The Weekly Report from Brussels, provided by the European Affairs team at the City of London, provides an update on key developments relating to financial services in the EU.

15 December 2017

Welcome to the Weekly Report from Brussels, prepared by the City of London Corporation European Affairs team.

This week includes:

- **European Council Summit**
- **European Parliament debate state of play of Brexit negotiations**
- **ECON Committee exchange views on the banking reform package**
- **In other news**
- **Upcoming EU Institutions events and consultations**

More information about the work of the City of London Corporation European Affairs team can be found **here.**

European Council Summit

The final European Council Summit of 2017 was held on 14-15 December. The first day of debate saw EU leaders, including UK Prime Minister Theresa May, discuss inter alia ongoing collaboration on security and defence; social, education and cultural issues; and the future of EU migration policy. Leaders of the EU27 convened on the second day of the Council Summit to determine the steps required to strengthen and deepen the Economic and Monetary Union (EMU) and the Banking Union. It also presented an opportunity for the EU27 to assess whether ‘sufficient progress’ had been achieved during Phase 1 of the Brexit talks, and to discuss the Council guidelines shaping Phase 2 of the negotiations including potential transitional arrangements.

'Sufficient progress' achieved in Brexit negotiations

Following the European Parliament's earlier **assessment** that sufficient progress had been achieved in Phase 1 of Brexit negotiations, leaders of the EU27 adopted **guidelines** allowing talks to move onto Phase 2 issues relating to potential transition arrangements and the future EU-UK relationship. In moving forward with the negotiations, EU27 leaders cautioned negotiators that 'the second phase can only progress as long as all commitments undertaken during the first phase are respected in full and translated faithfully into legal terms as quickly as possible'.

As regards possible transition arrangements, the Council guidelines advocate a similar approach to that which has already been set out by the UK government; i.e. a transition period of approximately two years, covering the whole of the EU acquis, with the UK continuing to domesticate EU law over the transition period and accept the jurisdiction of the Court of Justice of the EU (CJEU). Further, as stipulated in the agreed text, during any agreed transition period the UK will 'continue to participate in the Customs Union and the Single Market (with all four freedoms) during the transition, it will have to continue to comply with EU trade policy, to apply EU customs tariff and collect EU customs duties'. The Council hopes to adopt negotiating directives on transitional arrangements, to be drafted by the European Commission, in January 2018.

As regards the future relationship between the EU and UK, the text makes clear the EU27 leaders' desire for clarity from the UK government 'on its position on the framework for the future relationship', while reaffirming their approach to 'ensure a balance of rights and obligations, preserve a level playing field, avoid upsetting existing relations with other third countries' and, of course, to preserve the integrity of the Single Market.

Following the adoption of negotiating directives in January, the Council aims to agree on supplementary guidelines in March 2018 which will have a greater focus on the framework of the future relationship.

EMU and Banking Union

Leaders discussed the ongoing EU reforms and the work required to strengthen the EMU, particularly those reforms relating to the readiness of the EU as a whole to respond to potential economic shocks, such as the completion of the Banking Union. This not only relates to reaching an agreement on the creation of a European Deposit Insurance Scheme (EDIS), progress on which has been stalled by serious political unease with the balance between risk reduction and risk sharing, but also elements such as putting into operation a common backstop for the Single Resolution Fund (SRF), and further developing the European Stability Mechanism (ESM), possibly to become a so-called European Monetary Fund.

In his **comments** to the press following the Summit, Council President Donald Tusk stated that EU Finance Ministers would 'concentrate on areas where the convergence of views is greatest', which would suggest that more progress is expected on the evolution of the SRF and the ESM rather than discussions on EDIS. President Tusk suggested that some of the proposed EU reforms needed 'more time to mature'.

Council conclusions on the discussions held on 14 December, including comment on the One Planet Summit in Paris which took place earlier this week, can be found **here**.

European Parliament debates state of play of Brexit negotiations

Background

Ahead of the European Council Summit, MEPs noted 'sufficient progress' in Phase 1 of the Brexit talks but stressed that there are outstanding issues which remain to be addressed. Last week, the Brexit negotiators' presented a Joint Report that confirmed progress in the areas of citizens' rights, the Northern Irish border with Ireland and the financial settlement. The **Joint Report**, approved by EU27 leaders (see above), will enable talks to progress to determining the future relationship between the UK and EU as well as possible transition arrangements.

