower limit of 15% for G-SIBs exposures to other G-SIBs and to imposes the use of the SA-CCR methods for determining exposures to OTC derivative transactions, even for banks that have been authorised to use internal models.

3.5 Pillar 2

What are "Pillar 2" capital add-ons? How will they change?

Pillar 2 capital add-ons refers to the possibility for competent supervisors to impose on institutions to set aside further capital in addition to the so-called Pillar 1 capital requirements (i.e. "minimum" requirements applicable to all banks, laid down in law) and the combined buffers requirement (i.e. the combination of various buffer requirements related to certain risks applicable to all banks or a subset of banks).

The current legislative text has been interpreted differently across Member States, leading to different practices in the imposition of Pillar 2 capital add-ons. To enhance legal certainty and promote a level playing field among institutions, the proposal better clarifies the conditions for the application of Pillar 2 capital add-ons stemming from the CRD.

In doing so, it distinguishes between Pillar 2 capital requirements and guidance:

- The former are mandatory requirements that are imposed by supervisors to address risks not covered or not sufficiently covered by Pillar 1 and buffer capital requirements;
- Capital guidance refers instead to the possibility for competent authorities to communicate to an institution their expectations for such institution to hold capital in excess of Pillar 1 capital requirement, Pillar 2 capital requirements and combined buffers requirements in order to cope with forward looking and remote situations.

What is the situation around "Pillar 2" capital add-ons and macro-prudential issues?

Pillar 2 capital add-ons are institution-specific measures that should be used to address risks to which an institution is exposed. The nature of Pillar 2 capital add-ons is therefore not compatible with the objectives pursued by macro-prudential instruments which are aimed at addressing risks that an institution poses to the financial system. The use of Pillar 2 capital add-ons to address systemic risks may therefore undermine the effectiveness and efficiency of the dedicated tools that have been introduced after the crisis to deal with macro-prudential risks.

For this reason, the proposal provides that Pillar 2 capital add-ons should be confined to a purely micro-prudential perspective. This will avoid overlaps in the use of different capital tools and promote a more consistent application of rules.

3.6 Financial holding companies

What are financial holding companies (FHCs) and what rules are being introduced?

Financial holding companies are undertakings engaging in non-banking financial activities, whose subsidiaries are exclusively or mainly credit institutions, investment firms or financial institutions.

Several adjustments and new provisions were included in the CRD-CRR to bring financial holding companies and mixed financial holding companies directly in the scope of the EU prudential framework and make them responsible for ensuring compliance with requirements on a consolidated level.

Why are you proposing rules regarding intermediate EU parent undertakings?

In order to facilitate the implementation of the internationally agreed standards on internal loss-absorbing capacity for non-EU G-SIIs in EU law and, more broadly, to simplify and strengthen the resolution process of third-country groups with significant activities in the EU, a new requirement is introduced in the CRD for establishing an intermediate EU parent undertaking where two or more institutions established in the EU have the same ultimate parent undertaking in a third country. The intermediate EU parent undertaking can be either a holding company subject to the requirements of the CRR and the CRD, or an institution authorised in the EU".

The requirement will apply only to third-country groups that are identified as non-EU G-SIIs or that have entities on the EU territory with total assets of at least EUR 30 billion (the assets of both subsidiaries and branches of those third-country groups will be taken into account in the calculation).

3.7 Waivers from capital and liquidity

Why is the application of prudential requirements at individual level being made more flexible?

Single Market legislation should create possibilities for institutions to benefit from the potential offered by the economies of scale without posing a threat to financial stability.

Under current legislation, it is possible only to waive the application of prudential requirements at individual level for subsidiaries within the same Member State that are overseen on a consolidated basis by the same supervisor (except for liquidity requirements where subsidiaries authorised in several Member States can be waived under additional conditions).

With the establishment of the Single Supervisory Mechanism (SSM), group supervision has been substantially reinforced especially where group entities are situated in Member States participating in the SSM. That is why the Commission considers it opportune to take a step forward by allowing cross-border banking groups to benefit more from the Single Market potential, subject to clear safeguards for "host" Member States.

