How the EU took account of lessons learned from the 2008-2012 financial and sovereign debt crises
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ECA team
Executive summary

I The 2008-2012 global financial and subsequent economic and euro area sovereign debt crises had **long-term effects on growth and fiscal stability in the EU**. Their effects were accentuated by weaknesses in the EU financial system and by the inadequate policy tools, surveillance and regulatory environment in place, as well as by the incomplete institutional architecture of the euro area.

II The EU has learned lessons from these crises and has responded to them. The European Court of Auditors has published a number of special reports related to this area since their outbreak. In this review, which is not an audit, we describe the developments over the last decade, together with remaining challenges, potential risks or policy gaps. We draw from our past audits and other reviews carried out by EU institutions or bodies, and other relevant international organisations. Our review provides a timely overview of the ongoing debate regarding how to respond to future challenges.

III We describe the financial and institutional reforms. The EU tightened the regulation and supervision of banks, and created a framework for their orderly resolution. European supervisory authorities were established and micro-prudential and macro-prudential rules for banks and their supervisors were enhanced. It also created new institutions and produced policy responses for EU economic coordination and support for Member States in difficulty.

IV These regulatory and institutional measures, together with significant financial and economic support for banks and Member States in difficulty, created a **more resilient EU economy**. Banks have been obliged to improve their capital buffers and their risk and liquidity management. They have set about reducing the level of non-performing loans.

V We point to challenges that remain. For example, for the financial sector, low profitability of banks, the continued existence of decreasing but still high levels of non-performing loans in certain Member States, the resolvability of banks, and the need to complete the Banking Union and develop the Capital Markets Union.

VI State aid measures to support banks and fiscal stimuli helped to stabilise the economy in the early phase of the crisis, but led to a significant build-up of public debt. This, coupled with market doubts about the resilience of the institutional architecture of the euro area, generated large pressure on the sovereign yields and credit ratings of
certain Member States, and the sovereign debt crisis spilled back to the banking sectors and the wider economy.

**VII** The EU has taken important steps to break the bank-sovereign nexus (also known as the “doom-loop”) by reducing the dependency of banks on public funds when facing the risk of failure, and developing the necessary instruments for their orderly resolution. **EU Member States took important fiscal and economic measures** to avoid excessive deficits, thereby improving their fiscal position.

**VIII** These responses to the 2008-2012 crises have led to **more scrutiny of the financial system and a banking system with better capital and liquidity buffers and bail-in options.** Reformed and new micro-prudential rules were used to monitor individual financial institutions, and macro-prudential policy is used to monitor and address systemic risks.

**IX** The responses also resulted in **enhanced monitoring and coordination of Member States’ fiscal and economic policies.** The European Semester, introduced in 2010, provides a framework for the coordination of economic policies across the EU and our audits in this area have demonstrated a good quality of analysis, leading to relevant recommendations. However, their low rate of full or substantial implementation remains a challenge.

**X** The crises also affected other sectors, notably **insurance, pensions and non-bank financial intermediaries.** Policy responses were developed to mitigate risks that could stem from these sectors. The EU has created an enhanced EU regulatory framework for the insurance and pensions sectors and has introduced new rules to regulate and strengthen public oversight of non-bank financial intermediaries, derivatives and securities financing transactions. While a significant effort was made to promote consistent and comprehensive supervision in all Member States, regulatory arbitrage remains a reality and supervisory convergence remains a challenge.

**XI** Since their establishment, **further power was given to EU-level supervisory authorities but most key decisions are still taken at Member State level.** Our audits have identified inefficiencies in managing conflicting national and EU interests, which are still not resolved. In addition, more resources are planned for European supervisory authorities subject to annual budgetary approvals in the coming years.

**XII** The COVID-19 pandemic will be an important test to assess the resilience of the EU economic and financial architecture. The impact of the pandemic is far larger than that of the financial crises of 2008-2012, both in terms of the size of the economic
effect and the scale of public response, as attested by fiscal measures and interventions under development.

XIII The EU has acted with a number of measures. Temporary exemptions from State aid rules and the activation of the general escape clause of the Stability and Growth Pact allow Member States to implement support to business and fiscal policies immediately. However, a Member State’s fiscal health prior to the COVID-19 crisis has an important bearing on the ability to deploy policies and therefore on the economic impact of the pandemic. Phased reforms will need to be implemented, particularly in Member States with low potential economic growth and/or high debt. The COVID-19 crisis risks widening economic divergences in the EU.
Introduction

Background

01 More than 10 years have passed since the global financial crisis of 2008, but its impact on Europe’s economies has been profound. By 2010, Europe was in the throes of a banking and euro area sovereign debt crisis, incurring significant public costs and suffering the worst recession since the EU was founded. The crises had long lasting effects on the economies of a number of Member States.

02 The crises had structural consequences. The Commission Economic Autumn forecast of 2016\(^1\) shows that the potential growth in the euro area fell from 1.9% in 2000-2008 to 0.5% in 2009-2014. It also shows that total investment in the EU fell by about 20% from 2008 to 2013, and despite the recovery and the new EU investment plan, investment as a share of GDP has still not reached pre-crisis levels. The EU aggregate public debt level, which was already high before the crisis (between 60% and 70% of GDP), did not fall below 80% in the decade following the crisis.

03 The response to the crises involved institution building at EU or intergovernmental levels: the European System of Financial Supervision; the Banking Union; the temporary European Financial Stability Facility; the European Stability Mechanism; and the European Fiscal Board.

04 The response also involved an intensive EU reform agenda for enhanced regulation, supervision, orderly resolution, economic coordination and support for Member States in difficulty. This included: enhanced micro-prudential and macro-prudential rules for banks and their supervisors; a new crisis management framework for banks which are failing or likely to fail; an action plan for the Capital Markets Union; temporary European Financial Stability Mechanism; reforms of the Stability and Growth Pact; increased economic coordination under the European Semester; the Macroeconomic Imbalance Procedure; the European Stability Mechanism (set up as an intergovernmental institution); and Outright Monetary Transactions by the European Central Bank.

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The COVID-19 pandemic has caused an economic shock, which is still unfolding. Sound recovery will depend on learning **lessons from the last crisis and being aware of the weaknesses observed**. In addition to the challenges still being felt since the last crisis, COVID-19 has brought a number of new ones.

**Review scope and approach**

**06** This review is not an audit. We met and consulted with the main EU level institutions and bodies concerned (Commission DGs ECFIN and FISMA, ECB, ESRB, SRB, EBA, ESMA and EIOPA) and reviewed a large volume of new EU rules, guidelines and studies published over the decade since the crises. The review also summarises findings from a number of special reports related to this area since the crises.

**07** The review was considered important to take stock of **EU responses a decade after the crises**. During the review, the **COVID-19 crisis** made this work increasingly more relevant and the review gives a timely overview of the ongoing debate regarding how to respond to future challenges. We provide a summary of key measures the EU took in response to crises, the progress it achieved, remaining challenges, potential risks or policy gaps, and information on first responses to the COVID-19 crisis, complementing other concurrent work we have on this subject.

**08** Our review outlines the main causes of the last financial crisis and the factors which led to a sovereign and economic crisis in the euro area and the EU. We give an overview of:

1. EU institutional and policy responses to the **financial crisis**, and the challenges which regulation, supervision and the operators in different sectors within the system are still facing;

2. EU institutional and policy responses to the **sovereign debt crisis**, including the main areas where progress has been made and challenges are still being faced; and

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2 ECA work related to COVID-19 includes: ECA opinion 3/2020 on amending EU regulation for the European Structural and Investments Funds’ use in response to the COVID-19 outbreak; an ongoing review on the EU’s contribution to the public health response to COVID-19; and an ongoing review on the COVID-19 economic policy response: measures and challenges in the context of EU economic coordination.
(3) Initial impact of the COVID-19 crisis visible in the EU at the time of the review, the first EU responses to this, and current challenges.
Main causes of the financial and euro area sovereign debt crises in the EU

Main causes of the 2008 financial crisis in the EU

The global financial crisis of 2008 originated in the US real-estate market with the bursting of the subprime housing bubble. This led to severe bank losses, and spilled over into the EU in 2008 mainly through securitised loans. As well as being amplified by existing weaknesses in the EU financial system, the crisis also revealed weaknesses in the surveillance systems, policy tools and regulatory environments of the EU and its Member States.

Different economic and financial conditions and policies across EU Member States at the onset of the crisis led to different impacts. However, some causes of the crisis were common to the EU financial system, such as the regulatory and supervisory framework, and economic governance arrangements (see Table 1).

Table 1 – Overview of main causes of the EU financial crisis

<table>
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<th>Main causes</th>
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<td>Financial system</td>
<td>○ <strong>Weak corporate governance and risk management</strong>, with risks being insufficiently monitored and inadequately controlled internally, in particular for the process for applying for and granting loans (loan origination), for exposure concentration in specific assets (for example, exposure to real estate in some EU Member States), and for certain complex financial products which were largely outside the scope of any regulation at the time;</td>
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<td></td>
<td>○ <strong>Weak capital and liquidity buffers</strong> compared to the level of risk incurred, with a number of important institutions having an equity capital base that amounted to less than 3 % of their balance sheets at the time; and</td>
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<td></td>
<td>○ <strong>Failures of large banks that were ‘too big to fail’</strong> (such as Lehman Brothers in the US) or risks of large bank failures in the EU, caused the entire banking sector to experience systemic stress.</td>
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Regulatory and supervisory framework

- Inadequate micro-prudential oversight over the quality of internal risk management and capital and liquidity adequacy;
- Different rules between Member States within the internal market, and weak EU-level coordination for large financial institutions operating across borders and markets; and
- No resolution and adequate winding-up mechanisms for financial institutions, and no EU framework to deal with failures of cross-border financial institutions.

Economic governance

- Low interest rates prior to the crisis contributed to the formation of real-estate bubbles;
- Macroeconomic imbalances prior to the crisis remained largely unaddressed, with no EU macro-prudential framework in place for systemic risks; and
- High levels of debt accumulated prior or as a result of the crisis among financial institutions and the wider economy, with unbalanced growth in certain euro area Member States. This generated pressures on sovereign yields, financial instability and made it difficult to get finance from the capital markets, requiring assistance as the crisis unfolded.

Source: European Court of Auditors (ECA).

Main causes of the euro area sovereign debt crisis

11 Prior to the crisis, the monitoring and control of public finances was weak and fiscal buffers were low in certain Member States. Coordination of economic policies at EU level was also weak, for example by allowing economic fundamentals to diverge, loss of competitiveness, inflexible labour markets and product markets. Moreover, the lack of a robust supranational banking supervision and resolution framework also meant fragmentation and the risk of a bank-sovereign doom loop occurring.

12 The financial crisis led to high losses in the banking sector. The consequent bailouts led to stress in sovereign debt markets, reinforced by investors doubting the resilience of the architecture of the euro area and the sustainability of public debt levels, which caused a spill-over into the economy. Although State aid for banks, losses in tax income and other automatic stabilisers, together with other fiscal-stimulus measures, all helped to stabilise the economy in the early phase of the crisis, they also led to a significant build-up of an already high level of public debt.

13 Starting in 2009, the increase in public debt generated pressures on the sovereign yields and credit ratings of certain Members States and even triggered investors’ concerns about the break-up of the euro area. Member States entered the
crisis with different fiscal and macro-economic circumstances and the capital outflows from certain countries magnified pre-crisis macroeconomic imbalances.

