EUROPEAN COMMISSION

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Dear President,

The Commission would like to thank the Senat for its Opinion on the Reflection Paper on the Deepening of the Economic and Monetary Union {COM(2017) 291 final}.

The Commission welcomes the attention that the Senat dedicates to the discussion on the future of the Economic and Monetary Union, and the support given to its proposals in the field of economic and social convergence and to the establishment of the Accession Instrument in particular. Ownership of the process towards completing the Economic and Monetary Union especially by national Parliaments is of utmost importance for the success of the single currency. To foster the convergence and resilience of the European Union, often difficult reforms are needed. To create a common awareness of the issues and challenges ahead, the Commission intends to foster the dialogue with national Parliaments throughout the European Semester.

As regards the distribution key used for the Single Resolution Fund, the Commission would like to clarify that the methodology for the calculation of contributions to all resolution financing arrangements in the European Union is laid down in Directive 2014/59/EU and Commission Delegated Regulation (EU) 2015/63. For the Single Resolution Fund, as per Regulation (EU) No 806/2014, those rules are supplemented by Council Implementing Regulation (EU) 2015/81, which provides for an adjustment to address the specific circumstances of the transitional period related to national compartments established in accordance with the Intergovernmental Agreement on the Transfer and Mutualisation of Contributions. The methodology individually determines the outcome for each bank, without pre-determined national quotas. For the transitional period, said Implementing Regulation provides that contributions result from the combination of both a Banking Union-level and a Member State-level calculation; this latter only includes the banking system in the respective Member State.

Mr Călin POPESCU-TĂRICEANU
President of the Senat
Calea 13 Septembrie nr. 1-3, sector 5
RO – 050711 BUCHAREST

Concerning the use of the Single Resolution Fund, the relevant governance arrangements and decision-making procedures are laid down in Regulation (EU) No 806/2014. In particular, Article 50(1)(c) thereof provides that the plenary session of the Single Resolution Board, where the National Resolution Authorities of all participating Member States have a vote, should decide on individual uses for the Single Resolution Fund for amounts above a certain threshold. Furthermore, the plenary session should also evaluate the use of the Fund and provide guidance to the executive session on it, in accordance with Article 50(1)(d) of that Regulation, once the net accumulated use of the Fund over any given 12-month period reaches a certain threshold. Finally, the Council may, upon proposal by the Commission, approve or object to a material modification of the amount of the Fund provided for in a resolution decision of the Single Resolution Board, as laid down in Article 18(7) of the said Regulation.

In the debate on reforming the regulatory treatment of sovereign exposures, the position of the Commission, as expressed in its Reflection Paper, is that, to avoid negative impacts on financial stability of a reform, several preconditions must first be met, including the completion of the Banking Union and Capital Markets Union, and the launch of a European safe asset. If a level playing field for Europe's financial sector is desired, an agreement at the global level would also be essential.

As regards the European Deposit Insurance Scheme, the Commission would like to clarify some issues. First, the proposal for a Regulation establishing the European Deposit Insurance Scheme determines that national deposit guarantee schemes can only benefit from European Deposit Insurance Scheme coverage if their funds are being built up in line with a precise funding path. This ensures equal treatment of all deposit guarantee schemes throughout the build-up phase. Second, a key objective of the proposal is to preserve the integrity and enhance the functioning of the Single Market. A common insurance system would remove obstacles to the provision of cross border banking services and reduce distortions of competition due to differences in depositor confidence. The European Deposit Insurance Scheme, as part of the Banking Union, remains open to all Member States. Finally, the proposal on the European Deposit Insurance Scheme requires that contributions to the insurance fund are risk-based. It sets out the criteria by which the degree of risk should be assessed. Concrete indicators for these criteria are currently being discussed in the European Parliament and the Council. The Commission takes note of the Senat's request to take an indicator on the coverage of non-performing loans into consideration.

