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EXPLANATORY MEMORANDUM ON EUROPEAN UNION DOCUMENTS

CRR: PROPOSAL FOR A REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL AMENDING REGULATION (EU) NO 575/2013 AS REGARDS THE LEVERAGE RATIO, THE NET STABLE FUNDING RATIO, REQUIREMENTS FOR OWN FUNDS AND ELIGIBLE LIABILITIES, COUNTERPARTY CREDIT RISK, MARKET RISK, EXPOSURES TO CENTRAL COUNTERPARTIES, EXPOSURES TO COLLECTIVE INVESTMENT UNDERTAKINGS, LARGE EXPOSURES, REPORTING AND DISCLOSURE REQUIREMENTS AND AMENDING REGULATION (EU) NO 648/2012

ANNEX TO THE PROPOSAL FOR A REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL AMENDING REGULATION (EU) NO 575/2013 AS REGARDS THE LEVERAGE RATIO, THE NET STABLE FUNDING RATIO, REQUIREMENTS FOR OWN FUNDS AND ELIGIBLE LIABILITIES, COUNTERPARTY CREDIT RISK, MARKET RISK, EXPOSURES TO CENTRAL COUNTERPARTIES, EXPOSURES TO COLLECTIVE INVESTMENT UNDERTAKINGS, LARGE EXPOSURES, REPORTING AND DISCLOSURE REQUIREMENTS AND AMENDING REGULATION (EU) NO 648/2012

COMMISSION STAFF WORKING DOCUMENT IMPACT ASSESSMENT ACCOMPANYING THE DOCUMENT PROPOSAL AMENDING: - REGULATION (EU) NO 575/2013 ON PRUDENTIAL REQUIREMENTS FOR CREDIT INSTITUTIONS AND INVESTMENT FIRMS; - DIRECTIVE 2013/36/EU ON ACCESS TO THE ACTIVITY OF CREDIT INSTITUTIONS AND THE PRUDENTIAL SUPERVISION OF CREDIT INSTITUTIONS AND INVESTMENT FIRMS; - DIRECTIVE 2014/59/EU ESTABLISHING A FRAMEWORK FOR THE RECOVERY AND RESOLUTION OF CREDIT INSTITUTIONS AND INVESTMENT FIRMS; -

REGULATION (EU) NO 806/2014 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL OF 15 JULY 2014 ESTABLISHING UNIFORM RULES AND A UNIFORM PROCEDURE FOR THE RESOLUTION OF CREDIT INSTITUTIONS AND CERTAIN INVESTMENT FIRMS IN THE FRAMEWORK OF A SINGLE RESOLUTION MECHANISM AND A SINGLE RESOLUTION FUND

COMMISSION STAFF WORKING DOCUMENT EXECUTIVE SUMMARY OF THE IMPACT ASSESSMENT ACCOMPANYING THE DOCUMENT PROPOSAL AMENDING: - REGULATION (EU) NO 575/2013 ON PRUDENTIAL REQUIREMENTS FOR CREDIT INSTITUTIONS AND INVESTMENT FIRMS; - DIRECTIVE 2013/36/EU ON ACCESS TO THE ACTIVITY OF CREDIT INSTITUTIONS AND THE PRUDENTIAL SUPERVISION OF CREDIT INSTITUTIONS AND INVESTMENT FIRMS; - DIRECTIVE 2014/59/EU ESTABLISHING A FRAMEWORK FOR THE RECOVERY AND RESOLUTION OF CREDIT INSTITUTIONS AND INVESTMENT FIRMS; - REGULATION (EU) NO 806/2014 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL OF 15 JULY 2014 ESTABLISHING UNIFORM RULES AND A UNIFORM PROCEDURE FOR THE RESOLUTION OF CREDIT INSTITUTIONS AND CERTAIN INVESTMENT FIRMS IN THE FRAMEWORK OF A SINGLE RESOLUTION MECHANISM AND A SINGLE RESOLUTION FUND

CRD: PROPOSAL FOR A DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL AMENDING DIRECTIVE 2013/36/EU AS REGARDS EXEMPTED ENTITIES, FINANCIAL HOLDING COMPANIES, MIXED FINANCIAL HOLDING COMPANIES, REMUNERATION, SUPERVISORY MEASURES AND POWERS AND CAPITAL CONSERVATION MEASURES

