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# Legal Prudential Obstacles to the integration of the banking sector in the Euroarea

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- *The opinions expressed here are my own only and should not be attributed in any way to the European Central Bank or the Single Supervisory Mechanism*

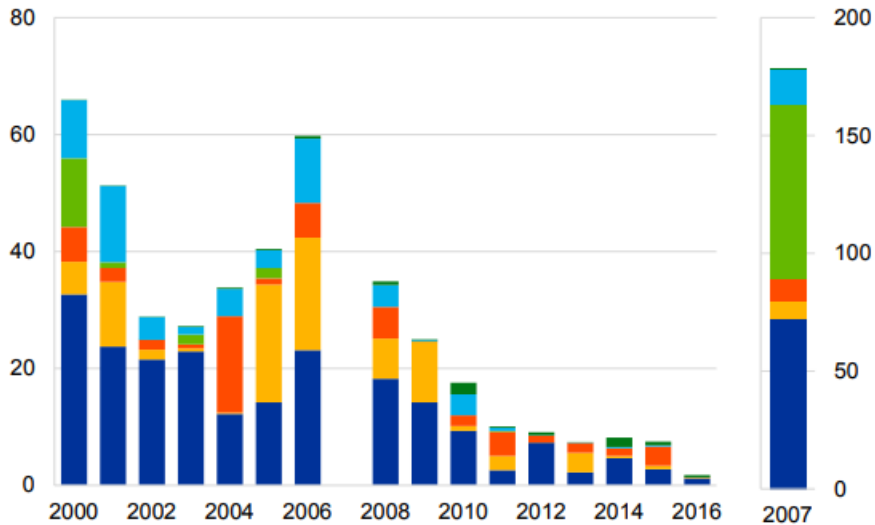
# Outline

- The compelling rationale for banking sector integration in the Euroarea
- The “Cornerstone” Provision of the SSM Regulation: applicable law
- Taxonomy of options and discretions available in Union Law
- The ECB Regulation on options and discretions
- The ECB Guide on options and discretions
- Capital, Large Exposures and leverage waivers (article 7 CRR)
- Liquidity waivers (article 8 CRR)
- Article 400.2.c) CRR and article 493.3.c) CRR on intra-group large exposures
- Conclusions : 19 prudential regulatory jurisdictions

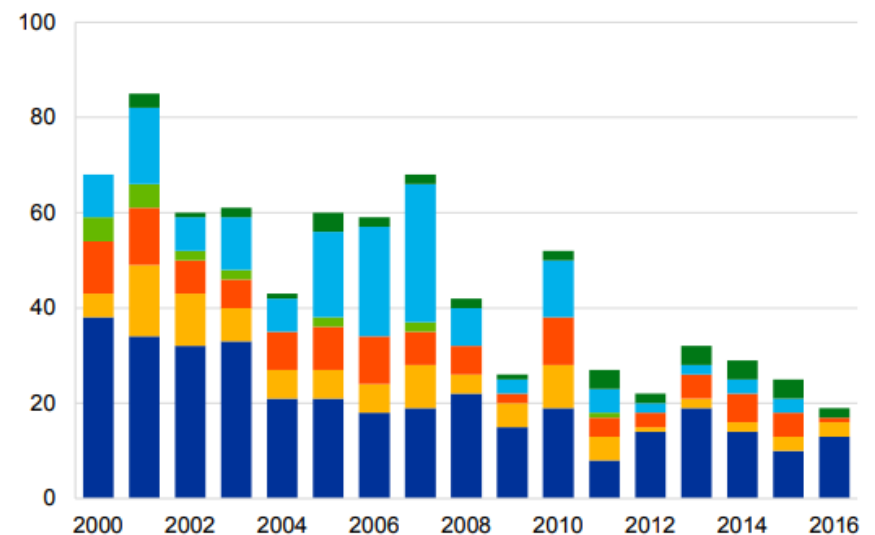
# Banking Sector Integration in the Euroarea

Bank M&As in the euro area – value of transactions

(EUR billions)



Bank M&As in the euro area – number of transactions



- Single money: fungibility of banking money/deposits (M1 and M2)
- Private ex-ante mechanisms of risk sharing
- Completing the Banking Union : a single prudential supervisory jurisdiction?

# The Cornerstone Provision of the SSM Regulation: a single prudential supervisory jurisdiction?

- Art. 4.3 SSMR:
  - ECB “shall apply all relevant Union Law, and where this Union Law is composed of Directives, the national legislation transposing these Directives”.
  - “Where the relevant Union Law is composed of Regulations and where currently those Regulations explicitly grant Options for Member States, the ECB shall also apply the national legislation exercising those Options”.
- Recital 34 SSMR:
  - “Where the material rules relating to the prudential supervision of credit institutions are laid down in Directives, the ECB should apply the national legislation transposing those Directives. Where the relevant Union Law is composed of Regulations and in areas where, on the date of entry into force of this Regulation, those Regulations explicitly grant options for Member States, the ECB should also apply the national legislation exercising such options. Such options should be construed as excluding options available only to competent or designated authorities”.