Therefore, where the same competent authority supervises parents and subsidiaries established in different Member States participating in the Banking Union, it should be able to waive the application of own funds and liquidity requirements. This waiver could be applied only where the parent guarantees to support the cross border subsidiaries for the full amount of the waived requirement and where that guarantee is collateralised for at least half of the guaranteed amount, with collateral governed by the law of the host Member State.

The same waivers are made available, as an option, for competent authorities of Member States outside the Banking Union.

3.8 Exempted Entities

What changes are being introduced with regard to entities exempted from CRD/CRR?

Currently the CRD contains a list of entities that have historically been exempted from its scope and which the Commission has the power to update. Whilst this list of exclusions will be maintained, it is proposed to replace the current implementing power of the Commission with a better framed delegated power, allowing the Commission to exempt further entities from the CRD only where specific criteria are fulfilled. This would give more legal certainty as regards any future exemptions from EU banking legislation.

The criteria were framed taking into account the features of entities that are currently on the list of entities exempted from CRD/CRR. For individual institutions the proposed criteria will reflect the profile of promotional and development banks without cross-border activities, and will entail a size limit to reflect the scope of direct supervision of significant banks by the SSM. The criteria applicable for categories of banks will also cover credit unions without cross-border activities and limited in size.

Under the proposal, the Commission will assess whether the criteria continue to be fulfilled. Furthermore, should any institutions exempted by the Commission no longer fulfil the specified criteria, the Commission will have the delegated power to decide if such institutions should be brought back into the scope of the CRD/CRR.

What's the objective of these amendments?

Public development banks and credit unions in certain Member States are already exempt from the CRD-CRR regulatory framework. To ensure a level playing field, all Member States should have the possibility to allow such entities to operate only under national regulatory safeguards, proportional to the risks incurred.

To this end, the Commission has committed in its Action Plan on Building a Capital Markets Union (September 2015), to explore the possibility for all Member States to authorise credit unions to operate outside the EU's capital requirements framework for banks.

4. RESOLUTION FRAMEWORK

4.1 The revision of MREL and the implementation of TLAC

What is MREL?

The main policy rationale behind the ***Minimum Requirement for own funds and Eligible Liabilities (MREL)*** is to ensure effective and credible application of the bail-in resolution tool. The EU resolution framework (consisting of BRRD and SRMR) requires banks to comply with MREL at all times by holding easily 'bail-inable' instruments in order to ensure that losses are absorbed and banks are recapitalised once they get into a financial difficulty and are subsequently placed in a resolution.

Under the current rules which became applicable as of 2016, when preparing bank resolution plans, resolution authorities have to fix a bank-specific level of MREL that reflects the foreseen resolution approach, together with an appropriate deadline to achieve it. The bank-specific nature of MREL recognises the diversity of business models and funding strategies among European banks, all of which fall under the broad scope of the resolution framework.

What is the total loss absorbing capacity (TLAC)?

The TLAC standard was specifically designed to deal with the too-big-to-fail problem at the international level and, thus, in a number of respects has been formulated differently from MREL. However, both concepts aim at the same regulatory objective which is to enhance effectiveness of resolution by asking banks to hold sufficient amounts of readily bail-inable liabilities, which is important in order to safeguard financial stability and public funds.

Why does MREL need to be revised?

Article 45 of the BRRD requires the European Banking Authority (EBA) to submit a report to the Commission on the appropriateness of certain modalities of the MREL requirement. Taking into account this assessment, the Commission is mandated, if deemed appropriate, to put forward a legislative proposal by 31 December 2016 on necessary revisions to MREL, including the possibility of introducing a common minimum level of the requirement.

One of the mandatory elements of this review is the need to ensure consistency of MREL with any standards developed in the international fora. To reflect this, the proposal revises a number of features of MREL in light of the commitment at the level of the G-20 to transpose into Union law the Total Loss-Absorbing Capacity (TLAC) standard that should be applied as of 2019.

To prevent unwarranted legal complexity and compliance costs due to a potentially parallel application of these two rules that have the same aim, the Commission proposes to merge them, by incorporating, as appropriate, the TLAC standard into MREL.