BRRD: PROPOSAL FOR A DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL AMMENDING DIRECTIVE 2014/59 ON LOSS-ABSORBING AND RECAPITALISATION CAPACITY OF CREDIT INSTITUTIONS AND INVESTMENT FIRMS AND AMENDING DIRECTIVE 98/26/EC, DIRECTIVE 2002/47/EC, DIRECTIVE 2012/30/EU, DIRECTIVE 2011/35/EU, DIRECTIVE 2005/56/EC, DIRECTIVE 2004/25/EC AND DIRECTIVE 2007/36/EC

SRMR: PROPOSAL FOR A REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL AMENDING REGULATION (EU) NO 806/2014 AS REGARDS LOSS=ABSORBING AND RECAPITALISATION CAPACITY FOR CREDIT INSTITUTIONS AND INVESTMENT FIRMS.

Submitted by HM Treasury on 20 December 2016

SUBJECT MATTER

1. The Commission proposals, published on 23 November, seek to implement further measures to reduce risk in EU's banking system in order to strengthen both the resilience of the banking sector as well as to advance the completion of the Banking Union. In its Communication on 24 November 2015, the Commission committed to bringing forward legislative proposals based on international agreements in order to address identified weaknesses in the existing prudential framework.

2. The Commission state that their intention is to complete the post financial crisis regulatory reforms and implement internationally agreed standards that have

only recently been finalised by international organisations such as the Basel Committee on Banking Supervision (BCBS) and the Financial Stability Board (FSB). To this end the Commission has published proposals that amend the Capital Requirements Regulation (CRR), the Capital Requirements Directive (CRD), the Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism Regulation (SRMR). CRR and CRD set the prudential rules for banks and large investment firms as well as rules on governance and supervision, therefore directly affecting the profitability and stability of banks. The BRRD sets a common approach across the EU to the recovery and resolution of banks and investment firms. The SRMR sets uniform rules and procedures for the resolution of banks and investment firms under the Single Resolution Mechanism and Single Resolution Fund. The proposals introduce a number of new measures and changes to existing provisions.

Amendments to Capital Requirements Directive:

3. The proposals include changes to Pillar 2 capital requirements and guidance, which are the tools used by supervisors to supervise firms above minimum standards. They introduce new guidance and restrictions on supervisors in their application of additional capital requirements. The changes and new amendments in this proposal set out the options for competent authorities to impose additional own funds requirements, clarify the conditions for setting additional requirements and provide additional guidance for competent authorities. The proposals are designed to reduce diversity in application with the intent of achieving greater harmonisation across the EU.

4. The proposed amendments to CRD and CRR introduce a modified framework for firms to calculate Interest Rate Risk. The proposal includes a new common standard approach that institutions might use or be required by supervisors to use if other systems are not deemed satisfactory. It specifies how to calculate risk weights for general interest rate risk (GIRR) and GIRR risk-factors. This is to better mitigate against any risk arising from changes in interest rates. The proposal also requires information on potential risks from changes in interest rates to be disclosed. The EBA is mandated to provide more details on the criteria and conditions that institutions should follow to identify, evaluate, manage and mitigate interest rate risks and to define the six supervisory shock scenarios applied to interest rates.

5. The proposals include new provisions that clarify consolidated requirements and supervision of financial holding companies and mixed financial holding companies. Under these proposals the holding company assumes responsibility for compliance, not the subsidiaries. The proposals aim to bring financial holding companies and mixed holding companies directly within the scope of the EU prudential framework.

6. The proposal contains a provision on Intermediate Holding Companies (IHCs). It introduces a new requirement for non-EU Global Systemically Important Institutions (G-SIIs) to consolidate their authorised EU entities into a single bank or intermediate holding company in the EU. This requirement will apply to third country groups that are identified as non-EU G-SIIs or that have entities in the EU with total assets of EUR 30 billion (£25.66 billion) or more. The Commission states that this measure is designed to strengthen the resolution process of third-country groups with significant activities in the EU as well as to facilitate the

implementation of internationally agreed standards on internal loss-absorbing capacity for non-EU G-SIIs.

