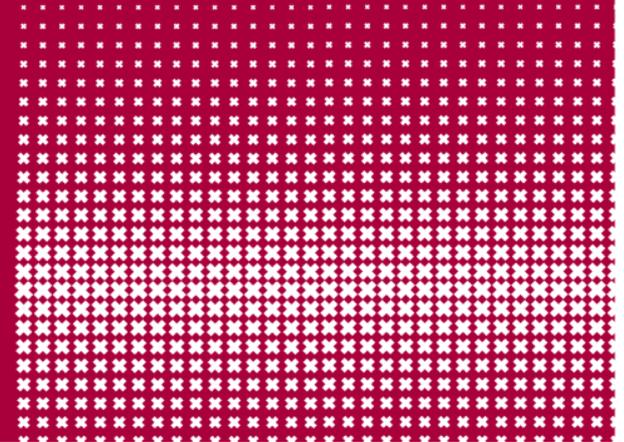




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National Options and Discretions in a Banking Union – A Contradiction?

Workshop: Challenges for banks in a changing regulatory environment
Frankfurt 27-28 January 2016

Points addressed

- Background Options & Discretions Prudential supervision framework
- Conceptual design of the Single Rule Book
- Options, discretions and own national laws
- Rationale of options and discretions in CRR and CRD IV
- ECB Proposal for NOD Regulation and NOD Guide
- Equal treatment of significant and non-significant banks

Only one Pillar of the Banking Union is discussed: that of the Single Supervisory Mechanism

Only one type of institution is discussed: “credit institutions” to which we will refer as “banks”

Background Options & Discretions

- Part of the negotiations of the 2006 CRD-Directive concerned the **removal as much as possible of national discretions**. In its 2004 advice, CEBS recommended to remove some 20 discretions for the CRD framework which was incorporated by the Commission in the final text;
- European Commission submitted a call for Technical Advice to CEBS on options and discretions in the 2006 CRD-Directive on 27 April 2007;
- CEBS organised public consultation and issued two pieces of technical advice:
 - TA of 17 October 2008
 - TA of 10 June 2009
- CEBS' technical advice of 2008 and 2009 has been incorporated in the construction of the Single Rule Book and **has been an important driver** for the choice to regulate the **main body of capital requirements by means of a regulation** in stead of a directive.

Background Options & Discretions -- Single Rule Book

- The objective of the removal of options and discretions from the European banking directives was to achieve **further harmonisation** throughout the Community;
- CEBS' technical advice of 2008 and 2009 has been incorporated in the construction of the Single Rule Book and **has been an important driver** for the choice to regulate the **main body of capital requirements by means of a regulation** in stead of a directive;
- De Larosière:

“The European Institutions and the level 3 committees should equip the EU financial sector with a set of consistent core rules. Future legislation should be based, wherever possible, on regulations (which are of direct application). When directives are used, the co-legislator should strive to achieve maximum harmonisation of the core issues. Furthermore a process should be launched to remove key-differences stemming from the derogations, exceptions and vague provisions currently contained in some directives”.

De Larosière Report, February 2009.

Conceptual design of the Single Rule Book

- The majority of provisions of the 2006 CRD prudential rules for banks moved to the level of the CRR extinguishing in a one off operation a patchwork of 28 different banking laws;
- CRR has direct application and direct vertical and horizontal effect in all the Member States;
- The adoption of CRD IV in parallel with the CRR is motivated by (i) constraints of the European Treaty and (ii) the need to arrive at a political compromise;
- CRR and CRD IV are designed as Siamese Twins, they share a common definition apparatus, a common scope of applicability and a common allocation of powers and authorities to national authorities and supervisors;
- Most of the provisions of the CRD IV are based on the principles of maximum harmonisation, compensating for the limitation of use of the regulation-legislative instrument in those instances that this was a political “bridge too far”.

Conceptual design of the Single Rule Book

Recital (12) CRR:

“Shaping prudential requirements in the form of a regulation would ensure that those requirements will be directly applicable. This would ensure uniform conditions by preventing diverging national requirements as a result of the transposition of a directive. This Regulation would entail that all institutions follow the same rules in all the Union, which would also boost confidence in the stability of institutions, especially in times of stress. A regulation would also reduce regulatory complexity and firms' compliance costs, especially for institutions operating on a cross-border basis, and contribute to eliminating competitive distortions.”