While the general BRRD framework remains valid and sound, to maintain coherence between the MREL rules applicable to ***Global Systemically Important Institutions (G-SIIs)*** and to ***other banks***, and taking into consideration the assessment conducted by the EBA, a number of targeted changes to the MREL rule applicable to other banks are proposed as well.

What is the scope of application of the minimum harmonised level (Pillar 1) of MREL?

The Commission proposes to introduce a minimum harmonised MREL requirement (also referred to as a Pillar 1 MREL requirement) applicable to G-SIIs only, in line with the scope of application of the TLAC standard agreed by the G20. As of the date of the adoption of this legislative proposal, 13 banking groups in the EU have been identified as G-SIIs.

The requirement to comply with TLAC will not be extended to non G-SIIs, as, in the EU, all banks already have to comply with the bank-specific MREL provisions stemming from the BRRD. Furthermore, as banks get smaller and less systemically relevant, setting the MREL requirement entirely on the basis of a case-by-case analysis - which is referred to as a Pillar 2 approach - delivers a more appropriate and proportionate outcome due to a proper consideration of specificities of individual banks. Nevertheless, powers to impose bank-specific MREL will allow resolution authorities to ensure a level playing field between G-SIIs and non G-SIIs which pose similar systemic risks.

Can resolution authorities ask that G-SIIs hold instruments eligible for MREL in excess of the Pillar 1 MREL requirement?

Under the current EU resolution framework (BRRD and SRMR), MREL is a bank-specific requirement which is determined on a case-by-case basis by the relevant resolution authority.

It is proposed that, in line with the current approach and with the FSB TLAC standard, resolution authorities should be able, on the basis of bank-specific assessments, to require that G-SIIs comply with a supplementary MREL requirement (i.e. a Pillar 2 add-on requirement). Such a Pillar 2 MREL requirement would have to be strictly linked to the resolvability analysis of a given G-SII and, in particular, its recapitalisation needs and, as with all discretionary requirements, be duly justified, necessary and proportionate.

Banks will be allowed to use certain additional types of highly loss absorbent liabilities to comply with their Pillar 2 MREL requirement as long as a bail-in of such liabilities in resolution would not result in a treatment of creditors that is worse in comparison to their treatment under insolvency.

What will be the consequence of breaching MREL when it comes to restricting discretionary payments?

In order to ensure compliance with MREL requirements, and in line with the FSB standard on TLAC, the proposal requires that in case a bank does not have sufficient amount of eligible liabilities to comply with its MREL, the resultant shortfall is automatically filled up with CET1 that, until to that moment, was counted towards meeting the combined capital buffer requirement. In turn, this may lead to a breach of the combined capital buffer requirement, triggering a limit (in order to conserve capital) of discretionary payments to the holders of regulatory capital instruments and employees.

Breaches of the combined buffer (while still complying with its Pillar 1 and Pillar 2 capital requirements) may be due to a temporary inability to issue new eligible debt for MREL. For these situations, the proposal envisages a six month grace period before restrictions to discretionary payments to the holders of regulatory capital instruments and employees kick in. During the grace period, authorities will be able to exercise other powers available to them that are appropriate in view of the financial situation in a bank.

What is the purpose of MREL guidance?

MREL is set at the amount necessary to (i) absorb losses (on the basis of Pillar 1 and Pillar 2 capital requirements as determined by the competent authorities) and (ii) To recapitalise the bank, so that following resolution, it complies with the continuing authorisation requirements in accordance with the CRD IV.

In addition, resolution authorities may set MREL guidance going beyond these requirements. MREL guidance may be set to cover capital guidance that has already been set by the bank's supervisor or to ensure market confidence in the resolved entity. However, in such cases it would be excessive to sanction breaches of MREL guidance with automatic limits on discretionary payments (see previous question).

How is MREL determined for entities belonging to a banking group?

In line with the approach underlying the TLAC standard, the proposal deals with entities belonging to a banking group in two different ways, depending on the resolution strategy:

- **An external MREL** requirement is applicable to resolution entities (entity to which according to the resolution strategy, resolution tools, including bail-in of instruments held by external creditors, will be applied), and
- **An internal MREL** requirement is applicable to subsidiaries which are not resolution entities and allows to upstream their losses to resolution entities without the need to place such subsidiaries in resolution.