The Commission thanks the Senat for sharing its observations and concerns about the expected proposal for an enabling regulatory framework for Sovereign Bond-Backed Securities. As indicated in last December's package on deepening the Economic and Monetary Union and, before that, in the Reflection Paper, in President Juncker's Letter of Intent accompanying his State of the Union address, and in the October Communication on Banking Union, the Commission is of the view that Sovereign Bond-Backed Securities have the potential to increase efficiency in the euro area financial sector and enhance its resilience and stability. This view is shared by the European Systemic Risk Board's high-level task force on safe assets, as expressed in their recently *published technical report. In turn, a more efficient and stable financial sector in the euro area is positive for the European Union as a whole.*

Therefore, the Commission intends to propose an enabling framework which levels the regulatory playing field between Sovereign Bond-Backed Securities and euro area central government bonds. No change is envisaged for the regulatory treatment of European Union sovereign bonds. The impact of the development of such instruments on the functioning of sovereign debt markets would be limited. Euro area members would continue issuing bonds as they do now; private arrangers could convert them into Sovereign Bond-Backed Securities. Debt management offices would not be obliged, but might want to coordinate issuances. The impact of private sector packaging of Sovereign Bond-Backed Securities on the demand and liquidity of the euro area sovereign bonds is, in principle, ambiguous; but especially if the overall volume of Sovereign Bond-Backed Securities is limited (e.g., through the licensing of arrangers), their impact on liquidity would be small. The liquidity and demand of national sovereign bonds can actually be enhanced by Sovereign Bond-Backed Securities, if for example Sovereign Bond-Backed Securities prove to be efficient for global investors to gain low-risk exposure to the euro area. This could be particularly relevant for Member States presently not on the radar screen of such investors, including because of the limited size of their debt issuances.

As synthetic products, Sovereign Bond-Backed Securities redistribute the risk of default of euro area Member States. Investors can choose how much risk to bear. The Commission does not believe that any euro area Member State is at risk of default, though it acknowledges that market participants' beliefs about the sustainability of public debt change over time and impact on the price of sovereign bonds. The senior Sovereign Bond-Backed Securities would be useful for investors who want to shield themselves from volatility associated with such beliefs. The added protection from the tranching would make senior Sovereign Bond-Backed Securities more, rather than less, attractive. Concerning the expected rating of Sovereign Bond-Backed Securities tranches, the Commission is aware of the preliminary analysis by Standard and Poor's, but note that it is based on an incomplete knowledge of their design and builds on very specific assumptions that we do not consider realistic. Off-the-shelf rating models from other agencies do result in an AAA rating for the senior tranche.

The Commission also notes the Senat's concerns about the proposed risk reduction measures in banks. The November 2016 banking package introduces the total loss absorbing capacity standard into European law and adapts the minimum requirement for eligible liabilities to achieve an integrated framework. The proposal specifies more clearly the single point of entry and multiple points of entry resolution strategies and clarifies the allocation of minimum requirement for eligible liabilities resources within groups, as well as the decision process between home and host authorities in this regard. It does not alter the competences of the national resolution authorities, nor their capacity to require the loss absorption and recapitalization of an entity in their jurisdiction: it merely clarifies how decisions are to be made more effectively with regard to the new elements introduced in the legislation. The final design on the elements of the banking package will be decided by the co-legislators based on the technical work in the European Parliament and in the Council.

The latest amendments to the large exposure provisions in the Capital Requirements Regulation were adopted on 12 December 2017, by Regulation (EU) 2017/2395 as regards transitional arrangements for mitigating the impact of the introduction of IFRS 9 standard on own funds and for the large exposures treatment of certain public sector exposures denominated in the domestic currency of any Member State. The Regulation does not affect exposures to central governments and central banks of Member States denominated and funded in the local currency, which remain to be fully exempt from large exposure limit pursuant to Articles 400(1)(a) and 144(4). This exemption will not be affected by any potential proposal on sovereign bond backed securities.

Finally, the Commission notes the Senat's concerns about a euro area budget. On this, it would like to stress that deepening the Economic and Monetary Union is good for both the euro area and for the European Union as a whole. While certain functions target the specific needs of euro area Member States on the one hand and non-euro Member States on the other, they are all anchored in a common approach and in a vision of the broader European Union framework. The futures of both euro and non-euro Member States are intertwined, and a strong and stable euro area is in the interest of all. This is why the proposals of the 6 December package address the needs and interests of both euro and non-euro Member States, as inter-dependent parts of our Economic and Monetary Union. A separate euro area budget is not envisaged in the Commission's proposals.

The Commission hopes that these clarifications address the issues raised by the Senat and looks forward to continuing our political dialogue in the future.

Yours faithfully,

Frans Timmermans
First Vice-President

Valdis Dombrovskis
Vice-President