**14 EU financial assistance programmes** in 2010 for Greece and Ireland, backed by the ECB’s extraordinary monetary interventions, were intended to address the underlying fiscal problems and monetary policy transmission and prevent contagion. Subsequently, financial assistance was also needed in Portugal (2011), Spain (2012) and Cyprus (2013).

**15** The “**doom loop**” refers to situations when risks related to weaknesses of banks and to indebtedness of sovereigns mutually reinforce each other. In certain Member States, the necessary **bailouts** of banks led to high sovereign debt levels. In turn, the quality of the assets of the banks, which held large amounts of “home” sovereign debt, was reduced and the banking system weakened. In other Member States, the high level of debt brought banks into difficulty. Many euro area countries also recorded negative GDP growth rates in 2012 and 2013 (nine and eight countries, respectively).

**16** From 2012, institutional and regulatory responses in the euro area helped to stabilise the situation in the banking sector (the launch of the Banking Union, the new European Central Bank (ECB) intervention tools, the European Stability Mechanism etc.). However, the recession hit the banking sector through **high levels of non-performing loans (NPLs)** that decreased during the recovery period (2014-2019) but are still under close supervision in certain euro area countries.

**17** In 2014, the Commission reported in its review of the crisis, that financial integration can also carry financial stability risks, especially in a single currency area, unless supported by an appropriate EU level institutional framework and economic policy coordination³.

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EU response to the financial crisis

Overview

Since 2009, a number of measures have been taken to improve the resilience of the financial system in the EU and the euro area. These can be grouped into (see Figure 1):

- Institutional responses:
  - the European System of Financial Supervision (ESFS), including the European Systemic Risk Board (ESRB), the three European Supervisory Authorities (ESAs) and the Joint Committee of the ESAs, together with the national competent and supervisory authorities; and
  - the Banking Union (BU) for the euro area as well as other Member States which choose to participate. The BU is currently made up of the Single Supervisory Mechanism (SSM) under the ECB, the Single Resolution Mechanism (SRM) with its Single Resolution Board (SRB) and the Single Resolution Fund (SRF). There are also proposals for the creation of a European Deposit Insurance Scheme (EDIS).

- Regulatory and policy responses:
  - enhanced micro-prudential and macro-prudential rules for banks and their supervisors;
  - a new crisis management framework for banks failing or likely to fail, currently consisting of the Bank Recovery and Resolution Directive⁴ and the Single Resolution Mechanism Regulation⁵;

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⁴ Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms, 15 May 2014.

— an enhanced regulatory framework for the non-banking sector, i.e. insurance, occupational pensions, non-bank financial intermediaries and market infrastructure sectors;

— the Capital Markets Union (CMU), including a Commission action plan\(^6\) to increase the focus on the work needed to develop a single market for capital and investment services.

**Figure 1 – EU crisis response to the financial crisis**

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Institutional responses to the financial crisis

Main developments

**European System of Financial Supervision (ESFS)**

19 In 2010, based on the conclusions of the report by the high-level group on financial supervision (the so-called Larosière report), the EU established the **ESFS** as a new supervisory framework in response to the crisis.

20 The ESFS is a multi-layered system of micro- and macro-prudential authorities to ensure **consistent and coherent financial supervision in the EU**. It consists of the ESRB, the ESAs, national and supervisory competent authorities and the Joint Committee of the ESAs through which coordination of the three supervisory authorities is managed (see *Figure 2*).

*Figure 2 – The European System of Financial Supervision (ESFS)*

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7 Report by the high-level group on financial supervision, February 2009.
‘Systemic risk’ means a risk of disruption in the financial system with the potential to have serious negative consequences for the real economy of the EU or of one or more of its Member States and for the functioning of the internal market. Financial intermediaries, markets and infrastructure may be systemically important depending on their scale, their link with other parts of the financial system, and the degree of impact on the system if they fail. The ESRB, which was established in 2010, has an oversight function for detecting systemic risks in the EU and recommending measures for the prevention or mitigation of these risks. It does this by:

- identifying and prioritising systemic risks;
- issuing warnings and recommendations, and monitoring how Member States, national authorities, the Commission, and EU financial supervisory authorities address its recommendations via an “act or explain” mechanism;
- giving opinions on the appropriateness of certain macro-prudential policy measures before they are adopted by EU Member States or the ECB;
- initiating and coordinating EU-wide stress tests in cooperation with the ESAs.

The three ESAs (the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA), and the European Securities and Markets Authority (ESMA)) which were established in 2011, share a similar structure in terms of governance, objectives and functions for their respective sectors (see Annex I). Their main role is to ensure that rules are consistently applied by national competent authorities (NCAs) across the EU, and to work with the Commission on detailed secondary legislation for implementing financial services regulations and directives:

- The EBA is the regulatory authority for banks. It ensures effective and consistent prudential regulation and supervision, and safeguards the integrity, efficiency and orderly functioning of the banking sector. Its key tasks are to contribute to the establishment and development of the European Single Rulebook for banks, and

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9 Article 133 of the Capital Requirements Directive (CRD IV) and Article 458 of the Capital Requirements Regulation (CRR) give the ESRB a mandate to adopt these opinions.

to promote supervisory convergence and monitor risks in the EU banking sector (including stress tests for banks). Since 2020, the EBA has also had a role in coordinating anti-money-laundering supervision;

- **EIOPA** is the regulatory authority for **insurance and occupational pension providers**. Its tasks include oversight of cross-border insurance groups, protecting consumers by ensuring a high, effective and consistent level of regulation and supervision, and rebuilding trust in the financial system; and

- **ESMA** is the regulatory authority for **financial markets**. It safeguards the stability of the EU’s financial system by enhancing the protection of investors and promoting stable and orderly financial markets. Its tasks include policy work, direct supervision of credit rating agencies (CRAs), trade repositories, securitisation repositories, recognition decisions and compliance monitoring of third-country central counterparties (CCPs), risk analysis, detecting breaches of EU law, and working to enhance supervisory convergence.

23 The three ESAs cooperate within the **Joint Committee of ESAs**, a forum for exchanging information with the ESRB, coordinating their supervisory activities and cross-sectoral cooperation in the areas of micro-prudential supervision, cross-sectoral developments, risks and vulnerabilities for financial stability, retail investment products, supervising financial conglomerates, accounting and auditing.

**Banking Union (BU)**

24 The **BU** aims to ensure banks are robust and able to withstand future financial crises, prevent situations where taxpayers’ money is used to save failing banks, reduce market fragmentation by harmonising the financial sector rules and strengthen financial stability in the euro area and the EU as a whole.

25 The BU is supposed to consist of **three pillars** (see *Figure 3*):

- **the SSM**, established in 2013, currently consists of the ECB together with 19 NCA, which are directly responsible for the supervision of less significant banks:

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— the SSM is responsible for the direct micro-prudential supervision of the most significant banks through the ECB and indirect supervision of all other banks in the euro area (other Member States can also enter into close cooperation);

- **the SRM**, established in 2015\(^\text{12}\), consists of the SRB and the National Resolution Authorities (NRAs):
  - the SRM currently consists of 20 NRAs from 19 Member States, which are directly responsible for all banks outside the direct remit of the SRB;
  - **the SRB** is the central resolution authority within the BU, and is responsible for ensuring orderly resolution of banks failing or likely to fail at minimal costs. It is responsible for resolution planning, for setting MREL, for assessing the resolvability of banks and removing substantive impediments to resolvability where needed, preparing for any resolution scheme for banks directly supervised by the SSM or cross-border banks, and for managing the Single Resolution Fund. Under certain conditions the SRM can use the SRF to finance the resolution of banks failing or likely to fail;
  - **the SRF** is funded by contributions from the banking sector.

- The proposal for an **EDIS**\(^\text{13}\) tabled by the Commission to complete the BU with a common framework for the deposit guarantee schemes\(^\text{14}\). This is still under discussion.

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\(^{12}\) Regulation (EU) No 806/2014 (SRMR).

\(^{13}\) Proposal for a Regulation amending Regulation (EU) No 806/2014 in order to establish a European Deposit Insurance Scheme, 24 November 2015.

\(^{14}\) The Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes has harmonised national schemes but is not sufficient to create an identical confidence across the single market.
Progress and key challenges

European System of Financial Supervision (ESFS)

The ESRB publishes its recommendations and monitors how Member States and other national and EU supervisory authorities address them via an “act or explain” mechanism. Since 2011, it issued recommendations to Member States and relevant authorities. It issued warnings and recommendations in 2016 and 2019 as regards medium-term vulnerabilities in the residential real estate sector. In 2019, the ESRB expressed the view that some national authorities had taken insufficient action regarding vulnerabilities in the residential real estate sector and issued recommendations with specific guidelines for supervisory intervention measures.¹⁵

To promote a consistent application of macro-prudential tools in the EU, the ESRB produced a set of macro-prudential policy papers. So far, most tools apply to the banking sector. The macro-prudential framework for other sectors is less developed and continues to be discussed at EU level.

The Commission tried to improve the ESAs’ mandates, governance and funding, by proposing changes to their founding regulations. However, the regulations adopted barely addressed inefficiencies in managing the conflicting national and EU interests highlighted by our audits:

- For example, in our special report on the EBA stress test, we found that the EBA’s governance structure has been based on considerable involvement by national authorities, since its board of supervisors comprises representatives of national supervisors whose appointment is not subject to any approval by EU bodies. This can give rise to tensions as members of the board may favour purely national rather than wider European interests;

- For the same reason, in our special report on EIOPA, we observed that the board of supervisors’ approval of EIOPA’s oversight strategy may compromise EIOPA’s independence and may prevent it from achieving its objectives, as some of EIOPA’s instruments (e.g. peer reviews) are intended to provide constructive but critical feedback on the NCAs’ work.

To ensure compliance with ESA guidelines and regulatory requirements, ESAs can take action under the “comply or explain” and “Breach of Union Law” procedures. However, we found that actions that the ESAs can take are essentially limited to monitoring and reporting cases of non-compliance rather than sanctioning them. In

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18 ECA, special report 10/2019: “EU-wide stress tests for banks: unparalleled amount of information on banks provided but greater coordination and focus on risks needed”, paragraph 8.

19 ECA, special report 29/2018: “EIOPA made an important contribution to supervision and stability in the insurance sector, but significant challenges remain”, paragraph 79.
addition, even though the “comply or explain” and “Breach of Union Law” are proven effective, they do not fully ensure transparency towards external stakeholders and consumers (as evidenced by the limited number of updates about the procedures and lengthy periods of non-communication). See for example our findings in this respect from an audit on EIOPA in 2018\textsuperscript{20}.

\textbf{30} Our audits also identified limitations on resources that prevented the ESAs from being able to implement their assigned responsibilities and supervisory functions in full. For example, in our special report on the EBA stress test\textsuperscript{21}, we observed that due to a lack of resources the EBA relied on competent authorities for verifying the way banks implement the stress test methodology. Our audit on CRAs\textsuperscript{22} found that ESMA’s resources make it difficult to satisfy all demanding regulatory requirements.

\textbf{31} Unlike the banking sector with the SSM, the EU insurance sector has no central supervisor. EIOPA has no direct supervisory functions over operators\textsuperscript{23}, who are supervised by NCAs. The ECA observed that the quality of supervision and cooperation between supervisors varies significantly. In our special report on EIOPA, we stressed that while EIOPA made a significant effort to promote consistent, intrusive and comprehensive supervision in all Member States, regulatory arbitrage remains a reality and supervisory convergence remains a challenge - this is particularly true in areas such as internal models. Some supervisors tried to protect local insurers through lower capital requirements, while others had stronger supervision and higher capital requirements. The ECA also noted that the NCAs did not provide EIOPA with the necessary data on internal models to perform adequate oversight\textsuperscript{24}.