In compliance with the TLAC term sheet, external Pillar 1 MREL (as of 2022 equivalent to the greater between 18% of risk weighted assets and 6.75% of the leverage ratio exposure measure) would be applicable to resolution entities that are part of EU G-SIIs.

Does the package change the conditions under which waivers from the MREL requirement for subsidiaries within banking groups can be applied?

The proposal foresees that in cases where the resolution entity and its subsidiary are established in two different Member States, subject to an agreement between the relevant resolution authorities, the subsidiary may be allowed to comply with its internal MREL requirement by a guarantee issued by the resolution entity to the subsidiary, instead of issuing intra-group liabilities that meet internal MREL eligibility criteria to the resolution entity.

This would be possible only subject to a number of important safeguards that aim at providing necessary degree of confidence to the resolution authority of the subsidiary. In case the subsidiary gets into financial difficulty, in accordance with the planned resolution strategy, the resolution entity will absorb the losses and extend additional resources to recapitalise it, without the need to place the subsidiary in a resolution.

How does the package address the need for proportionality of rules?

MREL is a Pillar 2 type requirement that is determined on the basis of a case-by-case analysis. Resolution authorities' decisions on its level or the extent to which it is to be met with subordinated liabilities must be well justified. The aim is to ensure that rules do not produce effects that are disproportionate from the point of view of the bank.

G-SIIs are expected to comply with the eligibility criterion of subordination to a large extent when complying with the minimum harmonised level (Pillar 1) of MREL. As regards the Pillar 2 MREL requirement, compliance with this criterion should only be required in cases where resolution authorities carry out an analysis showing that issuance of subordinated liabilities is necessary to prevent creditor claims that they have been treated worse under resolution than under a hypothetical insolvency (i.e. a potential breach of the "no creditor worse off" safeguard). This reflects that under the EU resolution framework senior debt can be bailed in as long as the bailed in creditors are not treated worse that in insolvency.

The package addresses the need for proportionality of bail-in related rules also by revising **Article 55 of the BRRD** under which banks have to include in contracts that are governed by the law of a third country a clause by which the creditor recognises the bail-in power of the EU resolution authorities. This obligation is important to make bail-in operational for such contracts. However, it applies to all contracts not legally excluded from bail-in, even if there is no practical possibility that these contracts will be affected by bail-in. This obligation has turned out to be particularly difficult to comply with in respect of business conducted by branches of EU banks in third countries, as contracts concluded by them are usually governed by the law of those third countries. The combined effect of these difficulties and the wide scope of liabilities to which Article 55 applies is that banks would either have to adopt structural measures, such as converting their branches in third countries into subsidiaries, or, in some cases, completely discontinue certain business activities in third countries.

To address this, the package proposes to amend the rule so that it could be applied by resolution authorities in a proportionate manner. It is foreseen to allow resolution authorities, for liabilities not counting towards MREL, to grant a waiver from compliance with the rule for certain types of liabilities where authorities determine that it is legally, contractually or economically impracticable for banks to include the bail-in recognition clause and that such waiver would not impede the resolvability of the bank. However, it remains at the full discretion of the resolution authority whether it actually grants such a waiver.

What is proposed regarding third country subsidiaries?

In order to enhance the effectiveness of the resolution process of third-country groups with significant activities in the EU, a new provision is included in the CRD requiring the establishment of an intermediate EU parent undertaking where two or more institutions established in the EU have the same ultimate parent undertaking in a third country. The intermediate EU parent undertaking can be either a holding company subject to the requirements of the CRR and the CRD, or an EU institution.

The requirement will apply only to third-country groups that are identified as non-EU G-SIIs or that have entities on the EU territory with total EU assets of at least EUR 30 billion (including the assets of branches although branches are not included in the scope of the intermediate EU parent undertaking).

4.2 Review of BRRD – creditors' hierarchy and moratorium powers

Why is it necessary to harmonise the priority ranking of unsecured debt instruments under national insolvency proceedings?

The internationally agreed TLAC standard requires G-SIBs to issue subordinated liabilities and regulatory capital instruments. These should absorb losses in resolution prior to other liabilities that are explicitly excluded from TLAC eligibility, such as derivatives, covered deposits or tax liabilities. In addition, for other banks, as explained above, resolution authorities may decide on a case-by-case basis that their MREL requirement should be met with subordinated instruments.