MEPs praised this success, but also expressed concerns as to how these commitments are to be translated into legal text.

Statement of Michel Barnier

The EU's Chief Negotiator, Michel Barnier, gave a statement to the plenary insisting that the EU 'will never accept any backtracking' on the commitments made and stated that they 'will have to be quickly converted into a legally binding Withdrawal Agreement'. This was a condition for the continuation of the negotiations.

As regards the interpretation of the agreed rights of citizens', Mr Barnier advised that 'current

ECJ case law will be part of the Withdrawal Agreement, and future case law will apply. British courts will have to take "due regard" of case law for the lifetimes of the citizens concerned.'

Mr Barnier noted that, with the agreement of the European Parliament and EU27 leaders, the next steps will be to draft a Withdrawal Agreement, move forward on defining a transition period and begin negotiations regarding the future relationship between the UK and EU. In relation to this, Mr Barnier opined that 'we think that a close, future partnership remains our common horizon'.

MEP Commentary

Guy Verhofstadt MEP (ALDE, Belgium), Chair of the Parliament's Brexit Steering Group, urged the prompt transposition of commitments 'into the legal text of a Withdrawal Agreement'. Further, Mr Verhofstadt commented on the number of issues that remain outstanding. He called for citizenship rights to 'also be granted to future partners' of EU citizens currently residing in the UK, for example. Mr Verhofstadt was adamant that citizenship rights should be conferred and enforceable without need for recourse to expensive legal processes in order that the rights become as effective for 'a European banker in the City' as they are for 'a Polish plumber or Romanian doctor'.

Comments were also made in relation to possible transitionary arrangements and the complexities ahead for negotiators to navigate. Danuta Huebner MEP (EPP, Poland) commented that 'we have to bear in mind that the EU acquis is strongly interdependent in a legally and politically complex way and this is a challenge in itself, but there will also be parts of the transition deal going beyond prolongation of the acquis, and this will require in my view a strong credible joint oversight mechanism with a strong role for the European Commission on our side.'

A number of MEPs praised the progress made and commented on the upcoming opportunity to negotiate a free trade agreement that benefits both the UK and EU. Leader of the Parliament's European Conservatives and Reformists (ECR) Group Syed Kamall MEP (UK) commended the progress: 'I hope that, last week, the British Prime Minister and Donald Tusk laid the first foundations for the journey ahead – a future where the EU signs a mutually-beneficial trade agreement with the UK, as one of the world's largest economies, but where we both make the case for open and free trade.'

ECON Committee exchange views on the banking reform package

Background

At an extraordinary meeting of the Economic and Monetary Affairs (ECON) Committee, MEPs held an exchange of views with Gunnar Hökmark MEP (EPP, Sweden) and Peter Simon MEP (S&D, Germany) as the rapporteurs on the banking reform package recently set out by the European Commission.

Gunnar Hökmark

Mr Hökmark advised the Committee that the legislation needed to take account of two main priorities. Firstly, the need for stable and dynamic banks must be met in a way that is supportive of the ambition to investment in Europe. In not achieving this ambition, there is a risk of financial instability in the form of a negative effect on economic development. Secondly, the legislation must 'defend the two important dimensions' of the Banking Recovery and Resolution Directive (BRRD). By this, Mr Hökmark suggested that bank defaults should not lead to tax payers having to provide funds unless there are 'crucial or necessary circumstances'. Mr Hökmark commented that this was a step towards 'revitalis[ing] capitalism in banks and safeguarding market discipline'. The underlying concept is that when investing in a bank, it should be known that there is a large exposure to risk.

The legislation is intended to provide for well capitalised institutions that are not forced to issue extra debt. Mr Hökmark opined that banks should in fact have higher capital levels than the legal requirement. Further, subordinated debt levels should not be higher than total loss absorbing capacity (TLAC).

Mr Hökmark had proposed an amendment to the moratorium provisions of the legislation. He contended that being in a moratorium gives a clear signal to the market that an institution is in distress and therefore an extended period in this state will lead to a total loss of credibility. Mr Hökmark analogised this to 'increasing the chance that the operation will be successful, but also the chance that the patient will not survive'. Taken together, the legislation on capital requirements is intended to give competent authorities clear rules on how to assess problems. This was supported by Ashley Fox MEP (ECR, UK) who noted that extending beyond two days could have 'severe unintended consequences for the economy' and noted the fact that no impact assessment had been conducted in relation to this provision.

