Banking sector

The banking system in the Euro area showed itself to be resilient throughout the many bouts of financial market volatility that occurred in 2016. Banks' capital and leverage ratios showed an improvement on 2015. In late July the European Banking Authority (EBA) published the results of the stress tests carried out on the European banking sector. For all the banks that were tested, the results showed an average CET1 (highest quality) capital ratio of 13.2%, well above the level demanded by regulators. In the worst of the scenarios for which the test was carried out, the average ratio would fall to 9.4% in 2018, with just one bank showing a negative CET1 ratio.

— European banks proved to be resilient in the face of repeated episodes of volatility in the financial markets. Bank profitability continues to face major challenges related to weak economic recovery, persistent low interest rates, asset quality issues and a heavy regulatory burden.

Regulatory environment

Banking Union

2016 was the first year in which the first two pillars of Banking Union were in full operation at the same time.

— The Single Supervisory Mechanism (which seeks to ensure uniform supervision across all Euro area banks;

— The Single Resolution Mechanism (which seeks the effective conduct of resolution processes for failing banks).

Full Banking Union is, however, not complete and a third pillar remains to be added: a European Deposit Insurance Scheme (EDIS).

In its 2015 proposal, the European Commission (EC) recommended that the new EDIS should be introduced gradually. This would begin in 2017 with a Europe-wide reinsurance system for national deposit guarantee schemes, followed by a gradually increasing mutualisation of deposit protection until full mutualisation was reached in 2024. There would in practice be no advance in the sharing of risks until 2020, when the co-insurance phase would begin. In April 2016 the ECB showed its support for the proposal. During the year, however, a number of EU member states expressed a reluctance to embark on any form of risk mutualisation under a deposit guarantee scheme unless the risks still present in domestic banking systems had first been reduced. In response to these reservations, in November the European Parliament's Economic and Monetary Affairs Committee published a draft report in which it modified the Commission's proposal and replaced it with a reinsurance system to be launched in 2019 with little or no mutualisation. The demands of certain key countries and the European political calendar make it unlikely that the European Deposit Insurance Scheme can be in full operation by the time or in the form proposed by the EC.

The Capital Markets Union - an action plan

In mid-September the EC put forward further measures to accelerate the completion of the Capital Markets Union (CMU). The aim of the CMU is to establish a genuine single capital market among EU member states, with a view to providing finance for companies, especially SMEs and start-ups, and thus boosting investment and job creation.

Among the most significant measures proposed by the EC was the early introduction of the package of rules on asset securitisation, which has the potential to rapidly increase the availability of funds in the real economy. In particular, the European Parliament and the Council have adopted a securitisation package that is simple, transparent and standardised (STS). STS securitisations should, it is hoped, free up capacity on bank balance sheets and provide investment opportunities, stimulate the economy and increase financial stability. An agreement has also been reached on modernising the rules governing prospectuses. This will ensure greater ease of access to capital markets, especially for smaller companies. The EC also called on the European Parliament and the Council to finalise a proposal to strengthen venture capital markets and social investments. This will boost investment in venture capital and social projects and make it easier for investors to fund small and medium-sized innovative companies. In addition, the Commission stated its intention to take forward a programme to support the development of national and regional capital markets in member states.

The Commission has also proposed a series of measures to take forward the next phase of CMU actions in the short term. These measures include support for the development of personal pensions; drawing up a comprehensive European strategy on sustainable finance; and a coordinated policy approach that supports the development of FinTech in an appropriate regulatory environment. Finally, the Commission promised to consider, in close consultation with the European Parliament and the Council, the further steps in relation to the supervisory framework that are necessary to reap the full potential of CMU.

Macro-prudential policy

Macroprudential policies (such as rules requiring banks to build additional capital buffers and measures to limit risks in certain sectors) continued to play an important role in 2016.

In August the European Commission started on a consultation process to review the EU's macroprudential framework, having come to the conclusion that macro-prudential regulation had developed incrementally over the years and that the existing fragmentary approach had created deficiencies in the system. The aim of the review is to bring the different elements of the macroprudential framework into alignment to make the system more effective in operation, and to strike the right balance between flexibility at national level and harmonised regulation at EU level. It should be emphasised here that macroprudential policy is a vital complement to monetary policy and microprudential policy, having the capability to address national or sectoral imbalances and thus be a further aid in overcoming disparities in the financial and business cycles of different EU member states.

Regulatory framework

In 2016 the authorities stated their intention to complete the unfinished part of their programme of regulatory reform without significantly increasing overall capital requirements, and at the same time ensuring the integrity of the capital framework. However, the considerable number of legislative reforms in the pipeline (especially in relation to the calculation of risk-weighted assets) and further changes to follow in the gradual implementation (or "phase-in") period continued to weigh on banks' business operations as investors priced in the prevailing regulatory uncertainty in the markets.

Some of this uncertainty was removed by the Commission in late November, when it presented a set of proposals for the reform of bank regulation in the EU with a view to boosting financial stability and strengthen the resilience of the region's banks. This addresses some of the weaknesses in the existing regulations and moves towards the definitive implementation of a more harmonised regulatory framwork within the EU, including regulatory elements that have recently been agreed at international level, while taking account of the specificities of EU institutions and the EU economy.

The EC proposes amendments to the following pieces of legislation:

— The Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism Regulation (SRMR) which were adopted in 2014 and which set out rules on the recovery and resolution of credit institutions and establish the Single Resolution Mechanism, one of the three pillars of the Banking Union.

— The Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD) which were adopted in 2013 and set out a regulatory framework of prudential requirements for credit institutions and investment firms, as well as rules on governance and on the supervision of these requirements.

The Commission's proposals include the following:

— Greater harmonisation of national insolvency legislation on the ranking of creditors in the event of insolvency. A new "senior non-preferred" category of senior debt is proposed, which will satisfy the subordination requirements for eligibility as cover for the requirements known as TLAC ("total loss absorbing capacity") and MREL ("minimum requirement for own funds and eligible liabilities"). The MREL applies to all European banks and the TLAC to global systemically important institutions (G-SIIs).

— The introduction of the TLAC into European legislation and the integration of TLAC requirements within the MREL rules, thus avoiding duplication and two sets of requirements side-by-side.

— A binding minimum Leverage Ratio (LR) of 3%.

— A binding minimum Net Stable Funding Ratio (NSFR) of 100%.

— Increased capital requirements for market risk (trading portfolio-related operations).

— Measures to enhance lending to particular sectors (SMEs and infrastructure).

The Commission has submitted this legislative package to tri-partite negotiations with the European Council and the European Parliament (the so-called "Trilogue" meetings) before the final drafts can be adopted as part of European law. Subsequently the directives will need to be transposed into the national laws of the different member states, whereas the regulations are directly applicable and do not require transposition.

In 2016, banking regulation in Spain focused on transposing EU legislation into Spanish law.
Notable new regulations included Bank of Spain Circular 2/2016, of 2 February, on supervision and solvency, which completed adaptation to the Capital Requirements Directive and Regulation (CRD and CRR); Bank of Spain Circular 5/2016, of 27 May, determining the bases and methods for calculating contributions to the Deposit Guarantee Fund; and the adoption by the Bank of Spain, on 27 July 2016, of the Guidelines on sound remuneration policies for credit institutions (EBA/GL/2015/22).