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Sustainable Architecture for Finance in Europe (https://safe-frankfurt.de/)

SAFE Finance Blog

The SAFE Regulatory Radar in December

12/18/2019

The ECB's plan to include climate change in its models, political agreement on the Taxonomy Regulation, and other topics: a selection of financial regulatory developments from this month

At the end of each month, the SAFE Regulatory Radar highlights a selection of important news and developments on financial regulation at the national and EU level.

Financial supervision: Council of the EU adopts a review of the supervisory framework for financial institutions

On 2 December 2019, the Council of the EU adopted a first fundamental review (https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-supervision-and-risk-management/european-system-financial-supervision_en#reviewoftheesfs) of the functioning of the European system of financial supervision (ESFS (https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-supervision-and-risk-management/european-system-financial-supervision_en)).

The ESFS (European system of financial supervision) was established in 2011 and includes the three European supervisory authorities (ESAs): the European Banking Authority (EBA (https://eba.europa.eu/)), the European Insurance and Occupational Pensions Authority (EIOPA (https://eiopa.europa.eu/)) and the European Securities and Markets Authority (ESMA (https://www.esma.europa.eu/)). Also, the European Systemic Risk Board (ESRB (https://www.esrb.europa.eu/home/html/index.en.html)) which is responsible for the macroprudential oversight of the EU financial system as a whole belongs to the ESFS (European system of financial supervision).

The main areas covered by the proposal amending the regulations which established the ESAs (https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-supervision-and-risk-management/european-system-financial-supervision_en#foundinglegislation), are mandate, governance, and funding of the ESAs (European supervisory authorities).

Regarding the scope of the authorities' mandates, the proposal (https://data.consilium.europa.eu/doc/document/PE-75-2019-INIT/en/pdf)recognizes a formal role to the ESAs (European supervisory authorities) in the ongoing monitoring of the equivalence process, improving their ability to ensure the correct application of Union law. It also transfers supervisory powers to the ESAs (European supervisory authorities) in targeted areas with predominantly third country or cross-border relevance.

With respect to governance, the proposal envisages independent members with voting rights in the decision-making process alongside the national competent authorities. It also introduces a new appointment procedure and an enhanced standing for the Chairperson of the ESAs (European supervisory authorities). Also, the proposal replaces the Management Board by an independent Executive Board composed of externally appointed full-time members.

Finally, when it comes to funding, the current annual EU contribution to the ESA institutions' budget is maintained. However, the amending proposal replaces the residual funding from national competent authorities with private sector contributions.

The new law (https://data.consilium.europa.eu/doc/document/PE-77-2019-INIT/en/pdf)introduces targeted changes in the Chair's mandate, in the composition and functioning of the ESRB (European Systemic Risk Board) Secretariat, in the ESRB (European Systemic Risk Board) composition and addressees of ESRB (European Systemic Risk Board) warnings and recommendations.

The set of regulations will be signed in December and then be published in the official journal by the end of the year.

Monetary policy: Climate change to be included in the ECB (European Central Bank)'s macroeconomic models

Christine Lagarde, President of the European Central Bank (ECB) since 1 November 2019, was heard for the first time in her new function by the Economic and Monetary Affairs Committee of the European Parliament.

Reacting to recent comments of Ms. Lagarde, questions on how the ECB (European Central Bank) is responding to the threat of climate change were raised repeatedly during the hearing (https://www.europarl.europa.eu/news/de/press-room/20191202IPR67811/new-ecb-boss-quizzed-for-the-first-time-by-economic-affairs-committee). Members of the European Parliament (MEPs) across the political spectrum wanted to know how the ECB (European Central Bank) could incorporate climate change measures into their monetary policy and whether the central bank would stop supporting unsustainable companies through their asset purchase program.