Following the adoption of the TLAC standard by the G20, in order to facilitate a more efficient path towards compliance with TLAC, a number of EU Member States have amended (or are in the process of amending) the ranking of creditor claims under their national insolvency law creating significant divergences.

Such discrepancies have the potential to amplify uncertainty for debt issuers, investors and resolution authorities and to make the application of the bail-in tool in cross-border resolution cases legally more complex and less transparent. At the same time, the buy-side would experience information asymmetry among different EU jurisdictions, rendering the process of pricing the risk more cumbersome. The resulting uncertainty could also trigger competitive distortions because unsecured debt holders could be treated differently in different Member States and the MREL compliance costs for banks may be different according to the location of the issuance.

In response to the above, the proposals include an EU harmonised approach on bank creditors' insolvency ranking that would enable banks to issue debt in a new statutory category of unsecured debt available in all EU Member States which would rank just below the most senior debt and other senior liabilities for the purposes of resolution, while still being part of the senior unsecured debt category (only as an un-preferred tier senior debt). Clear, harmonised rules on the position of bond holders in the bank creditors' hierarchy in insolvency and resolution could facilitate the way bail-in is applied, by providing greater legal certainty and reducing the risk of legal challenges.

The EU harmonised approach will not affect the existing stock of bank debt and will apply going forward to any new issuance of bank debt in the concerned category following the date of application of this amendment as provided in the proposal.

Does the package include other changes as regards the powers of authorities in relation to bank obligations to their creditors?

In order to make the EU resolution framework more operational, competent and resolution authorities must be equipped with appropriate powers to reduce uncertainty around the financial condition of banks in the run up to resolution, as well as during the resolution process. For these purposes, and in line with the ECOFIN roadmap on completing banking union of June 2016, the legislative package includes a clearly framed and regulated moratorium tool allowing for the suspension of certain contractual obligations for a short period of time in resolution as well as in the early intervention phase.

This is necessary because creditors of a bank which is close to entering resolution may decide to withdraw their credit positions, which may trigger a chain reaction, potentially putting in difficulty the orderly resolution process of the bank. Imposing a stay on the outflow of resources for a short period of time would facilitate the valuation of assets and liabilities and the prompt execution of any foreseen bail-in or other resolution strategies.

However, deposits covered by the Deposit Guarantee Schemes (DGS) are excluded from the harmonised EU moratorium tool because freezing the pay-out to covered depositors would conflict with the principles of DGS and may have a negative impact on market confidence.

What exactly is the date from which the new rules will apply?

The new rules will apply to all new debt issued after the date of application of the Directive. We propose that the Directive be applied as of 1 July 2017, but this will ultimately depend on the procedure and the outcome of the discussions in the European Parliament and the Council.

Debt issued before that date will be governed by the national laws of Member States as they were adopted on 31 December 2016. This includes national laws which are adopted by that date but enter into force or apply only at a later date.

5. PROPORTIONALITY

5.1 Reporting

What is the current European system of supervisory reporting?

The current CRR provides a legal basis for the single rulebook on supervisory reporting by banks to their competent authorities. The EBA has developed Implementing Technical Standards (ITS) with uniform reporting requirements, data definitions, reporting frequencies and remittance dates which have been adopted by the Commission as an implementing regulation with maximum harmonisation.

Supervisory reporting includes information about institutions' solvency (own funds and capital requirements), the overall financial situation, leverage, large exposures and liquidity.

What are you proposing on reporting?

Several provisions are being added to or amended in the CRR and the CRD to enhance proportionality and reduce costs on institutions in the overall regulatory reporting framework.

Under the CRR the EBA will be mandated to submit a report to the Commission on the costs of regulatory reporting. The mandate sets out a very precise methodology for the EBA to quantify reporting costs on institutions and provides for an obligation to make recommendations on ways to simplify reporting for small institutions through amendments of existing EBA reporting templates. Small institutions (as defined in new Article 430a) will be required to submit regulatory capital reports less frequently than it is the case now. Reporting on large exposures will be simplified by removing the reporting item on the expected run-off of the exposure and by better specifying, through secondary legislation, reporting obligations concerning shadow banking entities.