\textsuperscript{20} ECA, special report 29/2018, paragraphs 81-83.
\textsuperscript{21} ECA, special report 10/2019, paragraphs 68, 80 and 83.
\textsuperscript{22} ECA, special report 22/2015: “EU supervision of credit rating agencies – well established but not yet fully effective”, paragraph 55.
\textsuperscript{23} Regulation (EU) No 1094/2010 establishing EIOPA.
\textsuperscript{24} ECA, special report 29/2018, paragraphs 26-27, 41-42, 50, 96-97 and Box 3.
Overall, the ESAs have weak enforcement powers. This is due partly to the structure and composition of the boards and partly to the limited legal tools available. For all three ESAs, the Commission made a detailed estimate of the resources required to carry out stronger supervision work (full time equivalents: EBA 22, EIOPA 36 and ESMA 75 for the period 2020 – 2027)\(^\text{25}\). These additional resources are subject to annual budgetary approvals over the coming years.

**Banking Union (BU)**

In our special report on the SSM, we stressed that the SSM was successfully established within a short time frame\(^\text{26}\). However, we observed that joint supervisory teams and on-site inspections remained heavily dependent on staff appointed by the NCAs. In particular, for on-site inspections, the ECB had only limited control over the staffing of teams. We also noted evidence of insufficient staffing levels\(^\text{27}\). The ECB points out that it has in the meantime followed up on the findings of the report with a number of measures. The SRB annual report for 2019 reported an increase in its human resources over recent years reaching 87.5 % of the planned 400 staff at the end of 2019\(^\text{28}\). Our ongoing audit on the SRM assesses these developments in more detail.

The funding of the SRF had increased to around €42 billion in June 2020\(^\text{29}\). It is planned to reach the target level of at least 1 % of covered deposits (around €70 billion in 2019) of all credit institutions within the BU by the end of 2023.

In 2019, it was decided at a political level that the ESM would provide a revolving credit line to the SRF, as financial backstop since the SRF target level might not be sufficient to cover the resolution needs of significant institutions. This agreement is included in the ESM treaty reform whose signature and ratification are pending. The credit line should be of a size equivalent to the size of the SRF. The arrangement is only due to become operational by 2024 or earlier if the proposal of an early implementation is adopted. Although a fully funded SRF with a backstop might provide}

\(^{25}\) Annex 7 to the Commission Decision on the Internal Rules on the implementation of the general budget of the European Union (European Commission section) for the attention of the Commission departments, Legislative financial statement 'agencies', 21 April 2019.

\(^{26}\) ECA, special report 29/2016, paragraph 184.

\(^{27}\) ECA, special report 29/2016, paragraphs 190-191.


sufficient resources to resolve even a large international bank or multiple banks, it remains unclear whether it could provide sufficient liquidity in resolution\(^{30}\). This is being assessed in our current audit of the SRM.

36 While discussions on EDIS are ongoing at the political level\(^{31}\), it had not been set up by mid-2020.

**Policy responses to make the financial sector more resilient**

**Main developments**

**An enhanced set of micro-prudential and macro-prudential rules for banks and their supervisors**

37 Following the financial crisis, the EU reviewed the micro-prudential framework for banks operating in the EU, in line with global level reforms set out in Basel III\(^{32}\). Key elements of this framework are to:

- **Require better capital adequacy for banks** – since the crisis, banks have been required to adjust their capital ratios by ensuring sufficient capital in relation to their assessed risks. In addition, banks had to calculate, report and disclose their leverage ratio and by the end of June 2021 will act as an overall minimum capital requirement in relation to a bank’s assets irrespective of their risk profile;

- **Improve the quality of bank’s risk management** – banks are required to identify and assess their risks more accurately using either a standardised approach or their own internal models\(^{33}\). The results determine the level of capital banks need to hold;

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31 “Presidency Progress report on work in the AHWP on strengthening the Banking Union”, Report 9819/18, 12 June 2018; and Letter from Mario Centeno, President of the Eurogroup, to Charles Michel, President of the Euro Summit, 5 December 2019.

32 Basel III: international regulatory framework for banks - [https://www.bis.org/bcbs/basel3.htm](https://www.bis.org/bcbs/basel3.htm).

33 Article 107(1) of Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment (CRR Regulation), 26 June 2013.
Require better liquidity management – the liquidity coverage ratio (LCR) was introduced as a new requirement to enhance banks’ short-term resilience to liquidity risks. In 2021, the net stable funding ratio will be a binding requirement to reduce funding risk over a longer time horizon by requiring banks to fund their activities with sufficiently stable sources of funding; and

Improve asset quality and reduce NPLs – as a result of defaulting customers, during and after the financial crisis EU banks had to deal with high levels of NPLs. Banks are required to have sufficient impairments on loan portfolios to cover any losses that may arise. To address existing stocks of NPLs and avert the accumulation of NPLs in the future, ECOFIN Council "Action Plan To Tackle Non-Performing Loans in Europe" was adopted in July 2017, and the Commission added a package of measures to the prudential framework in March 2018.

The creation of a new crisis management framework for failing or likely to fail banks

The introduction of a crisis management framework for failing or likely to fail banks is an important step in terms of financial sector resilience. Although bank failures are a normal part of any functioning market, they can have significant disruptive effects on the economy in the absence of an adequate framework to manage the process in an orderly manner. To address these risks, the EU has established a comprehensive crisis management framework for banks, consisting of the Banking Recovery and Resolution Directive and the Single Resolution Mechanism Regulation.

The crisis management framework for banks consists of four key phases (see Figure 4). In the preparation phase, supervisors monitor banks to identify any crisis early on. At the same time, resolution authorities ensure that all banks are resolvable and resolution plans are up-to-date. If a bank gets into difficulties, supervisors can use early intervention measures. If the situation deteriorates nevertheless, supervisors or resolution authorities have to declare the bank as failing or likely to fail (FOLT). Resolution authorities then have to assess whether resolution is necessary, proportionate and in the public interest, and draw up a resolution scheme (see Annex II). If resolution is not in the public interest the bank is liquidated under national insolvency procedures.

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35 Commission package of documents on measures to address the risks related to NPLs, 14th March 2018.
Figure 4 – Four phases of crisis management for EU banks

<table>
<thead>
<tr>
<th>Supervision &amp; preparation</th>
<th>Recovery</th>
<th>Early intervention</th>
<th>Resolution or liquidation</th>
</tr>
</thead>
<tbody>
<tr>
<td>• On-going supervision</td>
<td>• Bank responsible to activate its own recovery plan</td>
<td>• Supervisory early intervention measures</td>
<td>• Bank declared failing or likely to fail</td>
</tr>
<tr>
<td>• Recovery planning</td>
<td>• Bank management take various voluntary measures</td>
<td>• Intensive monitoring</td>
<td>• Decision on public interest</td>
</tr>
<tr>
<td>• Resolution planning</td>
<td></td>
<td>• Preparation for potential resolution</td>
<td>• Resolution decision or liquidation under national insolvency procedures</td>
</tr>
<tr>
<td>• Ensuring resolvability</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: ECA, adapted from the ECB.

40 The new resolution framework includes the write-down and conversion of capital instruments tool\(^36\) and the **bail-in tool**\(^37\) which aim to shift the burden of losses from taxpayers to shareholders and creditors (who would have benefited from any profits). It also includes three **resolution tools**: the “sale of business” tool, the “bridge institution” tool and the “asset separation” tool. To protect the right to private property, the **“no-creditor worse off” principle** ensures that no shareholder and/or creditor is treated worse in resolution than in liquidation under national insolvency laws.

41 A key measure to ensure resolvability is requiring banks to hold a sufficient amount of loss absorbing capacity in the form of the **minimum requirement for own funds and eligible liabilities (MREL)**, as it ensures the possible use of the bail-in tool\(^38\). The MREL consists of the capital requirement and an amount of bail-in-able liabilities, which could be used to recapitalise the bank\(^39\). Another key measure is the identification and removal of substantive impediments to resolution\(^40\).

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37 Article 27 Regulation (EU) 806/2014.
38 Article 45 of Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms, 15 May 2014.
40 Article 10(7) of the SRM Regulation.
Apart from the bail in-tool, the SRF, the mandatory Deposit Guarantee Schemes and the proposed EDIS all complement the resolution framework to allow bank failures in an orderly manner without resorting to public bail-out, triggering potentially the doom-loop. They are prefunded by the industry.

All the above-mentioned resolution measures aim to break the doom-loop and prevent banks from becoming “too big to fail”. The Banking Recovery and Resolution Directive also requires that public funds should only be used “in the very extraordinary situation of a systemic crisis”, “as a last resort” under strict conditions and requirements.

Both liquidation and resolution must comply with State aid rules whenever public funds are used, including the SRF. State aid rules prevent any use of public funds, which could distort competition in the internal market. During and after the financial crisis, the Commission published various interpretive Communications on the application of State aid rules. It still applies the 2013 Banking Communication.

An enhanced EU regulatory framework for the insurance and pensions sectors

In response to the changing risk environment and international regulatory agenda, the sophistication of investment techniques and cross-sectoral developments, the EU adopted new micro-prudential rules for insurance undertakings within the Solvency II Directive which led to:

- the creation of a more comprehensive framework to supervise insurers’ risk management, with the aim of harmonising national standards for prudential supervision further;

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42 Articles 37(10) and 56(3) Directive 2014/59/EU.
43 Articles 107 and 108 TFEU.
44 Communications from the Commission on State aid for banks and financial institutions between 2008-2013: IP/08/1495; IP/08/1901; IP/09/322; IP/08/1993; IP/09/1180; IP/10/1636; IP/11/1488; IP/13/672.
the introduction of risk-sensitive capital requirements, similar to the reformed banking capital ratios, intended to ensure that individual insurers have the necessary capital relative to their specific risk profiles\(^\text{46}\);

- the elimination of restrictions imposed by Member States on the composition of insurers’ investment portfolios. Instead, insurers are free to invest according to the “prudent person principle” as long as the new capital requirements are met;

- the introduction of new qualitative requirements for insurers based on a supervisory review process (“pillar 2”) and rules for market disclosures and supervisory reporting (“pillar 3”). As of 2016, insurers had to calculate their own risk amounts stemming from their investment portfolios and insurance activities; implement own risk monitoring systems; build a market-consistent valuation of assets and liabilities; and hold sufficient capital to comply with the new capital ratios;

- greater cooperation between national insurance supervisors and EIOPA.

\(^{46}\) New prudential rules in the occupational pensions sector were introduced with the IORP II Directive\(^\text{47}\), which aims to modernise and further harmonise the micro-prudential rules of institutions for occupational retirement provision (IORPs) and beneficiary protection (such as better disclosures) in the EU. The new prudential requirements renew the focus on businesses’ governance and risk-management requirements modelled on the Solvency II Directive, e.g. new provisions on own risk assessment, remuneration policy, key functions, fit and proper management, and the safekeeping of assets.

**New rules for capital markets, market infrastructures, and the Capital Markets Union (CMU)**

\(^{47}\) An equally important dimension of the financial system is the capital markets sector, which consists of non-bank financial intermediaries (such as investment funds/firms, non-bank lenders, and special investment vehicles). Following the 2008 crisis, the EU implemented a broad range of responses, which include:

- **New EU rules to strengthen public oversight of financial products and intermediaries** – these addressed prudential requirements for unregulated entities in the asset-management sector, market infrastructure operators and the

\(^{46}\) https://ec.europa.eu/commission/presscorner/detail/fr/MEMO_15_3120.