Opposite to other monetary policymakers, Christine Lagarde calls for including climate change in the central bank's economic and risk analyses, and, therefore, in its monetary policy. At the hearing, Ms. Lagarde emphasized that the climate issue while being subordinate to the protection of price stability, would be included in the ECB (European Central Bank)'s macroeconomic models and taken into account in the risk assessment and supervision of EU banks. The strategic review which the ECB (European Central Bank) will conduct under her leadership will therefore cover these issues. She also reminded the MEPs (Members of the European Parliament) that the ECB (European Central Bank) is the main buyer of European Investment Bank bonds committed to phasing out fossil fuel investments.

Sustainable finance: agreement on the Taxonomy Regulation

On 5 December 2019, after the fifth round of political negotiations, the European Parliament and the Council of the European Union reached an agreement on the proposed Taxonomy Regulation (https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52018PC0353). The taxonomy is a legislative instrument of the Capital Markets Union that establishes a classification of the environmentally sustainable economic activities that satisfy technical screening criteria, a test would be introduced with the proposed regulation.

The Parliament and the Council have agreed that the scope of the taxonomy would not apply to all financial products, but only to those that contribute to environmentally sustainable economic activities. Previously, the EU Parliament supported the idea of an extended scope of regulation encompassing the full range of products.

There will be three categories of financial products: “green” for fully green investments and two other categories – “transition” and “enabling” – for the products that do not meet all criteria but may contribute to climate neutrality. Moreover, the second compromise foresees that the European Commission will adopt measures which implement the technical screening criteria, laying down what constitutes a sustainable economic activity, with limited involvement of the member states. Finally, it was agreed that the Taxonomy Regulation applies from December 2021.

The agreement is provisional and requires to be approved by the member states and the European Parliament.

Capital Markets Union: The Council of the EU announced its position on recovery and resolution for central counterparties

On 4 December 2019, the Council of the EU adopted its position (https://www.consilium.europa.eu/media/41614/st14540-ad01-en19.pdf)on proposed legislation (https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52016PC0856) for clearing houses and their authorities. The Council did not set out changes to the proposal and is ready to start further negotiations with the EU Parliament. However, the Council suggested that the new legislative acts will start applying two years after coming into force. That should leave enough time for member states and for market participants to implement all measures and comply with them. The legislative reform aims to preserve central counterparties (CCPs) critical function and to provide the national authorities with the proper tools to manage crises.

The Council's position is based on a 3-step approach. First, the new legislation has to follow the principle of prevention and preparation. Second, the authorities will obtain the right to intervene at an early stage. Third, in case of a CCP (central counterparty)failure, the national authorities can use resolution tools such as the write-down of instruments of ownership and the sale of the CCP (central counterparty).

CCPs (central counterparties) play an essential role in maintaining the stability of financial markets. Establishing the European legal framework for their recovery and resolution aims to help them to manage risks and encourage less risky behavior of CCPs (central counterparties) and other market participants.

Banking Union: The Council of the EU approved its position on a new mechanism for out-of-court enforcement for non-performing loans

On 27 November 2019, the Council presented its opinion on a proposal (https://data.consilium.europa.eu/doc/document/ST-14261-2019-ADD-1/en/pdf)for a common framework and minimum requirements for an out-of-court mechanism for non-performing loans (NPLs). The proposed framework aims to recover the value from loans guaranteed with collateral in case the borrower is not able to pay it back.

The Council noted that the proposed legislation should only apply to collateral which is owned by a business borrower. To ensure the customer protection, consumer loans are planned to be excluded. According to the Council's position, the extrajudicial collateral enforcement mechanism should be voluntary. That means that both parties should agree on the clause to use such mechanism and the creditor should not be precluded from using other enforcement mechanisms that may be applicable under national law.

In March 2018, the European Commission proposed a legislative package to regulate NPLs (non-performing loans) that covers two areas: introducing common minimum coverage levels for newly originated loans which become non-performing and an efficient mechanism of out-of-court value recovery from secured loans. The Council reached its position (https://www.consilium.europa.eu/en/press/press-releases/2019/03/27/non-performing-loans-council-adopts-position-on-secondary-markets-for-bad-loans/)on the first proposal on 27 March 2019. As soon as the European Parliament agrees with its position, further negotiations between the Council and the Parliament can proceed.

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