The CRD will be amended to set out the precise grounds on which competent authorities will be entitled to require additional reporting from institutions

Who will be the beneficiaries of the new rules on reporting?

These provisions are intended to address the concerns raised by stakeholders during consultations such as the Call for Evidence related to administrative burden on institutions, in particular small institutions, resulting from reporting and other requirements. The proposed reduced reporting frequency will benefit smaller institutions from the date the proposal comes into force. The EBA's mandate should lead to a reduced volume of reporting for smaller institutions at a later date.

5.2 Disclosure

How will the disclosure regime be improved?

The current disclosure requirements in the CRR apply at consolidated (group) level with some individual disclosure requirements for parents or subsidiaries that are significant in terms of relevance for their local market.

The disclosure requirements in the CRR will be amended with a threefold purpose:

(i) Make the requirements more proportionate to the size and complexity of institutions, with smaller institutions becoming subject to both less extensive and frequent disclosures;

(ii) Align the disclosure requirements more closely with international standards on disclosure and, where necessary, add new requirements or amend existing ones to reflect new or amended Pillar 1 requirements on TLAC, counterparty credit risk, market risk and liquidity;

(iii) Empower the EBA to develop uniform disclosure formats and the Commission to amend disclosure requirements in the CRR as it may be needed to reflect developments or amendments of international standards on disclosure.

As with regulatory reporting,distinctive disclosure requirements are intended to make these provisions more proportionate overall. Smaller institutions, in particular those with no listed securities, will be subject to a significantly reduced administrative burden. The purpose of the remaining amendments is to deliver a disclosure framework more consistent with international standards (Basel 'Pillar 3') to facilitate comparability across jurisdictions.

5.3 Remuneration

What changes are made to the rules regarding remuneration?

The recent review of the remuneration rules carried out by the Commission showed that the existing rules are generally effective in curbing excessive risk-taking behaviour and short-termism. The review however also showed that the rules should be made more proportionate on the following two points:

Firstly, some of the rules, namely the requirements to pay out part of the variable remuneration in instruments and to defer the payment over time, are not workable for the smallest and least complex institutions and for staff with low variable remuneration (as opposed to fixed remuneration). Also, the definition of proportionality reflected in Article 92(2) of the CRD has been interpreted in different ways, leading to an uneven implementation of the rules in the Member States.

The Commission therefore proposes a targeted amendment to cater for problems that emerged in the application of the rules on deferral and pay-out in instruments. This amendment consists in exempting small and non-complex institutions and staff receiving low variable remuneration from these rules. The amendment is expected to harmonise the implementation of the rules in the Member States, while leaving competent authorities some flexibility to adopt a stricter approach if deemed necessary.

Secondly, the review showed that there are impediments for listed institutions to repeatedly use shares for the purpose of paying out variable remuneration as required under the current rules. Share-linked instruments (often referred to as "phantom shares") were found to be as effective as shares in terms of aligning the interest of staff members with those of shareholders and with the long term interest of the institution, provided that they closely track the value of shares.

The Commission therefore proposes another targeted amendment to the remuneration rules, aimed at allowing listed institutions to use share-linked instruments for meeting the CRD requirements.

5.4 SMEs and Infrastructure

What changes does the Commission propose for bank exposures to SMEs?

The Commission appreciates the important role played by small and medium-sized enterprises (SMEs) in contributing to economic growth and job creation in the EU and has always been committed to identifying the most appropriate policies and tools to address their funding needs. In this spirit, the Commission supported the introduction of the so-called "SME supporting factor" in the Capital Requirements Regulation (CRR).

Today's decision proposes to maintain such deviation to the capital requirements for exposures to SMEs (Article 501), while also extending its scope with no upper limit.

In details, the current capital reduction of 23.81% for an exposure to an SME, if it does not exceed EUR 1.5 million, is maintained. In relation to an SME exposure exceeding EUR 1.5 million, 23.81% capital reduction for the first EUR 1.5 million portion of the exposure and a 15% reduction for the remaining part of the exposure above the threshold of EUR 1.5 million is now proposed.