7. The proposals contain changes on the rules regarding remuneration. The proposals introduce a new limit on the size of firms that need to apply some of the rules on deferral and pay-out in instruments. The proposals will allow the rules on deferral and pay-out in instruments to be disapplied for firms with less than €5bn of assets. The Commission's review of the efficiency, implementation and enforcement of the CRD remuneration rules showed that some of the rules, such as the rules on deferral and pay-out in instruments, are not workable for the smallest and least complex institutions and for staff with low variable remuneration. The proposal therefore aims to address this issue whilst also creating greater harmonisation across the EU in the application of proportionality to smaller firms and staff with low variable remuneration.

Amendments to the Capital Requirements Regulation:

8. The proposals implement BCBS standards for equity investments in funds. The new standard is aimed at clarifying the existing treatment and achieving a more internationally consistent and risk sensitive treatment of such exposures. This is to better reflect both the risk of a funds underlying investment and its leverage. The proposals use a hierarchy of approaches, which are:
    a. Look Through Approach (LTA) – Banks apply risk weights of funds underlying exposures as if exposures were held directly by the bank.
    b. Mandate Based Approach (MBA) – Banks assign risk weights on the basis of information contained in funds mandate or in relevant national legislation.
    c. Fall Back Approach (FBA) – applies a 1,250% risk weight to bank's equity investments in funds.

9. The Commission seeks to implement BCBS published standards on a new standardised method to compute the exposure value of derivatives exposures. This was done in order to address shortcomings of the existing standardised methods and replaces the previous Mark-to-Market method. The proposal introduces this new Standardised Approach for Counterparty Credit Risk (SA-CCR) whilst ensuring that the new rules remain proportionate. This method is designed to be suitable for a variety of derivatives transactions, introduce standardisation and avoid undue complexity.

10. The proposal implements final BCBS standards on the treatment of exposures to central counterparties (CCPs). It seeks to establish a capital treatment that ensures banks' exposures to CCPs are adequately capitalised, while also maintaining incentives for central clearing and promoting robust risk management by banks and CCPs. The new BCBS standard improved upon the shortcomings of the previous interim BCBS standard. It includes a single approach for calculating capital requirements for a bank's exposure that arises from its contributions to the mutualised default fund of a qualifying CCP (QCCP) and an explicit cap on the capital charges applicable to a bank's exposures to a QCCP. It employs a standardised approach for counterparty credit risk to measure the hypothetical capital requirement of a CCP. It also specifies how to treat multi-level client structures whereby an institution clears its trades through intermediaries linked to a CCP.

11. The proposals introduce to the EU new, tougher, BCBS standards on market risk. The new standards, which result from the BCBS's fundamental review of the trading book, address problems of the previous framework. This includes the insufficient capture of the full range of risks to which institutions were exposed to and uncertainty about the boundary between the trading and non-trading (i.e. banking) book which created opportunities for regulatory arbitrage. The new standard contains revised rules for the use of internal models for calculating own funds for market risk, as well as a new standardised approach which replaces the existing one. Part Ten also includes a transitional provision over the course of which the own funds requirements for market risk will be phased in.

12. In line with developments in Basel, the proposals specify large exposures and their limits. The financial crisis demonstrated that a loss in one Global Systemically Important Bank (G-SIB) can trigger concerns about solvency in another G-SIB. This new large exposures framework therefore introduces new limits to exposures between entities. An exposure is large if its value is equal or more than 10% of an institutions Tier 1 capital. Exposure to a client or group of connected clients is limited to no more than 25% of Tier 1 capital. The proposals limit (G-SIB) to G-SIB exposure to 15% of Tier 1 capital. The proposals also specify conditions for exposures on an institution's trading book to exceed those limits. The proposals also require institutions to report to competent authorities their 10 largest exposures to shadow banking entities.

13. The proposal introduces a binding leverage ratio of 3%, which is designed to prevent institutions from excessively increasing leverage. Further consideration will be given to an additional buffer for G-SIBs when international discussions are complete.

14. The proposals increase proportionality by reducing the reporting and disclosure burdens on smaller lenders. The new framework takes into account the relative size and complexity of institutions. This includes small institutions only being required to report on an annual basis instead of a semi-annual basis as is the case for all other institutions. Part Eight of the proposals classifies institutions into three categories: significant, small and other. Disclosure requirements will apply to each category on a sliding scale basis, differing in substance and frequency of disclosures.