\(^{47}\) Directive (EU) 2016/2341 on the activities and supervision of institutions for occupational retirement provision (IORPs), 14 December 2016.
CRAs. They also introduced new trading, clearing and settlement obligations for products in the wholesale markets that had experienced transparency issues during the crisis, as well as new specific supervisory measures;

- **Rules to address liquidity and leverage risks as regards Alternative Investment Funds (AIFs)** – the EU adopted the AIFMD Directive\(^48\) to enforce certain prudential behaviour rules for the managers of AIFs. Requirements concern capital, risk and liquidity management, the appointment of a single depositary and rules on transparency towards investors and supervisors. Leverage is subject to special monitoring;

- **Derivatives reforms to improve transparency and control over derivative markets** – a number of transparency requirements have been put in place to reduce the opaqueness of derivatives markets and mitigate counterparty credit risks, including:
  - the Markets in Financial Instruments Regulation (MIFIR)\(^49\), which requires certain categories of derivative to be traded in EU or equivalent third-country venues, providing better information on prices, liquidity and risk;
  - the Markets in Financial Instruments Directive (MIFID II)\(^50\), which defines harmonised requirements for EU regulated markets;
  - the European Market Infrastructure Regulation (EMIR)\(^51\), which introduced the obligation of over-the-counter derivatives to be cleared through (CCPs);
  - new EU rules adopted to identify and set specific supervision arrangements for third country CCPs\(^52\) that are systemically important to the EU or to one or more of its Member States;

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\(^51\) Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories, 4 July 2012.

\(^52\) Regulation (EU) No 2019/2099 amending Regulation (EU) No 648/2012 as regards the procedures and authorities involved for the authorisation of CCPs and requirements for the recognition of third-country CCPs, 23 October 2019.
— transposing the Basel standards for higher capital requirements of banks dealing with non-centrally cleared derivatives in the Capital Requirements Regulation (CRR II).

- **Secured lending market reforms to increase transparency** – the SFT Regulation\(^{53}\) was the main EU reform aimed at enhancing the transparency of the securities financing transactions conducted by any counterparty established in the EU (except central banks, and public debt agencies)\(^{54}\);

- **EU level supervision of CRAs** – the CRA Regulation\(^{55}\) includes regulatory measures for CRA’s registration and supervision (by ESMA), and aims to increase the use of smaller CRAs and increase competition;

- **Monitoring of systemic risks for the capital markets sector by the ESRB** – one of the ESRB’s key priorities in its strategy is to develop EU macro-prudential policy to address financial stability risks beyond the banking sector\(^{56}\); and

- **The establishment of the CMU** – the Commission action plan launched in 2015 and updated in 2017, with the objective of deepening and further integrating the capital markets of EU Member States. It aimed amongst others at making it easier for companies, especially for small and medium-sized enterprises, to enter and raise capital on public markets; fostering retail and institutional investment; facilitating cross-border investments.

## Progress and key challenges

**Micro-prudential framework for banks and their supervisors**

48 The following developments have taken place in relation to **capital adequacy** (see *Figure 5*):

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Aggregate EU capital ratios have risen by about 6 percentage points. This was driven by capital increases (€648 billion, or 33 % since 2008) and lower exposure to risks (by 16 % since 2008). Lower risk exposures were the result of declining total assets and a decrease of the average risk weight of banks exposures;

Aggregate leverage ratios have risen by about 2 percentage points and are well above the future minimum requirement of 3 %. While the aggregate figures show strong improvements, the situation can differ across individual banks, and depends on the adequacy of banks’ risk management and the quality of held capital;

The new rules within the Capital Requirements Regulation57, together with higher scrutiny by supervisors, have led to improved quality of capital, for example through higher share capital.

**Figure 5 – Changes in capital and leverage ratios within the EU (2008-2018)**

Note: The leverage ratio is calculated as tier 1 capital to total assets. It is a proxy for the regulatory leverage ratio that is being implemented in the EU.

Source: ECB CBD2 dataset.

While a number of Basel III requirements have already been adopted in the EU, some of the reforms agreed by the Basel Committee in December 2017 still need to be implemented in the EU. The EBA estimates that the benefits of elements still to be implemented will outweigh the costs, which will be modest, transitional and will fade

57 Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms, 26 June 2013.
over time. The reform is intended to mitigate the severity of future economic downturns through a reduction in both probability and intensity of future banking crises. Nonetheless, EU banks would need to raise up to €124.8 billion of capital (or retained earnings) to implement Basel III fully.

As regards the liquidity management, the introduction of the LCR improved short-term liquidity of banks, while the subsequent introduction of rules on the net stable funding ratio contributed to a reduction in reliance on short-term wholesale funding in the euro area. In addition, the considerable expansion of the Eurosystem’s liquidity injections have facilitated the build-up of banking liquidity buffers at low financing costs. However, these injections also created a dependency of some banks on central bank funding liquidity. This dependency may pose risks to banks in case of monetary policy changes.

The 2018 EBA and ECB stress-test results for European banks also show higher capital buffers even under adverse macroeconomic conditions, despite a more severe adverse scenario than in the 2016 stress tests. However, a 2019 audit report by the ECA assessed that the 2018 tests should have been more demanding. Indeed, significant systemic risks – and certain countries and variables – were subject to a low level of stress, or none at all.

During its on-site inspections and its review of internal models of large banks, the ECB found in some areas a variety of modelling practices and shortcomings in the identification of risks and the calculation of their size (e.g. lack of consideration of relevant risk drivers or weaknesses in the calculation of realised losses given default). The ECB stated in the course of this review that it made requests to the banks for follow-up and remedial actions to address these shortcomings.

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The current regulatory framework generally categorises sovereign exposures as *de facto* risk-free, and neither requires diversification nor provides for exposure limits (even though sovereign risk has been captured in stress tests exercises)\(^{64}\). However, while this treatment is in line with the international Basel framework, there is broad consensus that sovereign exposure in general – and domestic sovereign exposure concentrations in particular – entail risks for banks in the BU and are a fundamental source of systemic risk\(^{65}\). In 2017, the average sovereign exposure of large global banks was 19.4\% of their total assets and 28.1\% for smaller and mid-sized banks. In the EU, banks hold sovereign exposures of €4.15 trillion (June 2019), with a strong focus on domestic exposures. In 2018, the Commission proposed a regulation on sovereign bond-backed securities help investors diversify their sovereign exposures, but no progress has been made to end this part of the doom loop\(^{66}\).

### NPLs and bank profitability

Aggregate NPLs have been decreasing in the EU from a peak of 6.8\% of total loans and advances at the end of 2015 to 2.7\% by the end of 2019\(^{67}\). Despite significant progress made, some Member States still face relatively high levels of NPLs (see Figure 6). The build-up of new NPLs also needs to be prevented\(^{68}\). International Financial Reporting Standard 9 (IFRS 9) is considered a key step to ensure a more timely recognition of credit losses; this is based on expected credit losses rather than the previous approach of recognising losses when they occurred. In 2018, the SSM has carried out more than 50 on-site inspections on credit risk which have identified shortcomings in the identification of NPLs and the related necessary impairments\(^{69}\).


\(^{66}\) High Level Working Group, “Considerations on the further strengthening of the Banking Union including a common deposit insurance scheme”, June 2019; and Basel Committee on Banking Supervision, “Discussion paper on the regulatory treatment of sovereign exposures”, December 2017.

\(^{67}\) ECB dataset CBD2.

\(^{68}\) ECB Banking Supervision, “SSM Supervisory Priorities 2020”, 7 October 2019.

Figure 6 – Volume of NPLs (in billion euros) and NPL ratio (percentage), by Member State, as at Q4 2019

Source: ECA based on EBA preliminary analysis of COVID-19 on EU banks, Thematic Note EBA/REP/2020/17, Figure 12.

55 Numerous factors such as the costs of reducing NPLs, overbanking, intense competition, digitalisation costs, a persistent low interest environment, and regulatory costs have led to a relatively low profitability in the banking sector\(^\text{70}\). Aggregate returns on equity of EU and euro area banks averaged 6% at the end of 2018, which is below the standard cost of capital of 8-10%\(^\text{71}\). A prolonged period of low profitability may hamper banks’ ability to build up capital buffers from reserves or to raise capital. This may limit banks’ capacity to provide lending to the real economy, especially after a crisis.

\(^\text{70}\) Presentation by Andrea Enria (ECB) at the CIRSF Annual International Conference, Lisbon, 4 July 2019.

\(^\text{71}\) “Risk Assessment Questionnaire – Summary of Results”, EBA, 2018.
The new crisis management framework for banks which are failing or likely to fail

Building resolvability for all banks in the EU is still a work in progress, an issue also covered in our audit on the SRM. Although banks are working to make themselves resolvable:

- resolution plans are not yet at a final stage;
- MREL capacity has not yet been fully built up;
- the SRB’s annual work programme foresees the identification of potential impediments to resolvability in 2020 but is expected to require several years to address all substantive impediments; and
- the SRB outlined the actions that banks are expected to undertake with respect to the identification of potential impediments.

Our audit on the ECB’s crisis management for banks identified weaknesses in the ECB’s crisis identification procedures. For example, they lacked clear criteria and indicators, and did not react on the basis of evidence of a material deterioration in the financial condition of a bank. The ECB points out that it has in the meantime followed up on the findings of the report with a number of measures. Adequate cooperation between supervisors and resolution authorities is important to ensure that crisis management functions properly. However, while an early intervention notification is supposed to enable the SRB to prepare for resolution, a bank can be declared FOLTF even if there has been no early intervention, and this has happened in 2017.

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72 Speech by Elke König, Chair of the SRB, to the European Parliament ECON Committee, 3 December 2019.
73 Paragraph 146 of special report 23/2017, ECA: “Single Resolution Board: Work on a challenging Banking Union task started, but still a long way to go”.
74 “Quantitative MREL report 2020”, EBA, p. 15.
75 Figure 5 of special report 23/2017, ECA, and “SRB annual report 2020”, p. 15.
78 ECA, special report 02/2018, paragraph 34.
79 ECA, special report 02/2018, paragraph 34.
addition, **overlaps between supervisory powers and early intervention powers** have been identified by the Commission\(^{80}\).

58 The EBA’s guidelines suggest that a bank is FOLT if it infringes its total SREP capital requirements, and any supervisory requirements. However, in practice this has not been the case. As the FOLT assessment should consider all relevant circumstances of the case, the ECB did not always follow the harmonised EBA guideline (for instance, it did not consider breaches of corporate governance arrangements as it did not include them in its own internal guidance on implementing the EBA guideline)\(^{81}\).

59 A public interest test determines whether resolution is proportionate and necessary or whether the bank should be liquidated. However, the **public interest tests carried out by resolution authorities in the EU are at times applied differently** and may lead to different conclusions and consequences. For example, while in 2015 some NRAs considered resolution to be in the public interest even for very small banks\(^{82}\), the SRB decided in 2017 that a resolution of Banca Popolare di Vicenza S.p.A. and Veneto Banca S.p.A. was not in the public interest, despite their larger size, as the failure of the institutions was not likely to result in significant adverse effects on financial stability\(^{83}\). Contrary to this assessment, the Commission decided that State aid was compatible, as it was necessary to remedy a serious disturbance in the economy of the Member State\(^{84}\).

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81 ECA, special report 02/2018, paragraph 108.