The Commission has considered the risks posed by SME loans and found that the existing calibration for loans above 1.5 million euros has resulted in too high minimum own funds requirements.

How will the new rules enhance bank lending for infrastructure projects in the EU?

Investments in infrastructure are essential to strengthen Europe's competitiveness and to stimulate job creation. The recovery and future growth of the EU economy depends largely on the availability of financial resources from all economic actors, including the banks, for strategic investments in infrastructure in sectors like broadband and energy networks, transport, education, research and innovation and renewable energy and energy efficiency.

To encourage private investments in infrastructure projects, it is proposed to lay down a more risk-sensitive regulatory environment able to promote high quality infrastructure projects and reduce risks for investors. In particular, similar to what it is foreseen for insurance undertakings, capital charges for exposures to infrastructure projects are reduced, provided those projects comply with a set of criteria capable to lower their risk profile and enhance the predictability of their cash flows.

The Commission will review that provision after 3 years after the entry into force to assess its impact on the volume of infrastructure investments by institutions and its adequacy from a prudential standpoint.

5.5 Further proposals

What is proposed with regard to the implementation of IFRS9?

International Financial Reporting Standard (IFRS) 9 is an important standard for financial services companies and governs the accounting for most assets and liabilities on banks' balance sheets. The G20 called on the IASB to develop a new approach to accounting for losses on lending so as to avoid reporting "too little, too late". The new standard achieves this fundamental change.

IFRS9 has been endorsed in the EU for mandatory application from 1 January 2018 onwards. The most significant impact of the IFRS9 standard on financial instruments which will replace current IAS39 is the change from an incurred credit loss approach to an expected credit loss approach. As the impact on the level of provisions and capital ratios can be significant, a 5 year phasing-in period is proposed to prevent unwarranted sudden impact on capital ratios.

The phasing-in period will also provide time for observing possible pro-cyclicality effects of the revised credit loss approach as well to agree internationally fully harmonised prudential treatment of the expected credit losses under IFRS9 and the revised USGenerally Accepted Accounting Principles

(GAAP) standard on financial instruments which will enter into force in 2020.

6. Key Numbers mentioned in the 2016 Impact Assessment

Process and public consultations:

- The Commission services consulted on the potential impact of the CRR and CRD IV on the financing of the economy, including SME lending and long-term financing, in July 2015. There were 84 responses to the consultation. The majority of responses came from the financial industry. A Public hearing was held on 14 December 2015 to discuss the most important issues raised at the consultation.
- On 30 September 2015, the European Commission launched a public consultation entitled the Call for Evidence: EU regulatory framework for financial services. The purpose of the Call for Evidence was to consult all interested stakeholders on the benefits, unintended effects, consistency, gaps in and coherence of the EU regulatory framework for financial services.
- On 26 May 2016, the Commission launched targeted consultations (see annex 1 of the Impact Assessment to the proposals) on specific issues (NSFR, FRTB, SA-CRR).
- In May 2016, London Economics delivered the study on the impact of CRR on the access to finance for business and long-term investments.

7. Key Figures

Costs related to the financial crisis

Between the years 2008 and 2014 EU governments used almost €2 trillion in State aid (an amount equal to almost 14% of the 2014 EU GDP) to rescue the financial sector.

Costs and benefits of the proposed amendments

Available evidence shows that there are limited costs to be expected from the introduction of the new requirements.

- The estimated long-term impact on gross domestic product (GDP) ranges between --0.03% and -0.06%;
- The increase of funding costs for the banking sector due to new Basel standards such as the leverage ratio and the trading book could amount up to 3 basis points.

On the benefits side, public resources required to support the banking system in case of a financial crisis of the size similar to 2007–2008 would decrease by 32%, a decline from EUR 51 billion to EUR 34 billion.

8. BACKGROUND

What is the Capital Requirements Directive (CRD) and the Capital Requirements Regulation (CRR)?

In the wake of the financial crisis, the EU has, in line with global efforts, overhauled regulation and supervision to restore financial stability and market confidence. Such legislative framework, also known as **CRD IV and CRR**, comprises two legislative instruments, applicable to credit institutions and investment firms:

- The Capital Requirements Directive or Directive 2013/36/EU (hereinafter CRD) governing the access to deposit-taking activities, and
- The Capital Requirements Regulation or Regulation (EU) No 575/2013 (hereinafter CRR) establishing the prudential requirements institutions need to respect.