15. The proposal, follows agreement in Basel, with the introduction of the Net Stable Funding Ratio (NSFR), which is a new long term liquidity requirement. A new Title (IV) is added to Part Six, which establishes a harmonised standard for how much stable, long term sources of funding an institution needs to withstand periods of market and funding stress. The NSFR is calculated as the ratio of an institution's amount of available stable funding (ASF) to its amount of required stable funding (RSF).

16. The proposal introduces a transition period for the introduction of the new International Financial Reporting Standards 9 accounting requirements, which introduce 'expected loss' measurements that will require more timely recognition of expected credit losses. The transition is introduced in order to mitigate the cliff-edge impact on financial institutions of changes to accounting standards. Under these proposals credit institutions will be essentially allowed to 'top-up' their Tier 1 capital, and the amount by which they are able to do this by will fall

every year through to 31 December 2023, subsequent to which IFRS9 will apply in full.

17. The proposals recalibrate the capital requirements for exposures to Small and Medium Enterprises (SME's) and specialised lending. The proposal permanently extends an existing rule in CRDIV that gives lenders a discount in the amount of capital they need to hold against lending to SME's, in order to improve access to finance for SME's. The current capital reduction of 23.81% for exposure to an SME that does not exceed EUR 1.5 million (£1.27 million) is supplemented by a 15% reduction for the remaining exposure over EUR 1.5 million. It also introduces a similar discount to lending for infrastructure in order to promote infrastructure projects in sectors, such as transport and energy, which are important for the EU's economic growth by mobilising private finance for these infrastructure projects. The proposals specify criteria by which safe and sound infrastructure projects will be defined in order to reduce the risk profile of the exposures.

18. The review on investment firms is now in its second phase. In a first report the European Banking Authority (EBA) found that the bank-like rules under the CRR were not fit for purpose for the majority of investment firms, with the exception of the more systemic ones that pose risks similar to those faced by credit institutions. The EBA is conducting additional analytical work in order to determine a more appropriate and proportionate capital treatment for investment firms. The EBA is expected to deliver their final input to the Commission in June 2017. The Commission intends to present legislative proposals setting-up a specific prudential framework for non-systemic investment firms by the end of 2017. In the meantime it is considered appropriate to allow investment firms that are not systemic to apply the CRR in the version as it stood before the amendments come into force. However, systemic investment firms will be subject to the amended version of the CRR. This will ensure that systemic firms are treated appropriately while reducing the regulatory burden for non-systemic firms.

Bank Resolution Proposals

19. In November 2015, the Financial Stability Board (FSB) agreed a total loss absorbing capacity (TLAC) standard for global systemically important banks (G-SIB), set at a level which should ensure that if a G-SIB fails it has sufficient loss-absorbing and recapitalisation capacity available in resolution to implement an orderly resolution that minimises impacts on financial stability, ensures the continuity of critical functions, and avoids exposing public funds to loss.. Similarly, in the EU, the Banking Recovery and Resolution Directive (BRRD) requires resolution authorities to set an individual loss absorbing capacity requirement for each bank within its jurisdiction. This is known as the 'minimum requirements for own funds and eligible liabilities' (MREL). Taken in conjunction with the resolution tools, MREL/TLAC implementation should mean that in future when a firm fails, the costs will be borne by the creditors of a failed firm, rather than by the taxpayer.

20. The proposed changes are intended introduce the TLAC standard into EU law. The CRR proposals introduce a Pillar 1 requirement for G-SIBs to implement the TLAC standards through holding a minimum MREL of 18% of their risk weighted

assets (RWAs) with a 6.75% leverage backstop (a non-risk based measure) by 2022.

21. The BRRD proposals introduce the framework for setting an additional Pillar 2 requirement for G-SIBs and amend the framework for calibrating requirements for non-G-SIBs to support the implementation of the resolution plan. This sets MREL equivalent to a maximum of twice the minimum capital requirement.