84 State Aid Decision SA., European Commission, 45664 (2017/N), 25 June 2017, paragraph 49.
60 A further complication for assessments is the **fragmentation of national insolvency laws for banks**. These vary across Member States, even though a minimum level of harmonisation exists\(^85\). Member States in the BU also used resolution tools and special national liquidation legislation instead of the envisaged liquidator- or administrator-led national insolvency proceedings\(^86\), thus creating a de-facto resolution framework as part of their national insolvency proceedings. As resolution needs to be compared to national insolvency proceedings to assess the public interest and the possible breach of the no creditor worse-off principle\(^87\), this fragmentation creates a number of problems for the resolution of banks and may lead to unequal treatment of banks failing or likely to fail and their creditors\(^88\).

61 By the end of 2019, the write-down and conversion tool had only been used once as part of a resolution in the BU – for the resolution for Banco Popular Español. The resolution successfully protected public funds and thus taxpayer’s money. On the other hand, Member States still use public funds to bailout and support banks beyond the limitation of extraordinary systemic crisis situations:

- **Bailouts as part of national insolvency proceedings** – Member States use public funds to support national insolvency proceedings;

- **Bailouts through recapitalisations** – Member States use precautionary recapitalisations\(^89\) and recapitalisations that are not considered as State aid (as they are based on market terms) to support banks that do not meet their capital requirements; and

- **Support through public guarantees** – these are not considered as State aid as they are based on market terms to support the sale of NPLs.

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85 Directive 2001/24/EC on the reorganisation and winding up of credit institutions, 4 April 2001.

86 Article 2 (47) of Directive 2014/59/EU.

87 Article 73 of Directive 2014/59/EU.


89 Article 32(4d) (iii) of Directive 2014/49/EU.
EU regulatory framework for the insurance and occupational pensions sectors

62 Despite the existence of an EU-level prudential framework, some technical rules on insurance remain divergent across Member States. The ECA observed that the quality of supervision and cooperation between supervisors varies significantly. While EIOPA made a significant effort to promote consistent, intrusive and comprehensive supervision in all Member States\(^*\)\(^{90}\), regulatory arbitrage remains a reality\(^*\)\(^{91}\) and supervisory convergence remains a challenge.

63 The capital levels exceeded the minimum required for both solvency capital requirements and the minimum capital ratio. The aggregate levels were above the minimum for all Member States at the end of 2018, but significant differences remain. These partially reflect inconsistent application of the new requirements, such as those on national accounting rules, taxation and social security laws.

64 The EU rules do not address the identification and specific supervision/resolution and recovery of systemically important insurers. There are also no EU common backstops to fund the resolution or liquidation of insurance companies\(^*\)\(^{92}\). Insurers are wound-up under national frameworks for which the home supervisor is exclusively responsible\(^*\)\(^{93}\). Both EIOPA\(^*\)\(^{94}\) and ESRB\(^*\)\(^{95}\) called on the Commission to introduce minimum harmonisation of national recovery and resolution frameworks for insurers and reinsurers in the EU. The Commission has indicated that such an initiative is in preparation along with the review of the Solvency II framework.

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\(^{90}\) ECA, special report 29/2018, paragraphs 96-97.

\(^{91}\) ECA, special report 29/2018, Box 3 and paragraphs 26-27.

\(^{92}\) “Opinion to the institutions of the European Union on the harmonisation of recovery and resolution frameworks for (re)insurers across the Member States”, EIOPA, 5 July 2017, p. 14; and “Recovery and resolution for the EU insurance sector: a macro-prudential perspective”, ESRB, August 2017, pp. 4 and 7.


\(^{94}\) https://www.eiopa.europa.eu/content/institutions-eu-harmonisation-recovery-and-resolution-frameworks-reinsurers.

Ongoing policy discussions suggest the need to design additional rules for the management and supervision of concentrated risks such as sovereign exposures concentration. EU insurers are exposed to higher sovereign risk than banks, especially in Member States with higher overall debt levels. EIOPA monitors this type of exposures in its stability reports.

Only a small number of Member States have Insurance Guarantee Schemes (IGSs) to protect policyholders against insolvent insurers. In our report on EIOPA, we found that the protection of consumers depends on the legal structure of the insurer. Together with EIOPA, the Commission is assessing the need for a European network of national IGSs.

In the context of the ongoing Commission consultation procedures for the review of the Solvency II directive, both EIOPA and the ESRB are of the view that EU legislation lacks macro-prudential policies that could intervene at different points along a chain of events in the insurance sector leading to a build-up of systemic risks. Similar views were expressed by the FSB and the International Association of Insurance Supervisors (IAIS).

With respect to occupational pensions, a number of Member States had not yet completed the transposition process for the new IORP II Directive as at 1 June 2020.

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98 ECA, special report 29/2018, paragraph 29.
The assets of defined-benefit or hybrid IORPs represented about 80% of IORPs’ investments at the end of 2014. Low yields partially explain why solvency positions for occupational pensions were on aggregate fragile and close to the regulatory threshold at the end of 2018. EIOPA’s 2017 stress test also showed that, on average, IORPs had insufficient assets to meet their pension liabilities and that the effect of the average undercapitalised pension schemes can have a significant negative effect for pension beneficiaries. However, EIOPA’s 2019 stress test observed improved cover ratios, yet still expected detrimental effects on members and beneficiaries – or sponsoring undertakings – in the tested stressed scenario.

Capital markets, market infrastructures and the Capital Markets Union (CMU)

As capital markets in the EU are relatively underdeveloped (e.g. compared to the US), the EU aims to increase the share of capital-market funding relative to bank finance in order to lower capital costs for businesses and mitigate home bias risks by facilitating more cross-border investment and diversification. This should increase crisis resilience and facilitate faster recovery and growth. Deeper integration of capital markets, together with more integrated banking systems, can help to maintain cross-border capital flows and sustain investment in Member States suffering large asymmetric macroeconomic shocks.

The ESRB has set the development of EU macro-prudential policy for non-bank intermediation as one of the key priorities in its strategy. There is also an expert group on non-bank financial intermediation that monitors risks in the sector(s). Currently, there is no framework in place to address the systemic risks identified in this sector in a harmonised way. The framework to monitor systemic risks in this sector is gradually evolving, by for example, ESRB making a Recommendation to ESMA to develop guidance on macro-prudential leverage limits. The ESRB highlighted remaining data gaps that prevent a more comprehensive risk assessment in some sectors.

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105 “European Semester Thematic Factsheet on the adequacy and sustainability of pensions”, EC, November 2016, p. 9.
parts of the non-bank intermediation sector (e.g. a lack of sufficient data on non-bank leverage, and interconnectedness between banks and other financial intermediaries)\textsuperscript{109}.

72 Although Alternative Investment Fund managers must put in place risk management policies and are subject to stress testing and reporting obligations, the Directive does not contain leverage limitations for AIFs. A 2019 review report concluded that most of the AIFMD provisions achieved the intended objectives efficiently and effectively\textsuperscript{110}. However, supervisory concerns about leverage have continued to surface in the post-crisis period, for example in respect of collateralised loan obligations\textsuperscript{111}.

73 In 2018, the ESRB took the view that mismatches between the liquidity of open-ended investment funds’ assets and their redemption profiles could lead to “fire sales” to meet redemption requests in times of market stress, potentially affecting other financial-market participants holding the same assets or assets with correlated risks. Leverage may amplify the impact of negative market movements. The ESRB recommended that ESMA and the Commission should put in place macro-prudential policy instruments to manage those risks\textsuperscript{112}. For example, risks from leverage can be addressed by creating a harmonised reporting framework for Undertakings for the Collective Investment in Transferable Securities and by making better use of existing possibilities to set leverage limits for Alternative Investment Funds.

\textsuperscript{109} “NBFI Monitor”, ESRB, 2019.


\textsuperscript{112} “Recommendation on liquidity and leverage risks in investment funds”, ESRB/2017/6, 7 December 2017.

The Action Plan on the CMU adopted by the Commission in 2015 and expanded in its mid-term review in 2017, sets out more than 71 measures (33 from the CMU Action Plan and 38 from the Mid-Term Review). Each action has been assigned an indicative deadline. In the Mid-Term Review, nine priority actions were also introduced.

In 2019, the Commission reported that it has implemented most of the measures within the CMU Action Plan but that future action was necessary, in particular due to new priorities, related to the green and digital transition and Brexit. However, even with further measures at EU level, the CMU cannot be achieved unless they are supplemented by far reaching and ambitious national reforms to deepen capital markets.

The ECA is currently carrying out a separate audit on the implementation of the CMU action plan.

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EU response to the sovereign debt crisis

Overview

In addition to deficiencies in the financial system, which were common mainly at the global level, several EU-specific challenges turned the EU financial crisis into a sovereign debt crisis (see paragraphs 13-17). A number of initiatives have been taken to address the crisis, both at the fiscal and at the banking level, including (see Figure 7):

- **Institutional responses**: the European Financial Stability Mechanism (EFSM); the European Financial Stability Facility (EFSF); the European Stability Mechanism (ESM); and the European Fiscal Board (EFB); and

- **Policy responses**: Six-Pack and Two-Pack reforming the Stability and Growth Pact (SGP), organising the European Semester, introducing the Macroeconomic Imbalance Procedure (MIP) and laying down minimum requirements for national budgetary frameworks; the Fiscal Compact; and Outright Monetary Transactions (OMT) by the ECB.
Figure 7 – EU crisis response to the sovereign debt crisis

Institutional responses
Setup of EU level bodies, instruments, mechanisms and frameworks

Regulatory and policy responses
Rules for regulation and supervision of operators and financial instruments

Temporary crisis funding programme
European Financial Stability Mechanism (EFSM)

Temporary crisis resolution mechanism
European Financial Stability Facility (EFSF)

Permanent crisis resolution mechanism
European Stability Mechanism (ESM)

Independent monitoring of the EU fiscal framework and fiscal stance
European Fiscal Bord (EFB)

Economic policy
• SGP reforms (Six-Pack, Two-Pack)
• Fiscal Compact
• European Semester
• MIP

Monetary policy
• OMT

Source: ECA.

Institutional responses to the sovereign debt crisis

Main developments

78 The EFSM was established in 2010\textsuperscript{116} as a temporary EU funding programme. The objective was to provide financial assistance for Member States that are experiencing or are seriously threatened by severe economic or financial disturbance caused by exceptional circumstances beyond their control. Support could be provided through loans or credit lines, taking into account the possible application of the Balance of Payments Facility, an existing instrument already providing medium-term financial assistance to non-euro area Member States.

The **EFSF** was a temporary crisis resolution mechanism established in 2010. Its objective was to safeguard financial stability by providing financial assistance for the euro area Member States, mainly through loans. In 2012, it was succeeded by the ESM, and can **no longer provide further financial assistance**. However, it can still:

- receive loan repayments from beneficiary countries;
- make interest and principal payments to holders of EFSF bonds;
- roll over outstanding bonds.

The **ESM** was set up in 2012 by a treaty between the euro area Member States as a permanent intergovernmental organisation. Its mission is to provide financial assistance for Euro area countries experiencing or threatened by severe financing problems. Such assistance is granted only if there is evidence it is **necessary to safeguard the financial stability of ESM Members or the euro area as a whole**. The ESM provides financial assistance to euro area Member States which are experiencing or threatened by severe financing problems under strict economic conditionality appropriate to the financial instrument chosen and discussed with the Commission and the beneficiary. Under specific circumstances, the ESM may also directly recapitalise financial institutions that are systemically important in the euro area. The Commission and the ESM regularly assess the repayment risks of the beneficiary Member States that exited financial assistance programmes. The Court started an audit that aims to assess the effectiveness of the Commission post-programme surveillance.