## Legal taxonomy of O&Ds

- CRDIV ONDs granted to Member States (e.g. art. 94.(1)(g));
- CRDIV ONDs granted to competent authorities (e.g. art. 40);
- CRR ONDs granted to Member States (e.g. art. 412.5 - 1<sup>st</sup> part);
- **CRR ONDs (LCR delegated act) granted only to competent authorities (e.g. art. 49.1);**
- CRDIV ONDs granted alternatively to Member States or competent authorities (e.g. art. 94(1)(l));
- CRR ONDs granted alternatively to Member States or competent authorities (e.g. art. 450(1)(j), art. 412.5 – 2<sup>nd</sup> part).
- **Additional category: CRR ONDs granted both to Competent Authorities and Member States (only one case: art. 400.2 and art. 493.3 CRR).**
  - Symmetric options with reverse field pre-emption: national legislation pre-empts European (federal) legislation<sub>6</sub>

# Options and Discretions: Numbers and Examples

- We identified more than 150 O&Ds (some for Member States only)
- Almost 130 O&Ds granted to Competent Authorities only (both CRR and CRDIV).
- Some examples:
  - Capital, large exposures, leverage and liquidity waivers (artt. 7 and 8 CRR)
  - Intra-group large exposures waivers (artt. 400.2.c) and 493.3.c) CRR)
  - Qualifying holdings outside the financial sector (art. 89.3 CRR)
  - Definition of default (art. 178.1 CRR)
  - Definition of capital (e.g. insurance holdings - art. 49.1 CRR and transitionals - art. 471.1 CRR and art. DTAs)
  - 0% risk weight for intragroup exposures at the domestic level (art. 113.6 CRR)
  - Institutional Protection Schemes (art. 113.7 CRR)
  - Leverage ratio intragroup exposures exemption (art. 429.7 CRR)
  - IFRS reporting for credit institutions required to use n-GAAP (art. 24.2 CRR)
  - Governance provisions
    - Combination of risk and audit committee (art. 76.3 CRDIV)
    - Combination of the roles of chairman and chief executive (art. 88.1.e CRDIV)
    - Additional non-executive directorship (art. 91.6 CRDIV)

# The ECB Regulation on Options and Discretions

- General Options and Discretions
- Regulation (EU) 2016/445 on the exercise of options and discretions available in Union Law (general O&Ds)
  - is directly applicable to all the credit institutions under direct ECB's supervision (significant credit institutions)
  - directly creates obligations for supervised entities
  - needs to be applied taking into account the principles of legal certainty, equal treatment and legitimate expectations pursuant to ECJ case law



# The ECB Guide on Options and Discretions

- Case-by-case Options and Discretions
- ECB Guide on options and discretions available in Union Law (Consolidated version 3 November 2016)
  - is addressed to JSTs
  - sets out the policy approach the ECB intends to follow in the assessment of the applications for specific supervisory decisions
  - constrains the discretion of the ECB
  - creates in the supervised entities expectations of a specific supervisory approach
  - is not legally binding, not even for the ECB, but any departure from the Guide when taking specific decisions needs to be accurately motivated and must respect the principles of equal treatment, legal certainty and legitimate expectations pursuant to ECJ case law

## Article 7 CRR prudential waiver for solo requirements

- Waives all prudential requirements at the solo level (capital, large exposures, leverage, disclosure, etc.) apart from liquidity requirements (article 8 CRR)
- Article 7.1 waives the solo prudential requirements of the subsidiaries, while article 7.3 waives the solo prudential requirements of the parent company
- But only within the same Member State:
  - “where both the subsidiary and the institution are subject to authorisation and supervision by the Member State concerned”
  - “institution is subject to authorisation and supervision by the Member State concerned”
- Proposal from the Commission for an article 7 CRR cross-border waiver (COM (2016) 850 final : new article 7.2 CRR)