22. G-SIBs must meet their Pillar 1 requirement with subordinated liabilities, apart from 3.5% which may be unsubordinated if the resolution authority agrees, and the resolution authority can require an additional amount of the Pillar 2 requirement to be subordinated to avoid no creditor worse off risks. The latter provision thereby permits the resolution authority to require a limited amount of subordination for non-G-SIBs. ‘Soft’ guidance MREL may be set up to a maximum of the level of the combined buffer requirement in addition to the ‘hard’ Pillar 1 and Pillar 2 requirement.

23. A requirement is introduced for non-EU G-SIBs operating in the EU to pre-position internal TLAC (iTLAC) in their European operations. The amount of iTLAC pre-positioned is calculated as at least 90% of their projected external TLAC requirement if the EU operations were an independent resolution entity.

24. The Commission proposals also amend requirements in BRRD for the contractual recognition of bail-in and introduce new moratorium powers. A separate Explanatory Memorandum covers the Commission’s proposal on the ranking of unsecured debt instruments in insolvency hierarchy.

25. Article 55 of the BRRD requires firms to include a clause in a large number of contracts governed by non-EEA law, acknowledging that the contract may be subject to the bail-in powers of the EU resolution authority. Article 55 has very broad scope and industry raised concerns that it was extremely difficult and costly to implement and extends to contracts which would be unlikely to be bailed-in. The Commission proposal amends Article 55 so that it need not apply in instances of legal, contractual and economic impracticability.

26. The Commission’s proposal introduces a new pre-resolution 5-day moratorium tool moratorium tool and adds another resolution moratorium tool which is limited to 5 days. The moratorium would freeze the flow of payment and delivery obligations for a short period of time (subject to exceptions, including covered deposits).

27. The package of proposals includes amendments to the SRMR. The intention of these amendments is to implement the TLAC standard for firms under the Single Resolution Mechanism. These regulations do not apply to the UK.

28. The proposals are accompanied by an impact assessment and a summary of the impact assessment, both of which appear as ADDs multiple times.

SCRUTINY HISTORY

29. CRD IV and CRR were proposed by the Commission in 2011 in documents 13285/11 and 13284/11. They were formally adopted in 2013 having cleared scrutiny in the EUC on 25/04/12 and 14/05/13 respectively. Both documents

were cleared simultaneously by the Commons ESC through debate on 14/03/12. BRRD was proposed in 2012 in EU document 11066/12. It was adopted in 2014 following clearance by the Commons ESC on 12/06/13 and the Lords EUC on 18/06/13.

MINISTERIAL RESPONSIBILITY

30. The Chancellor of the Exchequer has responsibility for United Kingdom policy on European Union monetary and economic issues. The Foreign and Commonwealth Secretary and the Secretary of State for Exiting the EU are responsible for overall United Kingdom policy towards the European Union.

INTEREST OF THE DEVOLVED ADMINISTRATIONS

31. Financial services and bank resolution are reserved matters under the UK's devolution settlements and no devolved administration interests arise. The devolved administrations have not been consulted in the preparation of this EM.

LEGAL AND PROCEDURAL ISSUES

i. Legal basis

32. The proposed Regulation (14775/16, COM(2016) 850 final), resolution Directive (COM(2016) 852/3) and SRM Regulation have their legal basis in Article 114(1) of the TFEU and the proposed Directive (14776/16, COM(2016) 854 final) has its legal base in Article 53(1) of the Treaty on the Functioning of the EU (TFEU).

33. The Justice and Home Affairs opt-in is not a consideration in relation to these legislative proposals.

ii. European Parliament Procedure

34. The Directive and Regulation are adopted by the Ordinary Legislative Procedure, with the joint agreement of the Council (Qualified Majority Voting) and the European Parliament.

iii. Voting procedure

35. Qualified Majority Voting (QMV).

iv. Impact on United Kingdom Law

36. The Directives will need to be transposed into UK law by way of amendments to the Capital Requirements Regulations 2013, the Banking Act and the Prudential Regulation Authority (PRA) Rulebook. Amendments to the Financial Services and Markets Act 2000 and the Financial Conduct Authority (FCA) Handbook may also be required. The Directive will come into force on the twentieth day following their publication in the Official Journal of the European Union. Member States are required to adopt and publish national implementing measures within one year of that date.