In 2015, the Commission established the **EFB**. The EFB has the aim of strengthening the current economic governance framework by providing an annual evaluation of the implementation of the EU fiscal framework and the appropriateness of the actual fiscal stance at euro-area and national level.

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117 Treaty establishing the European Stability Mechanism, 2 February 2012.
Progress and key challenges

Since 2008, several Member States with financial difficulties have received loans from the EU (Hungary, Latvia, Romania from the balance of payments facility, and Ireland and Portugal from the EFSM) as well as from intergovernmental rescue funds (Greece from the Greek Loan Facility, Greece, Ireland and Portugal from the EFSF and Cyprus, Greece, and Spain from the ESM):

- Our report on macro-financial assistance\(^{119}\), reported that the Commission was not prepared to handle the management of the macro-financial assistance programmes and recommended an institution-wide framework allowing rapid mobilisation of human and technical resources and horizontal consistency checks of macroeconomic conditionality;

- In the latter report, as well as in our second report on crisis management\(^{120}\), we also recommended that the Commission’s preparations should improve the general procedures for designing support programmes and should clarify the role of programme conditions. We also stressed the importance of developing robust cooperation agreements between the Commission and the other international stakeholders involved, such as the ECB and the IMF. During this review, we found that there have been developments in this respect between the Commission, the ECB, the ESM and the ESAs.

In our special report on EU requirements for national budgetary frameworks\(^{121}\), we found that the set-up and mandate of the EFB leave room for improvement in terms of independence, and that the Commission is able to ignore the EFB’s proposals and recommendations without providing appropriate explanations.

\(^{119}\) ECA, special report 18/2015: “Financial assistance provided to countries in difficulties”.

\(^{120}\) ECA, special report 17/2017: “The Commission’s intervention in the Greek financial crisis”.

\(^{121}\) ECA, special report 22/2019: “EU requirements for national budgetary frameworks: need to further strengthen them and to better monitor their application”.
Policy responses to improve economic governance

Main developments

The SGP is a set of rules in force since 1997\textsuperscript{122}, whose aim is to ensure sound public finances of the EU Member States and a coordination of their fiscal policies by setting the threshold for national public deficit and public debt, the so-called “Maastricht fiscal criteria”.

- The SGP consists of two arms:
  - the preventive arm, which aims to ensure that the EU Member States’ fiscal policies are sound and coordinated by setting parameters and budgetary targets; and
  - the corrective arm, which refers to the Excessive Deficit Procedure (EDP)\textsuperscript{123}, introduced by the Maastricht Treaty with the objective of Member States adopting appropriate policy responses to correct excessive deficits. It applies more stringent fiscal targets for Member States that exceed the budgetary deficit or debt ceiling defined in the SGP (3 % and 60 % of GDP respectively). Since its introduction, the EDP has been launched in 25 Member States\textsuperscript{124}. However, no financial sanctions have yet been imposed. All EDPs have been closed with the exception of Romania, which is under EDP in 2020.

- The Six-Pack of 2011\textsuperscript{125} and the Two-Pack of 2013\textsuperscript{126} introduced a number of amendments to both the preventive and corrective arm of the SGP. These rules:
  - introduced an expenditure benchmark for the annual increase in a Member State’s expenditure, net of revenue measures;

\textsuperscript{122} Resolution on the Stability and Growth Pact in Amsterdam, European Council, 17 June 1997.
\textsuperscript{123} Article 126 of the TFEU.
established the European Semester to coordinate the monitoring of fiscal and economic policies in the EU and improve the timing of policy advice given to Member States;

— allowed the EDP to be opened solely on the basis of insufficient decline of excessive debt towards reference value (i.e. 60 % of GDP);

— continued to impose graduated financial sanctions of up to 0.5 % of the respective Member State’s GDP;

— introduced a common budgetary timeline and correction of excessive deficits for euro area Member States;

— introduced new rules related to enhanced, programme and post-programme surveillance of euro-area Member States.

To address some of the remaining shortcomings of the reinforced EU fiscal governance framework under the Six-pack, the inter-governmental Treaty on Stability, Coordination and Governance in the Economic and Monetary Union and in particular its Title III known as the Fiscal Compact entered into force in 2013. It mainly consist of the adoption of national fiscal rules closely linked to those of the preventive arm of the SGP, introducing in particular a balanced budget rule and an automatically triggered correction mechanism at the national level in case of breach of this rule.

The European Semester is an ex ante cycle of economic and fiscal policy coordination of the EU Member States, and was introduced with the Six-Pack as part of a wider reform of EU economic governance. It entails assessment of and recommendations for Member States’ fiscal and economic policies in accordance with the SGP, the MIP and the Union’s policies for growth and jobs. All Member States, except those under a macroeconomic adjustment programme, participate in the European Semester by engaging in a detailed dialogue with the Commission about their national economic policies. The main purpose is to ensure sustainable fiscal policies, monitor and correct macroeconomic imbalances and recommend structural policies for growth and jobs.

The MIP was introduced as part of the Six Pack. It aims to identify, prevent and eventually address EU Member States’ macroeconomic imbalances that may affect not only the economic stability of the Member States in question, but also the euro area or the EU as a whole. The Commission has set a scoreboard of main and side stock and flow indicators with accompanying thresholds that provide insights on both short-term and long-term deteriorations and accumulations of macroeconomic imbalances.
Depending on whether any of the threshold(s) have been breached, there are three possible outcomes for a Member State:

- no macroeconomic imbalance, if the macroeconomic situation is sound;
- macroeconomic imbalance followed by recommendations of preventive actions; or
- excessive macroeconomic imbalance having negative consequences on other Member States, potentially leading to the activation of the Excessive Imbalance Procedure (EIP), requiring the implementation of corrective measures. In case of continuous and repetitive non-compliance with Council’s recommendations, a set of sanctions may be imposed on the concerned euro area Member State. So far, the EIP has never been launched.

The ECB also played a pivotal role in the euro area in the aftermath of the sovereign debt crisis. An important turning point in market confidence and crisis response, was the declaration by ECB President Draghi in 2012, that “the ECB was ready to do whatever it takes to preserve the euro”. Under the Outright Monetary Transactions (OMT) programme the ECB can buy euro-area sovereign bonds on the open market for countries in an adjustment programme (EFSF, ESM). It was introduced to safeguard appropriate transmission and coherence of the monetary policy, and transactions are conducted under a specific framework. Following the ECB’s commitments to do whatever it takes and the launch the OMT programme, the spread on euro sovereign bond yields stabilised.

Progress and key challenges

In our audits of fiscal policy coordination, we found that economic governance at EU level is becoming increasingly complex, the enforcement of rules is difficult to
implement, and relies on a high degree of discretion and expert judgment by the Commission and subsequently by the Council. We also found that the flexibility provisions, applied cumulatively, might not lead to the timely build-up of the necessary fiscal buffers and policy mix to deliver on stability and growth simultaneously. In addition, certain Member States continue having high levels of public debt.

90 Our MIP audit of 2018 concluded that the procedure is generally well designed and based on good-quality analysis. However, we pointed out the [challenges with activating the enforcement aspect of the procedure (EIP)](#) and the associated political considerations that come to play with implementing such framework. In addition, the Commission Alert Mechanism Report of 2019 on Member States’ macroeconomic imbalances shows [lasting or emerging economic imbalances in important areas](#) such as private and public debt, international investment positions, the housing market and unemployment levels in certain Member States.

91 Our audit on the [European Semester](#) confirmed that the process produced relevant country-specific recommendations to address medium-term fiscal targets, macroeconomic imbalances and other necessary structural reforms. However, even though “some progress” was achieved in the implementation of more than two thirds of the country-specific recommendations, the [low rate of full implementation by Member States](#) shows that further efforts are needed to speed up implementation of important and necessary reforms. Primary responsibility for this lies at national level.

92 Together, these audits highlight a common point about the challenges faced and the need for full use of all available monitoring procedures available at EU level to make EU-level coordination more effective.

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22/2019 “EU requirements for national budgetary frameworks: need to further strengthen them and to better monitor their application”.

Impact of the COVID-19 crisis and the initial EU policy response

93 The EU economic context changed considerably when the COVID-19 pandemic hit Europe in March this year. COVID-19 is a serious threat to EU public health, and the confinement measures taken resulted in a major economic shock (Annex III shows the costs of the financial and sovereign debt crises over 2008 – 2017 in the first column and the initial cost (partially estimated) of the response to the COVID-19 pandemic in the second column).

94 COVID-19 health and confinement measures have caused disruptions in production, services, and global supply chains, and have affected key sectors such as tourism, transport and trade. According to the Commission, EU GDP is forecast to decrease by 7.4 % (7.7 % for the euro area) this year, a greater fall than during the financial and sovereign debt crisis of 2008-2012, and to rebound by 6 % (6.3 % for the euro area) in 2021 131.

Financial sector

Initial impact of the COVID-19 crisis

95 Banks entered the COVID-19 crisis better capitalised and with better liquidity management compared to previous crises. The lockdown measures led to a significant loss of revenue for businesses, as well as an increase in demand for loans and risks of business defaults. In addition, higher rates of unemployment (see Figure 8) may lead to defaults on private loans and mortgages, potentially affecting real estate prices.

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Consequently, in the next few years, banks will probably be exposed to a higher stock of NPLs, and losses from necessary private debt restructuring. According to preliminary estimates that do not consider the impact of policy measures, the EBA expects that the average coverage ratio of NPLs will reach levels similar to those in the aftermath of the 2008-2012 crisis.\footnote{The EU banking sector: first insights into the COVID-19 impacts, EBA, 25 May 2020.}

It is important for the relevant mechanisms to be able to fulfil their roles when required, particularly in the context of the crisis created by the COVID-19 outbreak. The extent to which banks will be affected by the current crisis will mostly depend on the evolution of the crisis and the subsequent rebound, banks’ pre-crisis available capital, their level of exposure to the most affected sectors and the related level of public support for the real economy.

The pandemic led to high volatility in capital markets and further flattening of the euro swap curve (swaps are used for interest rate hedging, and the swap curve can indicate expected interest rate development) with a significant drop in market value of financial assets and increase in market value of long-term insurance and defined

\footnote{The EU banking sector: first insights into the COVID-19 impacts, EBA, 25 May 2020.}
benefit pension liabilities with negative implications on the insurance and pensions sectors. Based on recent stress-test results for the insurance sector\textsuperscript{133}, the majority of insurers showed adequate solvency ratios under the tested stressed market scenarios. Pension funds, known as Institutions for Occupational Retirement Provision (IORPs), have shown slightly improved cover ratios (assets covering liabilities) in 2019, yet have been struggling with the persistently low interest rate and low yield environment, which affected the profitability of their investments and the valuation of defined benefit obligations\textsuperscript{134}.

The ESRB, ESMA and EIOPA have called for actions to address COVID-related systemic vulnerabilities\textsuperscript{135}. In particular, ESMA reported that high volatility and inherent valuation issues caused by the COVID-19 pandemic have prompted liquidity stress in some segments of the investment fund sector. It also expressed its support for the ESRB recommendation concerning NCAs’ focused supervisory engagement with investment funds that have significant exposures to corporate debt and real estate, and the importance of the timely and effective use of liquidity management tools by investment funds with exposures to less liquid assets. EIOPA has also taken several initiatives\textsuperscript{136}, such as publishing a statement on dividends distribution and variable remuneration policies in the context of COVID-19 or calling to action insurers and intermediaries to mitigate the impact of the pandemic on consumers. For IORPs EIOPA highlighted the need to be mindful of the implications of the COVID-19 pandemic on pension funds, regarding business continuity, in particular benefit payments and incoming contributions, effects on liquidity and funding levels, as well as potential long-term detrimental effects of IORP members’ decision to tap into savings or switching of investment option at an inopportune moment.