# Article 8 CRR prudential waiver for liquidity requirements

- Article 8.1 CRR: prudential waiver for solo liquidity requirements (single liquidity sub-group) in the same Member State
- Article 8.3 CRR: prudential waiver for solo liquidity requirements (single liquidity sub-group) across Member States.
- Exercise of the cross-border waiver by the ECB in the Guide: limited to 25% of HQLAs for “significant” subsidiaries and “significant” sub-groups
  - “The current incomplete banking union is asymmetric: while decisions on liquidity waivers are taken at European level, the relevant risk-sharing mechanisms are still national. In each country, bank depositors are protected by the national guarantee scheme. If a bank fails ..... it is a national credit line that backs the SRF. In this context, the ECB’s Supervisory Board decided this spring that there should always be a floor on the liquidity coverage ratio for those subsidiaries that are significant on a stand-alone basis. This is to ensure that they hold a sufficient level of high-quality liquid assets to respond to liquidity needs at national level. *Liquidity ring-fencing* reflects the absence of a common fiscal backstop in the banking union”  
P. Praet
- In any case, obstacles to cross-border liquidity waivers are intrinsic in the CRR nationally based framework: e.g. condition in article 8.1.c) and interaction with absence of cross-border 7 waiver and large exposures

# Intra-group large exposure exemption (article 400.2.c CRR)

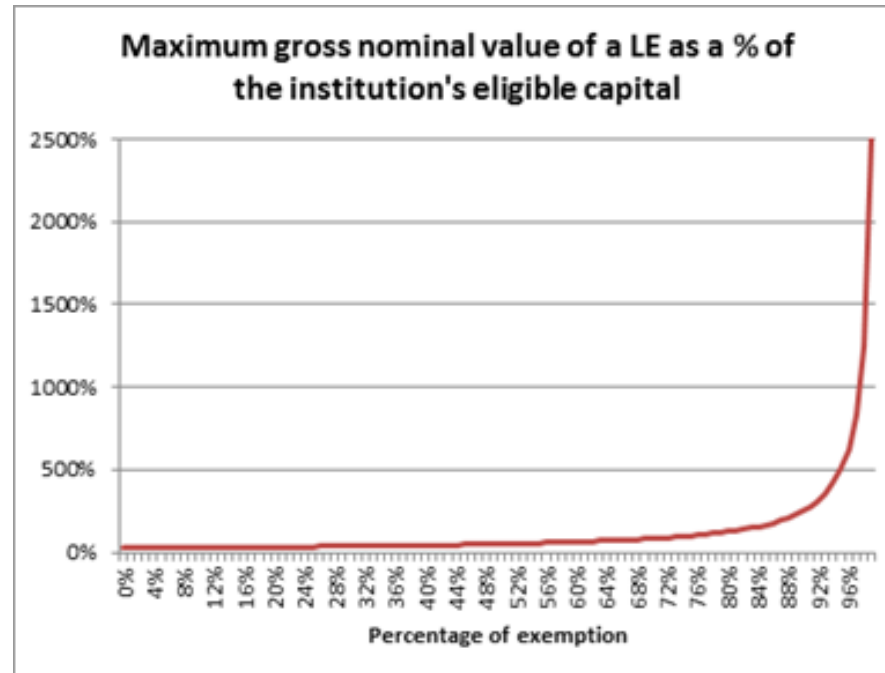
- Article 9.3 and Annex 1 O&D Regulation (General O&D)
  - No limits in relation to own funds
  - Self-assessment by the credit institutions
  - Ex post verification by the ECB within ongoing supervision
  - Annex includes specifications and documentation for the assessment of the criteria in article 400.3 CRR
- Application
  - Inherent limit given by the exercise of the *symmetric option* for Member States in article 493.3.c) CRR (see article 9.7 O&D Regulation)
  - Complexity of the self-assessment and ex-post verification approach
  - Text of article 400.2.c on equivalent third countries

# Intra-group large exposure exemption (article 493.3.c CRR)

- **Germany (GroMiKV – July 2014)**
  - Automatic up to 75% of the exposure (100% of eligible own funds)
  - Upon decision from the Competent Authority up to 93.75% of the exposure (400% of own funds)
- **Belgium (Arrêté Royal 1<sup>st</sup> September 2016)**
  - Exposures of subsidiaries towards parents and sister companies exempted up to 100% of own funds
  - Exposures of parents towards subsidiaries: unlimited

# The German exercise of article 493.3.c) CRR

- $$\frac{\text{Max amount of a LE (as a \% of the institution's eligible capital)}}{25\%} = (100\% - \% \text{ of exemption})$$



# Conclusions

- The ECB has been entrusted with the task of prudentially supervising the largest banking sector in the world within the Single Supervisory Mechanism
- Complexity
  - Decision-making process
  - Applicable law: between European Law and national law (application of Directives as transposed, „national“ powers, options and discretions available in Union Law in the CRR)
  - Regulatory ring-fencing considering the unavailability of article 7 cross-border waiver and the interaction between the requirements for the cross-border liquidity waiver and the member state option for intra-group large exposure exemptions
- Centralisation of prudential supervision is a clear objective of the legislator but due to regulatory constraints in the Level 1 text we are far from having a single prudential supervisory jurisdiction.