Statement to the Joint Committee on Finance, Public Expenditure and Reform, and Taoiseach – 10am, 9 March 2017

INTRODUCTION

Cathaoirleach, Deputies and Senators thank you for inviting the Department here today to discuss with the Committee the Risk Reduction Proposals published by the European Commission in November 2016.

This banking reform package aims to complete the reforms that the EU implemented in the wake of the financial crisis, which made the financial system more stable and resilient. These proposals tackle remaining weaknesses and implement some outstanding elements that are essential to ensure the institutions' resilience. These risk reduction measures will not only further strengthen the resilience of the European banking system and increase market confidence, but will also allow further progress in completing the Banking Union - an issue to which I will return to shortly.

The Commission is proposing amendments to the following key pieces of legislation:

- The Capital Requirements Regulation and Directive, CRR and CRD, which were adopted in 2013 and which provide the prudential requirements for institutions and rules on governance and supervision of institutions operating in Europe;

  and

- The Bank Recovery and Resolution Directive and the Single Resolution Mechanism Regulation (BRRD and SRMR) which were adopted in 2014 and which set the rules on the recovery and resolution of failing institutions and establish the Single Resolution Mechanism, respectively.

The proposals aim to implement international standards into EU law, while taking into account European specificities and avoiding undue impact on the financing of the real economy.

CRR/CRD

The Capital Requirements Directive IV sought to address a number of the lessons learned from the financial crisis in the years following 2008. Such lessons included the fact that banks which appeared to be resilient were found to be poorly capitalised in terms of quality and quantity of capital. It was also evident that banks reliance on short-term liquidity had grown in the period up to 2008, which resulted in financial institutions becoming heavily reliant on emergency liquidity provided by central banks as market sources of short-term funding disappeared. Other issues such as inadequate group wide risk management and insufficient governance were also revealed.

The Capital Requirements Directive and Regulation – CRD IV and CRR – were introduced in 2013 in response to the lessons learned across the world and included, among other things, requirements for banks to hold high quality capital as well as enhancing supervisory powers in order to assess and address Banks' capital, business models, governance and their risk profiles.

While these reforms made the financial system more stable and resilient against many types of possible future shocks and crises, they did not comprehensively address all identified risks. In order to therefore complete the reform agenda the EU Commission introduced these proposals we are discussing today.

The amendments to CRD IV and CRR which are introduced in these proposals for the most part follow internationally agreed standards. Such standards include a binding Leverage Ratio which seeks to prevent banks from excessively increasing debt, as well as a Net Stable Funding Ratio to ensure that banks have stable long term funding sources in order to prevent their vulnerability to liquidity issues.

In addition to introducing these international standards, the proposals aim to refine and improve the existing rules, especially in terms of making them more proportional for smaller and less complex institutions, so that they are not subject to an excessive regulatory burden, disproportionate to their size and business models.

Another area the proposals seek to refine is regarding the process that enables bank supervisors to impose additional capital requirements on financial institutions, often referred to as “Pillar II” requirements. The EU Commission is looking to bring consistency and clarity to the process as the current framework allows for different interpretations meaning that the level of additional capital being added varies substantially across the EU.

These proposals also introduces changes to the SME supporting factor which is intended to increase the provision of credit by banks to finance the real economy. This is achieved by making it more attractive for Banks to lend money to SMEs, there is also proposed changes to help promote bank lending for infrastructure projects.

The next proposal from the Commission relates to recovery and resolution of financial institutions.

BRRD

The EU Bank Recovery and Resolution Directive and the Single Resolution Mechanism Regulation, adopted in 2014, provides authorities with more comprehensive and effective arrangements to deal with failing banks at national level, as well as cooperation arrangements to tackle cross-border banking failures.

Resolution occurs at the point when the authorities determine that a bank is failing or likely to fail, that there is no other private sector intervention that can restore the institution back to viability within a short timeframe and that normal insolvency proceedings would cause financial instability.

This particular proposal provides for a number of amendments to the BRRD, as follows:

- The EU resolution framework, consisting of BRRD and SRMR, requires banks to comply with the **Minimum Requirement for Eligible Liabilities**, or “MREL”. This is achieved by the bank holding instruments that can be written down or “bailed in” if the bank is in difficultly and is placed into resolution. The bailing in of liabilities is intended to ensure that losses are absorbed by the creditors to the bank and in doing so recapitalises the bank allowing it to operate normally post resolution. The proposed amendment ensures that MREL complies with international standards in this area to prevent any unwarranted legal complexity and compliance costs due to a potentially parallel application of these rules.

- There is a proposed amendment to the BRRD which seeks to ease compliance costs of banks where their liabilities are governed by the laws of third countries.

- A further amendment to the BRRD seeks to harmonise the powers of resolution authorities to suspend the executions of bank commitments towards third parties, known as the moratorium tool.

- There is also a proposal for an EU harmonised approach on bank creditors' insolvency ranking. The harmonised approach would enable banks to issue debt in a new statutory category of unsecured debt available in all EU Member States which would rank just below the most senior debt and other senior liabilities for the purposes of resolution. The introduction of clear, harmonised rules on the position of bond holders in the bank creditors' hierarchy in insolvency and resolution will facilitate the way bail-in of liabilities is applied, by providing greater legal certainty and therefore reducing the risk of legal challenges.

Overall, the Department of Finance welcomes and broadly supports the proposals and believes that they will further strengthen the resilience of the European banking system and increase market confidence both in Ireland and the European Union. The proportionality aspects of the proposals should help relieve the regulatory burden for smaller institutions and we especially welcome the measures which aim to promote the financing of the real economy.

Banking Union

I will now provide a brief update as to the current position regarding Banking Union.

As you are aware, in 2012 the European Council agreed on a roadmap for completing EMU based on deeper integration and mutual support. Completing the Banking Union is an indispensable step to a full and deep EMU. The first pillar of the Banking Union consists of the single rulebook for the supervision of banks implemented by the Single Supervisory Mechanism; the second pillar consists of a common framework for bank resolution implemented by the Single

Resolution Mechanism. Those two pillars have been put in place. The third pillar, a deposit insurance scheme, is under negotiation at present.

The European Deposit Insurance Scheme, or "EDIS", seeks to deepen EMU and to weaken the link between banks and their national sovereigns by means of risk-sharing among all the Member States in the Banking Union.

Together with the national deposit guarantee schemes, EDIS would cover deposits below €100,000 of all credit institutions which are affiliated to any of the current national DGS in the Banking Union.

In the first stages of EDIS, re-insurance and co-insurance, funding would be shared between the Deposit Insurance Fund and the national participating DGS. The share of funding provided by EDIS in case of a pay-out would progressively increase. In the final stage, EDIS would fully fund pay-outs in the event of bank failures.

EDIS would intervene in two scenarios along with the national deposit guarantee scheme in the first two stages of EDIS:

- when a failing bank is liquidated and deposits need to be paid out, and

- when a failing bank is resolved and the transfer of the deposits to another institution needs to be financed so that deposit access is not disrupted.

As the third pillar of the Banking Union project, EDIS is an essential part of its guiding principle of weakening the link between banks and the sovereign, particularly since it should ensure that savings are equally protected in all Member States.

Conclusion

I hope you have found it useful the brief outline I have provided you on the Commission proposal and we are happy to take any questions you may have on these issues.