\textsuperscript{133} “2018 insurance stress test report”, EIOPA, p. 6.


Initial EU responses

100 Prompt decisions were taken by national authorities to release countercyclical and other macro-prudential capital buffers, which increased banks’ capacity to lend to the real economy and absorb unexpected losses (see Annex IV and Annex V). EU and national authorities also took other measures to increase banks’ lending capacity, including temporary relief on capital and liquidity requirements, extending transitional provisions aimed at mitigating the impact of increased provisioning under IFRS 9 on regulatory capital and a more accommodating regulatory treatment of publicly guaranteed loans. Supervisors also continue to shoulder responsibility to monitor banks’ credit risk, the level of impairments and NPLs and the impact thereof. This is essential in order to ensure the timely identification of failing or likely to fail banks.

101 In order to provide further capacity to absorb losses during the pandemic crisis, the ECB asked banks not to pay dividends until at least October 2020.

102 To balance the need for resolvability for all banks and relief for the sector in times of crisis, the SRB took the approach of postponing certain information or data requests or bank deliverables during the 2020 resolution planning cycle while maintaining the main standard reports that allow calculating the MREL requirements. The SRB declared that it would take a forward-looking approach to banks facing difficulties meeting the MREL targets before the new decisions would take effect. The SRB also announced that it will provide temporary relief on banks’ MREL requirements for banks facing difficulties to meet their targets.

103 On 28 April, the Commission issued an interpretative communication confirming flexibility in the rules, in line with the Basel Committee, including flexibility for public and private moratoria on loan repayments and supervisory measures that allowed banks to make temporary use of liquidity and capital cushions.

137 “Banking package to facilitate lending to households and businesses in the EU”, EC, 28 April 2020.

138 SRB Blog of 1 April, 8 April and 17 June 2020 as well as speech by SRB Board Member Sebastiano Laviola at the Financial Institutions Conference on 2 June 2020.

139 “Coronavirus Response: Commission adopts banking package to facilitate lending to households and businesses in the EU”, EC, 28 April 2020.

104 The Commission also proposed a **set of amendments to the CRR for exceptional temporary measures**, which include a 2-year extension of the current transitional arrangements for mitigating the impact IFRS 9 on banks' regulatory capital and a 1-year deferral of the new leverage ratio requirements of the revised Capital Requirements Regulation (CRR II)\(^{141}\).

105 The ESAs and the SSM are taking various measures and issuing coordination guidance to competent authorities in Member States responsible for the different sectors within the financial system. The Commission pointed out that **ESAs need to ensure that if NCAs apply a flexible approach in different Member States, it should be applied consistently** and should not create unfair conditions within the internal market\(^{142}\).

**Fiscal and economic policy**

**Initial impact of the COVID-19 crisis**

106 The COVID-19 crisis will cause a **severe deterioration in the fiscal deficit** (see *Figure 9*) and **public debts** (see *Figure 10*), as it exerts significant pressure on government spending and revenue in the Member States. In particular, governments took measures to bail out systemic business operators, aid businesses and provide general social support. Furthermore, credit support for businesses that is backed by guarantees from both Member States and the EU, may increase **fiscal expenditure in the medium term**. The crisis may therefore have uneven effects on the Member States and may deepen their divergence (according to the Commission, these disparities will be reflected in the fact that the **recession will be close to 10 \% for some Member States, compared to an average of 6-7.5 \%**)\(^{143}\).

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141 Regulation (EU) No 2019/876 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 Regulation (EU) No 648/2012, 20 May 2019.


The ECB’s asset purchase programme ensures an appropriate transmission of monetary policy. The confirmed eligibility for all Member States to ESM credit lines also gives comfort that support for Member States would be available to partially alleviate these pressures.

Figure 9 – Deficit (-) and surplus (+), general government (as a percentage of GDP, 2001-2021)

The repricing of government bonds which may occur as a result of uncertainty during and after the crisis could have a negative impact on exposed banks, damaging their profitability or even their viability. The risks are highest in those Member States with less fiscal space.

Initial EU responses

To address this new economic reality, the EU has provided fiscal and economic support for Member States via different economic and budgetary instruments to enhance recovery and restore growth.

In the last few months, important developments relevant to EU-level fiscal and economic coordination and the European Semester include:

- **activation of the general escape clause under the SGP** – allowing Member States to deviate from the requirements of the preventive arm (i.e. to reach the medium term budgetary objective or the adjustment path towards it) and giving the Commission the possibility of recommending an extension of the deadline for Member States to correct excessive deficits under the corrective arm (i.e. the EDP);
o activation of national escape clauses by the Member States – allowing Member States to suspend the restrictions set by their national fiscal frameworks in the face of severe economic downturns and other exceptional circumstances; and

o new Commission guidelines for the 2020 Stability and Convergence Programmes (SCPs) – streamlining the format and content of the SCPs in the current 2020 cycle.

111 In addition, the EU has envisaged new budgetary instruments to support the recovery of Member States and to protect the EU internal market and the stability of the euro. These include in particular the Next Generation EU instrument worth €750 billion whose centrepiece is the new EU recovery and resilience facility and three safety nets worth a total of €540 billion (see Annex IV).

112 To protect the cohesion of the EU’s single market and ensure a competitive level playing field, the Commission has proposed several initiatives, such as the Single Market Enforcement Task Force, the Solvency Support Instrument, the Pact on Migration and Asylum, the Strategic Investment Facility and the pharmaceutical strategy. In addition, the EU adapted State aid rules by adopting a new State aid Temporary Framework on 19 March 2020, extending it on 3 April (see Annex IV). A number of other instruments that may enhance recovery have also been approved and activated, such as the instrument for temporary Support to mitigate Unemployment Risks in an Emergency (SURE) and the ESM Pandemic Crisis Support (PCS; see Annex IV).

113 Numerous fiscal and economic measures have also been taken at national level. The fiscal support measures provided so far are estimated to account for more than 3 % of EU-27 GDP, and measures to provide liquidity support for sectors and companies facing difficulties for more than 16 % of EU-27 GDP. According to the European Fiscal Monitor, most Member States will increase their spending by around


1.6 % of GDP and provide tax relief for another 1.4 % of GDP within their fiscal response. For more detail on national measures taken in response to the COVID-19 crisis, see Annex V.

On 15 April 2020 the two Presidents presented, a Joint European Roadmap towards lifting COVID-19 containment measures. The report highlights four key areas for action as part of the way forward:

- measures to restore the functioning of the Single Market;
- greater efforts to boost investment;
- global action, in particular in the EU’s immediate neighbourhood;
- a functioning system of EU and national governance.

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Concluding remarks

115 The 2008 – 2012 financial, economic and sovereign debt crisis had long-term effects on growth and fiscal stability in the EU.

116 The EU financial system was characterised at the time by weak supervision including weak cooperation on banks cross-border activities and associated risks inadequate rules on risk assessment and capital requirements, and a lack of a crisis management framework for large banks (paragraphs 08 to 09).

117 The financial crisis of 2008 soon became a sovereign one. Losses in tax income, State aid measures to support banks and fiscal stimuli helped stabilize the economy in the early phase of the crisis but led to a significant build-up of public debt. This, coupled with the incomplete institutional architecture of the euro area, generated pressure on sovereign yields and credit ratings of certain Members States, and the sovereign debt crisis spilled back to the banking sector and the wider economy (paragraphs 11 to 16).

118 To overcome these weaknesses and contribute to a stronger and more resilient financial system, the EU has strengthened its institutional and regulatory framework: EU-level supervisors were established; micro-prudential and macro-prudential rules for banks and their supervisors were tightened; a new crisis management framework for failing or likely to fail banks was adopted; and the BU and CMU initiated (paragraphs 18 to 25).

119 Measures taken in the aftermath of the financial and sovereign debt crisis resulted in:

- A better regulated financial system – enhanced regulation and scrutiny in response to contagion and other risks affecting banks and non-bank financial intermediaries were put in place (paragraphs 37, 45-46);

- A banking system with improved capital and liquidity buffers and bail-in options. The BU and the EBA contribute to reducing the risks to financial stability (paragraphs 38-43); and

- More coordination of economic policies and national budgets – the European Semester, made up of the revised SGP, the MIP and the Union’s policies for growth and jobs, allows for broad coordination of economic policies across the EU, while paying greater attention to debt levels (paragraphs 78-89).
Nevertheless **challenges and weaknesses remain**: these include the low profitability of banks, the high level of NPLs in some Member States, still high concentration of sovereign exposures in some banks (paragraphs 49-62).

The crisis has revealed **vulnerabilities in other sectors of the financial system, including insurance and pension funds, other non-bank financial intermediaries, investment funds and market infrastructure** (paragraphs 63-70). A number of policy responses were also developed to mitigate risks that could stem from these sectors in the future, particularly for large systemic operators.

Ongoing challenges include the need to complete the BU (paragraphs 33-37) and the CMU (paragraphs 74-76), the insufficient speed of economic convergence among Member States, performance constraints for EU authorities, deficiencies in multi-layered cooperation between the EU and national authorities, deficiencies in the accountability process, and the weakening of fiscal positions in most Member States. Recent ECA reports have covered many of these issues (paragraphs 27-33, and 49-77).

Our audits on the EDP, the preventive arm of the SGP, the MIP, and the European Semester found that the EU coordination processes produces sound assessments and relevant recommendations. However, despite more than two thirds of the country-specific recommendations have at least “some progress” in implementation from 2011-2018, the low rate at which Member States fully implement these recommendations remains a challenge. Primary responsibility lies at national level (paragraphs 90-93).

In 2020, the EU found itself in a new crisis as a result of the COVID 19 pandemic, affecting production, supply chains and consumption and putting pressure on public finances. The initial reaction has been to take monetary, fiscal and prudential policy measures to safeguard the financial sector from the economic impacts, preventing the economic crisis from being amplified into a financial one (paragraphs 94-100).

Our review shows that the EU toolbox to deal with the crisis has improved. However, the current crisis is different, it could be bigger in size, depending on the depth and speed of the rebound, and it comes with a high level of uncertainty in terms of how to overcome the health risks that are causing it. The lessons learnt from the 2008-2012 crisis show that:
The costs of a crisis are significant and create extraordinary pressure on public finances, with the risk of three-way spill over effects between economic sectors, sovereigns and the financial sector;

A strong, common EU response, complemented by coordinated economic and fiscal policies as well as sound monetary policies achieves good results in managing and overcoming a crisis and enhancing recovery;

A strong single market, cohesion, solidarity and balanced economic development, restoration of investments and support for businesses are crucial for exiting a crisis and returning to a path of economic growth.

As a result of the lessons learned from the financial and sovereign debt crises, banks are now under much more scrutiny in terms of their operations, and have more capital and liquidity buffers to absorb losses. Overall, the BU and the EBA contribute to reducing risks to financial stability. However, profits remained subdued, and exposures to sovereign debt remain high, as does the level of NPLs. Depending on the length and depth of the recession caused by the COVID-19 crisis, credit losses could make the financial system more fragile (paragraphs 100-108).