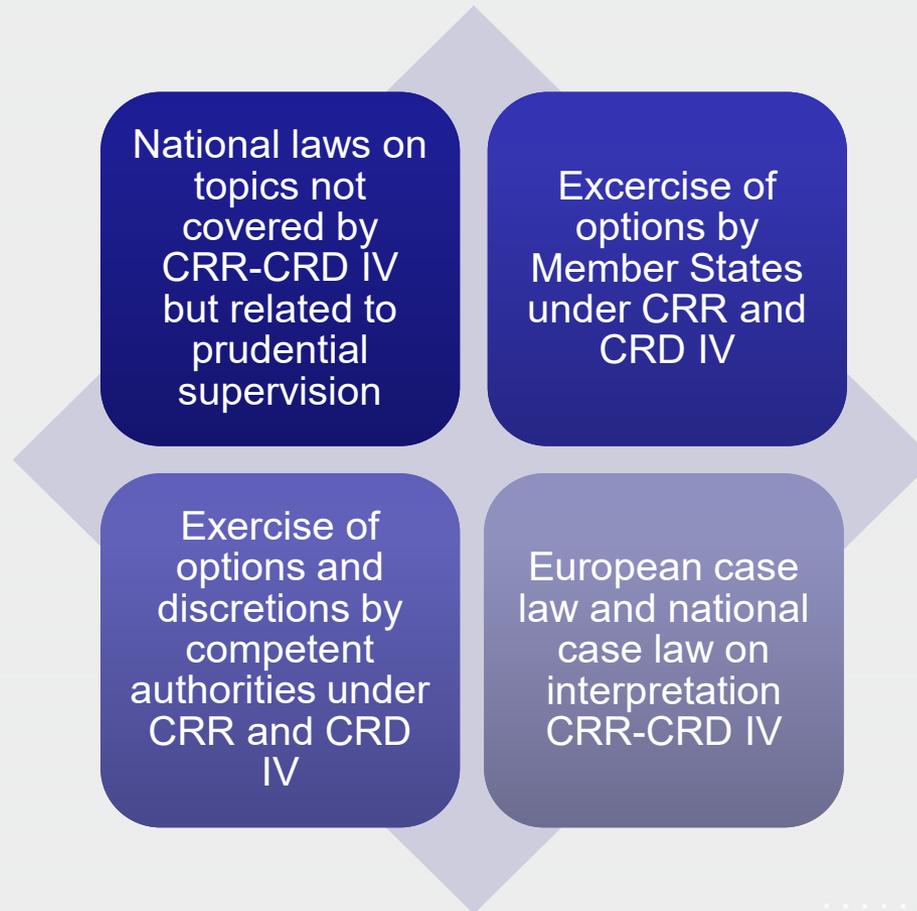
The main principles underpinning the Single Rule Book

- Direct application and direct vertical and horizontal effect of regulation provisions fundamentally restricts the discretion exercisable by national authorities and supervisory authorities.
- The CRR-regulation provisions are “the law of the country”, they are superseding national laws that are conflicting with the regulation provisions.
- The interpretation of CRR is no longer at the discretion of national courts, rather this interpretation will primarily be made by the European Court of Justice. This also contributes to uniform application and harmonisation.
- Because of the primarily application of the principle of maximum harmonisation in CRD IV provisions, there is further support to the aim to develop a true single rule book for banks.

The main flaws undermining the Single Rule Book

- The many (more than 100) national options and discretions are in direct conflict with the ambition to create a true Single Rule Book;
- The restricted scope of rules comprised in the Single Rule Book setting forth the prudential supervision framework inflates the concept of a level playing field for banks. There are many more topics that should be regulated at the level of a Single Rule Book, for instance:
 - ❖ Payment services and oversight on payment systems and instruments;
 - ❖ Integrity supervision, anti-money laundering, counter terrorism rules and sanctions laws.
- The concept of a regulation (CRR) and directive (CRD IV) regulating topics that are closely related to each other (e.g. capital requirements and capital buffers) results in differences throughout the Union.

Options, discretions and own national laws



Rationale of the options and discretions in CRR and CRD IV

- There should be room for Member States or competent authorities to adopt national rules for areas not covered by CRR (dynamic provisioning, provisions on national covered bond schemes, rules on acquisition or holding of participations in both the financial and non-financial sector for purposes not related to prudential requirements);
- Peculiarities of markets for immovable properties justify the retention of national powers and authority to regulate at national level;
- Recital (12) CRR:
“the peculiarity of immovable property markets, which are characterised by economic developments and jurisdictional differences that are specific to Member States, regions or local areas, competent authorities should be allowed to set higher risks weights or to apply stricter criteria based on default experience and expected market developments to exposures secured by mortgages on immovable property in specific areas”

Rationale of the options and discretions in CRR and CRD IV

- National rules to address macroprudential risks related to the structure and size of the banking sector of a Member State compared to the wider economy and credit cycle.
- Recital (16) CRR:
“Member States retain a leading role in macroprudential oversight because of their expertise and their existing responsibilities in relation to financial stability.”
- Until the uniform application of liquidity requirements in 2015 and leverage ratio in 2018, Member States retain freedom to adopt own national measures.

