EUROPEAN COMMISSION

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Dear President

The Commission would like to thank the Bundesrat for its Opinion on the Commission´s Communication on completing the Banking Union {COM(2017) 592 final}.

As stated in the Five Presidents' Report in June 2015 and reiterated by President Juncker in his State of the Union address in September 2017, the Banking Union must be completed to deliver its full potential as part of a strong Economic and Monetary Union. It is one of the key elements for the Economic and Monetary Union, which underpins our common currency, the euro.

The Communication takes stock of what has been achieved in creating the Banking Union and what measures are still needed to complete it, based on the Roadmap to Complete Banking Union agreed by the Ecofin Council in June 2016 It also calls on the co-legislators to quickly progress with the adoption of measures to tackle remaining risks in the banking sector. These risk reduction measures include the implementation of the 2016 banking package, and – going beyond what is foreseen in the Roadmap - new actions to reduce non-performing loans. A Banking Union can only function if risk-reduction and risk-sharing go hand in hand. The Communication also maps out the path towards the setting up of a common backstop for the Single Resolution Mechanism and aims to give new impetus to the negotiations on the proposal for a European deposit insurance scheme.

In the context of existing legacy risks and possible moral hazard, the proposal on the European deposit insurance scheme offers the possibility to introduce the scheme more gradually and in two phases: i) a re-insurance phase, planned in 2019, in which it would only provide liquidity to national Deposit Guarantee Schemes after they have exhausted their available financial means and ii) a co-insurance phase, which would start subject to conditions, in which it would also cover losses. This element of loss mutualisation could increase over time.

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It is important to note, that neither risk sharing nor mutualisation are put in place under the suggested re-insurance phase. Any liquidity support provided by the European deposit insurance scheme to a Deposit Guarantee Schemes in need would need to be repaid and losses stemming from pay-outs would be borne by the national Deposit Guarantee Schemes, and ultimately by their affiliated banks via (ex-post) contributions. At the same time, depositors in the Banking Union would benefit from a much higher protection. Therefore, the Commission believes that the implementation of this stage should not be made conditional on additional requirements compared to the exiting June 2016 Roadmap.

In the course of the first phase, while work on risk reduction continues, an asset quality review would be performed as an entry condition into the second phase to further reduce legacy risks. The risk reduction measures and entry conditions into the second phase create an environment more favourable to a healthier banking sector with reduced moral hazard. The work on further risk reduction and the fulfilment of the conditions prepare solid grounds for the start of risk sharing scheduled in 2022, which involves gradually increasing loss coverage provided by the European deposit insurance scheme.

The Commission is aware of the specific nature of the German banking sector, in particular with regard to banks affiliated to institutional protection schemes. Thus, it would like to reassure the Bundesrat that the European deposit insurance scheme will not prevent the institutional protection schemes from continuing their bank protection function. The specific risk profile of their members could be appropriately reflected under the system of risk-based contributions. In particular, the effectiveness of institutional protection schemes in reducing the risk that the European deposit insurance scheme would need to make payments for depositor compensation, could be taken into account.

Article 114 of the Treaty on the Functioning of the European Union (TFEU) allows the adoption of measures for the approximation of national provisions aiming at the establishment and functioning of the Internal Market. The proposed European deposit insurance scheme aims to preserve the integrity and to enhance the functioning of the Internal Market via a uniform application of a single set of rules for deposit protection, together with access to a European Deposit Insurance Fund managed by a central authority. It will remove obstacles to the exercise of fundamental freedoms avoiding significant distortion of competition. Against this background, Article 114 TFEU is the appropriate legal basis.

The Commission fully agrees with the Bundesrat that all legislation, such as the Deposit Guarantee Scheme Directive, needs to be fully transposed by Member States and is strongly committed to ensuring this, including through any necessary infringement proceedings. Participation in the European Deposit Insurance Scheme would be made conditional upon full transposition and implementation of the Directive. At the moment, all Member States have notified the transposition of the Deposit Guarantee Scheme Directive to the Commission.

The Commission agrees with the Bundesrat that tackling non-performing loans is primarily the responsibility of the affected banks. At the same time, the non-performing loans issue has a European dimension. Weak growth in some Member States, due to high levels of non-performing loans, might affect economic growth elsewhere in the European Union. Importantly, reducing existing non-performing loans and preventing the creation of new non-performing loans will contribute to further reduce risks in the European banking sector. While the Commission understands that the current non-performing loans' stock affects some Member States more than others, new non-performing loans may arise in any Member State and therefore measures to prevent them will only effectively reduce risks if they apply in the European Union as a whole. In accordance with the Council Action Plan, on 14 March 2018 the Commission presented a comprehensive package of further measures to tackle non-performing loans. The Commission is committed to apply the principle of proportionality as set out in Article 5 of the Treaty on European Union. This of course also applies to new regulatory initiatives in the context of non-performing loans.

The Commission considers it important to have in place efficient procedures to facilitate the preventive restructuring of viable companies to avoid insolvencies, and the proposal for a Directive on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures {COM (2016) 723 final} contains a balanced approach which takes both creditor and debtor interests into account. The proposal does not deal with insolvent debtors and is carefully crafted in order not to interfere with well-functioning insolvency systems, but to build on them and complement them in order to guarantee the availability of efficient restructuring procedures to avoid insolvency in cases where debtors have a prospect for returning to viability. The Commission hopes that the European Parliament and the Council of Ministers will now make decisive progress in adopting this proposal.

The Commission notes the Bundesrat's view that further clarification on Sovereign Bond-backed Securities is necessary, and would like to point to the work of the European Systemic Risk Boad on the matter which has been made public in the meantime. In any event, this instrument would not rely on any risk sharing or mutualisation between Member States. Only private investors would share risk and possible losses.

The Commission hopes that the clarifications provided in this reply address the issues raised by the Bundesrat and looks forward to continuing the political dialogue in the future.

Yours faithfully,

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