37. The Regulation will be directly applicable in the UK on the date that it comes into force (on the twentieth day following its publication in the Official Journal of the European Union). It is possible that some provisions may require transposition in order to be fully effective, for example where they confer a discretion.

v. Application to Gibraltar

38. Both the Directives and the Regulation will be applicable to Gibraltar

vi. Fundamental rights analysis

39. No fundamental rights issues arise from this proposal

APPLICATION TO THE EUROPEAN ECONOMIC AREA

40. The capital requirement proposals will apply to members of the EEA. The BRRD and SRMR are EEA relevant.

SUBSIDIARITY

41. The Government is satisfied that no subsidiarity concerns arise as a consequences of these proposals. Prudential rules, capital requirements and resolution rules for banks and investment firms are an issue across the EU and these measures aim to supplement already existing EU legislation. EU legislation is required to amend existing EU rules.

POLICY IMPLICATIONS

42. On 23rd June the EU referendum took place and the people of the United Kingdom voted to leave the European Union. The UK remains a full member of the EU until withdrawal. Full rights and responsibilities continue to apply and UK will continue to play a constructive role and fulfil our responsibilities in the meantime. Now that the proposal has been adopted by the Commission it will be negotiated in Council and European Parliament in the usual way, and the UK will defend its interests.

Capital Requirements Proposals

43. The Government welcomes the Commission's proposals and measures to support the financial stability of the EU's banking system. These measures will make institutions better capitalised, have more stable sources of funding, prevent them from having excessively leveraged balance sheets and allow them to be resolved more effectively. This will put banks in a better position to withstand economic shocks, reduce the likelihood that they would need to be bailed out by the public sector and in the event of failure, minimise the impact on taxpayers and real economy.

44. The Government recognises the importance of making sure that the regulatory framework simultaneously facilitates the ability of banks to provide support to the real economy. We also welcome the addition of measures to increase proportionality and reduce the burden on smaller and less complex institutions.

45. The Government strongly supports international harmonisation and the implementation of the internationally agreed Basel standards. International

harmonisation provides regulatory certainty and supports financial stability, reducing costs to the wider economy and contributing to collective growth and competitiveness. In that context the government supports measures implementing international standards on:

- Counterparty credit risk.
- Exposures to CCPs.
- Market risk, although further analysis of the Commission's proposed transition period will need to be undertaken.
- Changes to the large exposures framework.
- Equity investments in funds
- Interest rate risks implementing international standards agreed at BCBS.
- The leverage ratio, already applied in the UK by the Bank of England.
- The Net Stable Funding Ratio.

46. As negotiations progress, the Government will push for EU standards to be updated in line with developments internationally.

47. On Pillar 2 capital requirements and guidance, the Government supports the harmonisation of rules, which will provide certainty to the market, so long as supervisors have the necessary flexibility to allow them to react to, and pre-empt, financial stability risk.

48. The Government supports the focus on proportionality in the provisions for reporting and disclosure requirements. These calibrate the prudential rules for smaller firms, which will reduce the compliance costs for smaller and less complex institutions. This will all help to support the wider economy as well as competition in the banking sector.

49. The Government recognises that bank-like rules are not appropriate for the majority of investment firms. The Government supports further analysis towards the goal of giving investment firms the dedicated capital regime they require.

50. The new IFRS9 accounting standards will impact bank capital ratios as a lot of own funds may no longer be considered Tier 1 capital. Therefore the Government, in agreement with the Bank of England, welcomes the introduction of a transition period for the implementation of the new rules in order to mitigate against any cliff edge effects.

51. The Government supports the provisions for SME and specialised lending as these improve SME's access to finance. The Government aims to ensure that the details are right so that these measures will support economic growth and competitiveness while not compromising financial stability.

52. The Government is currently undertaking analysis as to what, if any, implications the intermediate holding companies (IHC) measure will have on the UK and the UK's banks.

53. The Government is considering the impact of the proposals on remuneration, which may restrict the ability of the Prudential Regulatory Authority (PRA) and the Financial Conduct Authority (FCA) to apply proportionality when applying remuneration rules to smaller firms. The government is performing analysis and engaging with stakeholders to evaluate the impact of these rules. The UK is at

the forefront of global efforts to tackle unacceptable pay practices in the banking sector and has the toughest regime on pay of any major financial centre. Currently some remuneration rules are disapplied to firms with asset sizes under £15 billion. The proposals reduce this proportionality threshold to firms under £5 billion, increasing the number of firms the remuneration rules apply to.