Options and discretions in CRR and CRD IV

- Are all options and discretions related to this rather restricted number of topics for which the CRR-CRD IV framework allows own national discretion and rules? No they are not. For instance:
 - Phasing in of own funds requirements of CRR respects enhancements made by individual Member States prior to the adoption and entry into force of the CRR-CRD IV;
 - Diverging prudential adjustments to own funds in Member States are phased in during a transitional period;
 - National measures requiring banks to restrict investments in certain business activities or to restructure the bank organisation with a view to protecting depositors and preserving financial stability;
 - Specific indirect holding structures supporting social housing in jurisdictions are treated as direct participations in real property;
 - Derogation from the application of prudential requirements on an individual basis if an institution is comprised in the prudential consolidation circle.

ECB Proposal for NOD Regulation and NOD Guide

- Consultation on Regulation and Guide national options and discretions launched in November 2015;
- ECB NOD Regulation to be published in March 2016 in OJ *EU*;
- ECB NOD Regulation and ECB Guide NOD only apply to significant institutions or provide guidance to the JST's for significant banks;
- ECB NOD Regulation addresses 24 options or discretions conferred on competent authorities under CRR and DR 2015/61 (LCR)
- ECB NOD Regulation does not address CRD IV options or discretions
- ECB NOD Guide deals with the various options and discretions in a topical way addressing some 90 options and discretions in CRR and CRD IV

ECB Proposal for NOD Regulation and NOD Guide

Capital Requirements Regulation, FINREP Regulation and
LCR Regulation

Capital Requirements Directive IV

NCA
Eurozone LSI

Member State
Options

NCA non-
Eurozone

ECB
Eurozone SI

ECB Proposal for NOD Regulation and NOD Guide

- Topics addressed in ECB NOD Regulation
 - 1) Own funds – Risk weighting and prohibition qualifying holdings outside the financial sector.
 - 2) Capital requirements: (i) definition of default of obligor, (ii) Hedging sets, (iii) Netting convertibles and (iv) requirements in the event of system-wide failures.
 - 3) Large exposures
 - 4) Liquidity
 - 5) Transitional provisions

ECB Proposal for NOD Regulation and NOD Guide

- Topics addressed in ECB NOD Guide – Generic exercise JST
 - 1) Consolidated supervision and waivers of prudential requirements
 - 2) Own funds
 - 3) Capital requirements
 - 4) Large exposures
 - 5) Liquidity
 - 6) Transitional provisions on capital requirements and reporting
 - 7) Credit institutions affiliated to a central body
 - 8) Timeline for assessment qualifying holdings
 - 9) Governance arrangements and prudential supervision

ECB Proposal for NOD Regulation and NOD Guide

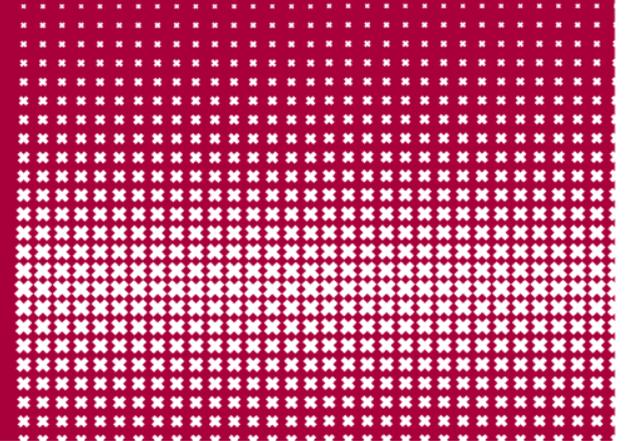
- Topics addressed in ECB NOD Guide – Exercise after assessment JST
 - 1) Consolidated supervision and waivers of prudential requirements
 - 2) Own funds
 - 3) Capital requirements
 - 4) Large exposures
 - 5) Liquidity

Equal treatment of significant and non-significant banks

- ECB is, based on articles 4, 6 and 9 SSM Regulation to exercise options and discretions by “competent authorities” for which mandates are set forth in Union law.
- The SSM Regulation forms the solid basis for the mandate of the ECB to exercise its role in the SSM;
- The ECB is to be considered the “competent authority” for all Eurozone significant banks in all places where the CRR and CRD IV provide for instructions, powers, authorities and discretions of competent authorities;
- Is the ECB only the “competent authority” for significant banks, or is the ECB also the competent authority for non-significant banks?

Concluding remarks

- Are national options and discretions in a Banking Union a contradiction: they most certainly are!
- Are we risking to further undermine the aim to create a level playing field for banks in the European Union by adopting the ECB NOD Regulation and ECB NOD Guide: we do!
- Is there urgency in adopting a further harmonized banking law for the entire European Union by moving CRD IV provisions to an expanded CRR II Regulation? There most certainly is!
- Should the legislation for banks be further harmonized by including other topics in a Single Rule Book (e.g. payment services)? Yes, it should be done!



The slides will be available and the Working Paper on National Options and Discretions is to be published at about 15 February 2016 in draft at www.ebi-edu.eu. Working Paper is also available at <http://www.ssrn.com>.