This package transposes the so-called Basel III accord (i.e. the detailed rules of new global regulatory standards on bank capital adequacy and liquidity) into European legislation. It was adopted by the Commission in 2011 (MEMO/13/ 690) and follows the timelines as agreed in the Basel Committee: entry into force of the new legislation on 1 January 2013, and full implementation on 1 January 2019.

The CRD also includes areas where the degree of prescription is lower and where the links with national administrative laws are particularly important. This concerns in particular the powers and responsibilities of national authorities (e.g. authorisation to commence the activity, supervision, capital buffers and sanctions), the requirements on internal risk management that are intertwined with national company law as well as the corporate governance provisions.

The CRR provides for the detailed and highly prescriptive provisions on calculating capital requirements. The two instruments transpose the so-called Basel III accord (i.e. the detailed rules of new global regulatory standards on bank capital adequacy and liquidity) into European legislation.

What are the Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism Regulation (SRMR)?

The Bank Recovery and Resolution Directive or Directive 2014/59/EU (hereinafter BRRD) establishes the EU framework to manage bank failures in a way that avoids financial instability and minimises costs for taxpayers. Moreover, the Single Resolution Mechanism Regulation (SMRR) sets out specific provisions for Member States participating in the Banking Union when banks need to be resolved.

The BRRD and the SRMR form the **EU resolution framework,** which provides competent authorities with comprehensive and effective arrangements to deal with failing banks, as well as cooperation arrangements to tackle cross-border banking failures.

The key objectives of the EU resolution framework, in line with efforts at international level, are to preserve the continuity of banks' critical functions while avoiding the use of taxpayers' money and adverse effects on the financial system.

According to this framework, banks are required to prepare recovery plans to overcome early financial distress, while resolution authorities are required to prepare resolution plans for banks once there are no alternative private sector measures or supervisory action that would prevent their failure. In order to be able to apply those measures, resolution authorities are equipped with comprehensive powers and tools to restructure banks by selling all or part of their assets and liabilities to third parties, and/or allocating losses to shareholders and creditors following a clearly defined hierarchy through the "bail-in" mechanism.

Precise arrangements are set out for how home and host authorities of banking groups shall cooperate in all stages of cross-border resolution, from resolution planning to resolution itself, with a role for the European Banking Authority (EBA) to coordinate and mediate in case of disagreements.

What is the Single Rulebook?

The CRD IV package together with the Bank Recovery and Resolution Directive (BRRD) form the so-called **Single Rulebook***,* i.e. a single set of harmonised prudential rules that institutions throughout the EU must respect and which ensures uniform application of the EU rules in all Member States.

The Single Rulebook also comprises the BTSs (Binding Technical Standards) which are developed by the European Banking Authority (EBA), adopted by the European Commission and applied directly in all Member States.

KEY TERMS GLOSSARY

BRRD Bank Recovery and Resolution Directive

CCP Central Counterparty

CRD Capital Requirements Directive

CRR Capital Requirements Regulation

EBA European Banking Authority

FRTB Fundamental review of the trading book

FSB Financial Stability Board

G-SII Global Systemically Important Institution (CRR lingo for G-SIB)

G-SIB Global, Systemically Important Banks

LCR Liquidity Coverage Ratio

MREL Minimum Requirement for Eligible Liabilities and Own Funds – MREL

NSFR Net Stable Funding Ratio

O-SII Other Systemically Important Institutions (CRR lingo for domestic SIBs)

QCCP Qualifying Central Counterparty

SRF Single Resolution Fund

SRMR Single Resolution Mechanism Regulation

TLAC Total Loss Absorption Capacity

[1] The Call for Evidence was intended to cover the entire spectrum of the financial services regulation. The impact assessment addresses issues limited to the areas of banking only. Other issues involving other segments of the EU financial legislation will be dealt with separately.

[2] The term institution is used to refer to both credit institutions (i.e. banks) and investment firms, as both are subject to the requirements of the CRR and the CRD.

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