MEP comments

Broadly, MEPs welcomed the banking package as a whole however some improvements were sought. Silva Pereira MEP (S&D, Portugal) contended that there should be a harmonised minimum transitional period for certain provisions to avoid a future cliff-edge scenario.

Lieve Wierinck MEP (ALDE, Belgium) noted that banks are evolving in a globalised environment and echoed the European Central Bank's (ECB) caution that over-regulation of the minimum requirement for own funds and eligible liabilities (MREL) could have implications for financial stability. Martin Schirdewan MEP (Greens, Germany) also commented on MREL calibration, which he opined should be based on unconditional subordination. 'Otherwise we fear that on the basis of the no creditor worse off principle, there will be constantly challenges to bail in'.

Peter Simon

Mr Simon interpreted the Commission's proposals as balanced. In his assessment, he had tried to take into account as many national specifities as possible in order to produce a balanced report. He advocated raising the leverage ratio proposed by Commission to 4% for systemically important institutions as most such institutions are already able to meet the 3% requirement. In other countries higher leverage rates are already in force (for example 5% in the US and 6% in Switzerland).

Mr Simon has revised the Commission's implementation phase to allow 'more margin for manoeuvre' by suggesting a five year phase to reach 100% compliance. Further, he has proposed to adjust the remuneration ratio to a provision comparable to that found in US legislation. According to this ratio, each bank may decide for itself the remuneration of board members as compared to the median wages of employees more broadly but is obliged to disclose this. This is intended to bolster transparency and, without enforcing the level of remuneration, allow for pressure to be applied by shareholders. It was noted that the legislation also requires institutions to take account of climate change risks, and green and sustainable finance.

Commenting broadly on the package, Mr Simon contended that good periods should be used to strengthen banks and ensure lending to real economy. The trading ability of banks has led to instability in the past and therefore the Commission has proposed a more stringent framework.

MEP Comments

MEPs were largely satisfied with the package and Mr Simon's proposed amendments however some concerns were raised. Othmar Karas MEP (EPP, Austria) feared that the legislation might 'throw the baby out with the bathwater' and raised questions as to whether the inclusion of climate risks and support for green investment had been wrongly 'shoehorned' into this report. Mr Karas commented that the core criteria for assessing risk exposure were assessments of whether the risk is measured and justified. He therefore advocated instead a comprehensive call for evidence when taking on the action plan for sustainable investment.

Mr Fox expressed surprise that the Commission has proposed an intermediate parent undertaking (IPU) without an impact assessment and was disappointed that the rapporteur has not suggested changes. He called for a detailed analysis to ensure capturing the correct institutions with these provisions. Further, Mr Fox stated that he did not approve of cross border prudential waivers.

Next Steps

The rapporteurs are working to a 25 January deadline for amendments to the files and are anticipated to complete their work in advance of this date.

In other news

- Comission Vice President Valdis Dombrovskis set out the three main points of an upcoming action plan on sustainable and green finance in a **speech** at the One Planet Summit in Paris.
- The European Council approved the **EU's legislative priorities** for 2018-2019 which have been agreed with the European Parliament and the Commission.
- The Estonian presidency and the European Parliament reached a provisional deal on structural funds and on the main pillars of the revision of the Commission's so called **Omnibus Regulation**.
- The European Council extended the **European fund for strategic investments (EFSI)** with a target of half a trillion euros of additional investments.
- The **European Commission** recognised several third country trading venues as operating in an equivalent regime for trading shares under the EU's revised Markets in Financial Instruments Directive (MiFID II).
- The **European Parliament** backed recommendations from the PANA Committee for EU governments to do more to curb tax-avoidance and evasion as well as money-laundering activities across the bloc.
- The **AFCO Committee** voted on a report by co-rapporteurs in relation to the composition of the European Parliament.

Upcoming EU Institutions events and consultations

5 January: Deadline for EBA **consultation** for home-host cooperation under PSD2
5 January: Deadline for **consultation** paper on EIOPA's second set of Advice to the European

Commission on specific items in the Solvency II Delegated Regulation

15 January: Deadline for ESMA **consultation** on draft guidelines on standards for trade repositories' derivative positions

22 January: Deadline for Commission **consultation** on how best to encourage sustainable investments

31 January: Deadline for EBA **consultation** on guidelines to strengthen pillar 2 framework

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City of London Research

The City of London produces regular research on EU Financial Services which can be accessed **here.**

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