Bank Resolution Proposals

54. Following the global financial crisis, domestic, European and international consensus was reached that the policy framework for dealing with struggling banks needed to include tools to bail-in struggling banks, to avoid future bail-outs. The agreement of the TLAC standard in November 2015 was an important milestone, establishing a clear standard to ensure that G-SIBs will have sufficient loss-absorbing and recapitalisation capacity available for authorities to implement an orderly resolution.

55. The Government welcomes the move to transpose the TLAC standard into EU law to provide clarity and consistency in this area. However, the UK has some concerns about the details of the proposal. It is important that the proposal transpose internationally agreed standards fully and truly. It is also important that the proposals do not impose constraints on the flexibility for the resolution authority to set an appropriate amount and quality of loss absorbing debt to support the resolution strategy.

56. The government welcomes the proposed amendments to requirements for the contractual recognition of bail-in, which are intended to ensure a more proportionate approach to the requirement. The government will continue to engage with the Commission to ensure that firms must include the contractual provision unless impracticable, similar to the approach taken in the UK.

57. The moratorium tool is a key element of effective resolution. However, the government will explore how these new powers work in relation to the moratorium tool already provided in BRRD and the existing pre-resolution powers.

CONSULTATION

58. The Government will continue to undertake extensive bilateral and multilateral consultation with regulatory authorities, other Member States, the EU institutions, and industry stakeholders throughout the negotiation. No formal domestic consultation was launched, but the Commission did undertake full public consultations earlier in the year. In July 2015 the Commission launched a consultation on the possible impact of CRR and CRD on bank financing of the EU economy. In September 2015 the Commission also launched a Call for Evidence for EU financial legislation. The Commission further consulted stakeholders on specific provisions on remuneration, proportionality and the implementation of the NSFR in the EU. A number of measures also follow standards developed in Basel, which were subject to extensive consultation.

IMPACT ASSESSMENT

59. Joint impact assessments were undertaken by the Commission in some cases. Addendum 1 of CRD, addendum 2 of CRR and addendum 1 of BRRD are

covered by SWD (2016) 377 final. Addendum 2 of CRD, addendum 3 of CRR and addendum 2 of BRRD are both covered by SWD (2016) 378 final.

60. The Government considers that the Commission's Impact Assessment provides appropriate analysis of the issues facing the market and the potential impact of the policy options developed. Additionally BCBS is continually carrying out Basel III monitoring exercises. These monitor the impact of Basel III rules and measures and report on a semi-annual basis. The results of these exercises are published at the end of June and December each year. The Government considers that the continual monitoring of the impact of internationally agreed standards by BCBS provides appropriate analysis for impact of these policies.

FINANCIAL IMPLICATIONS

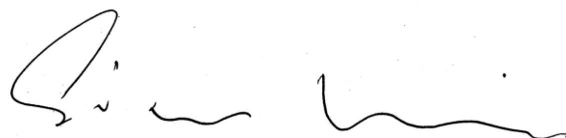
61. There are no direct financial implications of the Commission proposal on either the budget of EU nor for the UK Exchequer.

62. To the extent that a financial institution does not already have sufficient capital to meet the new/revised capital requirements it would have to either raise capital or reduce its exposures to meet the new standards. Likewise is a firm does not already have sufficient stable funding to meet the stable funding requirement it would have to either raise additional stable funding or change the maturity structure of its assets. There will also be a one off cost for firms as they adapt to new reporting requirements. However the increased proportionality and the simplification of reporting and disclosure requirements for smaller firms would reduce costs and result as a net benefit for these firms.

63. To the extent that a financial institution does not already have sufficient MREL eligible debt to meet new requirements it will have to issue this debt. Any costs will be borne by firms.

TIMETABLE

64. The proposals were discussed at ECOFIN on 6 December. Council welcomed the proposals and Member States, including the UK, intervened to express views on the detail. The Chancellor set out the UK's support for the continued implementation of international standards, the need for appropriate levels of supervisory flexibility to allow regulators to go further if needed, and raised concerns over the Commission's proposed plans for intermediate holding companies. Negotiations will be taken forward by the Maltese Presidency in 2017, who have expressed an intention to report back on progress in time for June ECOFIN.



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