The activation of the general escape clause of the SGP allows all Member States to implement immediate supportive fiscal policies. However, those countries that entered the crisis with already high levels of public debt may face increased vulnerability (paragraphs 109-114). According to the Commission’s spring forecast of 2020, the COVID-19 crisis risks leading to a further widening of economic divergences in the EU. The impacts of the pandemic differ between Member States. Factors such as the evolution of the health crisis, the size of the tourism sector and the room for discretionary fiscal policy responses influence the effect on each. This could distort the internal market. The way forward for overcoming COVID-19 will entail further institutional and policy responses.

This Review was adopted by Chamber IV, headed by Mr Alex BRENNINKMEIJER, Member of the Court of Auditors, in Luxembourg at its meeting of 8 September 2020.

For the Court of Auditors

Klaus-Heiner LEHNE
President
Annexes

Annex I — Similarities between the three ESAs

01. The three ESAs (EBA, ESMA and EIOPA) replaced the previous so-called ‘Level 3 Committees’. They share some similarities in terms of governance, objectives and functions (see Figure 1):

- **Governance**: governed by a board of supervisors, which takes all policy decisions. It consists of the ESA chair, a representative from each of the 27 Member States, and other members (non-voting);

- **Objectives**: contributing to short, medium and long-term stability of the financial system; improving the functioning of the internal market; ensuring integrity, transparency, efficiency and the orderly functioning of financial markets; strengthening international supervisory coordination; preventing regulatory arbitrage; and enhancing customer and investor protection;

- **Core functions**: carrying out risk analysis and producing regular risk dashboards, statistical reports and other policy papers, which also serve to flag any systemic risk to the ESRB; developing policies and single rulebooks containing technical and regulatory standards for Commission delegated regulation (Level 2 rules) and for guidelines and Q&A documents (Levels 3 and 4 standards);

- **Convergence**: to build a common supervisory framework among NCAs, the ESAs issue guidelines, opinions, and Q&As, undertake peer reviews to assess national supervisory practices, mediate between NCAs and take action on breaches of EU law;

- **Data collection and information dissemination**: compiling and providing a central repository for the single rulebook, lists of NCAs in Member States, all guidelines and technical standards, registers and data.
After 10 years of functioning, **the ESAs have constantly developed their role and implemented an intensive reform agenda**. The Commission proposed a package of reforms in September 2017\(^\text{149}\) to improve the mandates, governance and funding of the three ESAs. The proposals included setting up an independent Executive Board (to be in charge of case-by-case decisions and certain supervisory matters), strengthening the ESA’s role in validating internal models, and enhancing available tools to foster supervisory convergence.

In 2019, **the founding regulations of the ESAs were amended by Regulation (EU) 2019/2175**. As a result, their chairs’ roles were strengthened to steer the boards’ agendas and oversee investigations, case decisions, dispute settlements, and Breach of Union law proceedings.

Annex II — Four key phases of EU’s crisis management framework for banks

01 Phase 1 – preparation for resolution and making all banks resolvable: During the “on-going supervision and general preparation phase”, supervisors monitor banks compliance with prudential rules. In addition, supervisors ensure that banks have adequate recovery plans in place and resolution authorities create and update resolution plans\(^{150}\) and ensure that banks are prepared for a potential resolution.

02 Phase 2 – recovery: Bank supervisors have crisis identification procedures in place to identify possible issues. A key tool for this is the annual supervisory review and evaluation process. During the “recovery phase”, banks can voluntarily use the recovery options set out in the recovery plan or other management options if the bank’s situation deteriorates.

03 Phase 3 – early intervention: This phase is triggered by supervisors\(^{151}\) if the situation keeps deteriorating. Supervisors can take various intrusive measures with the aim of improving the situation, such as requiring the use of recovery options or even replacing a bank’s management\(^ {152}\). If supervisors take early intervention measures, the resolution authorities have to be notified to be able to start preparations for a potential resolution. While an early intervention phase is foreseen, it is not a precondition for declaring a bank as FOLTF\(^ {153}\).

04 Phase 4 – resolution or liquidation: If the situation does not improve the “resolution or liquidation phase” starts with an assessment that the bank is FOLTF\(^ {154}\). Supervisors or resolution authorities\(^ {155}\) must declare that a bank is FOLTF when the relevant FOLTF conditions are satisfied. Thus, there also needs to be an assessment of whether there is a reasonable prospect that any alternative private sector measures or


\(^{152}\) Article 27(1) of Directive 2014/59/EU.

\(^{153}\) Article 18(3) of Regulation (EU) No 806/2014.

\(^{154}\) Article 32(4) of Directive 2014/59/EU.

\(^{155}\) The SRB and NRAs in some Member States can also perform a FOLTF assessment under certain conditions.
supervisory action would prevent the failure of the bank within a reasonable timeframe.

05 Once a bank is declared FOLT and there is no prospect of other measures preventing its failure, the resolution authorities have to assess if the bank should be liquidated under national insolvency proceedings or put into resolution based on the public interest assessment (see Figure 1). The default procedure to deal with a bank failing or likely to fail is liquidation under national insolvency rules. However, if a public-interest test determines that resolution is proportionate and necessary to achieve one or more of the five resolution objectives, resolution action is taken\textsuperscript{156}.

**Figure 1 – Decision tree for using resolution or default liquidation of banks in the Banking Union**

Source: ECA.

06 If resolution is considered not to be proportionate and necessary in the public interest, liquidation under national insolvency rules applies. If on the contrary, resolution is considered proportionate and necessary in the public interest, the resolution authority has to prepare a resolution scheme\textsuperscript{157}. The resolution scheme defines inter alia the resolution tools to be used and whether as well as to which extend the SRF shall be used. If the SRF shall be used, the Commission needs to

\textsuperscript{156} Article 32(5) of Directive 2014/59/EU.

\textsuperscript{157} Article 18(1) Regulation (EU) No 806/2014.
approve the use of the Fund from a state-aid / competition point of view\textsuperscript{158}. The Commission then needs also to endorse the resolution scheme. Potentially, the Council needs to finally decide on elements of the resolution scheme\textsuperscript{159}. NRAs are then responsible to implement the endorsed resolution scheme in Member States under national laws.

\textsuperscript{158} Article 19(1) Regulation (EU) No 806/2014.

\textsuperscript{159} Article 18(7) Regulation (EU) No 806/2014.
Annex III — Examples of costs of the financial and sovereign debt crisis and costs of the COVID-19 crisis

<table>
<thead>
<tr>
<th>Economic parameter</th>
<th>Financial and sovereign debt crisis</th>
<th>COVID-19 crisis</th>
</tr>
</thead>
<tbody>
<tr>
<td>State aid</td>
<td>State aid to the financial sector totalling to €5058.9 billion (40.3% of EU GDP) was approved from 1 October 2008 until 1 October 2012, mainly comprising guarantees on banks’ bonds and deposits.</td>
<td>As at 21 May, national liquidity measures, including schemes approved by the Commission under the new State aid Temporary Framework (including guarantees), total about €2.5 trillion.</td>
</tr>
<tr>
<td>Direct fiscal net cost</td>
<td>Direct fiscal net costs for the 2007 – 2018 period totalled €246 billion (2% of 2018 EU GDP).</td>
<td>In April and May 2020, Member States took discretionary budgetary measures of about 3.2% of EU GDP and created liquidity facilities of 22% of EU GDP. The negative economic effects of the pandemic, together with discretionary budgetary measures adopted by the euro area Member States by way of a response, are estimated to create additional costs for the euro area of about €830 billion (around 7% of GDP) in 2020 and €280 billion (around 2% of GDP) in 2021. Across Member States, these additional costs would range from around 6% of GDP to more than 9% of GDP in 2020 and from around 1.5% of GDP to 4.4% of GDP in 2021.</td>
</tr>
</tbody>
</table>

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160 State aid Scoreboard 2013, European Commission.


<table>
<thead>
<tr>
<th>Economic parameter</th>
<th>Financial and sovereign debt crisis</th>
<th>COVID-19 crisis</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Guarantees</strong></td>
<td>Eight Member States granted guarantees, ranging from 10% to 190% of the respective Member State’s GDP for 2007-2018. Contingent liabilities peaked at around 12% of EU GDP (€1 421 billion) at the end of 2009 and decreased to 0.8% at the end of 2018. The total impact on public debts peaked at 6% of EU GDP (€778 billion) in 2010 and decreased to 3% in 2018.</td>
<td>As at 9 April, Member States have committed to provide liquidity support (public guarantee schemes and deferred tax payments) for sectors and companies facing disruptions and liquidity shortages, estimated at 16% of EU GDP. The EU is providing €25 billion to the European Investment Bank (EIB) to mobilise up to €200 billion in investment to support companies, in particular small and medium enterprises.</td>
</tr>
<tr>
<td><strong>Financial assistance for Member States</strong></td>
<td>In total, the EU (through the balance-of-payment facility and the EFSM) and euro area Member States (through the EFSF, the ESM and the Greek loan facility) lent €414.7 billion of financial assistance.</td>
<td>Based on existing precautionary credit lines, the ESM will provide Pandemic Crisis Support of up to 2% of 2019 GDP for each euro area country (up to €240 billion in total) to finance health-related spending. In addition, the EC adopted a proposal for a €3 billion macro-financial assistance package for 10 enlargement and neighbourhood partners to support them in limiting the negative economic effects of the pandemic.</td>
</tr>
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<table>
<thead>
<tr>
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<tbody>
<tr>
<td>Crisis liquidity assistance from central banks</td>
<td>€1.3 trillion of loans were given to credit institutions at the end of 2012, provided through Eurosystem to inject liquidity into the banking system, particularly in vulnerable countries.</td>
<td>The ECB announced liquidity assistance of 7.3% of euro area GDP (€750 billion through the new Pandemic Emergency Purchase Programme until the end of the year, in addition to the €120 billion decided on earlier). An estimate of liquidity measures taken by national central banks in response to the COVID-19 crisis is not available at the time of writing.</td>
</tr>
<tr>
<td>Loss in economic output</td>
<td>In 2016, the Commission estimated that potential growth in the euro area had fallen from 1.9% over the 2000-2008 period to 0.5% in the following period (2009-2014).</td>
<td>The Commission estimated that potential growth in the euro area rose from 0.7% over the 2011-2015 period to 1.3% in the following period (2016-2018). In 2020, real GDP in the euro area is projected to fall by 7.7%, recovering by about 6.3% in 2021. Despite that, output in 2021 is expected to be almost 2 percentage points lower than in 2019.</td>
</tr>
</tbody>
</table>

Source: ECA.

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### Annex IV — Overview of initial measures taken at EU level in response to the COVID-19 crisis

<table>
<thead>
<tr>
<th>Institution</th>
<th>Measure</th>
<th>Description</th>
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</table>
| **European Commission** | **Next Generation EU instrument**           | On 27 May, as part of the new EU recovery plan totalling €1,850 billion, the Commission proposed a Next Generation EU instrument with a budget of €750 billion. The Next Generation EU is a new one-off recovery instrument with an end date of 31 December 2024, which should be embedded in the new MFF to protect livelihoods, support economic recovery and foster growth. Funds for the instrument should be raised from a temporary increase in the own resources ceiling, which would allow the EU to borrow funds on the financial markets. Funds would then be channelled to the Member States through EU programmes and spent across three pillars, consisting of €500 billion in grants and €250 billion in loans:  
  - **Pillar 1 — Supporting Member States to recover, repair and strengthen** by: setting up a new Recovery and Resilience Facility with a budget of €560 billion; introducing a new REACT-EU initiative of €55 billion to top up Cohesion support for Member States; and by providing support for the green transition;  
  - **Pillar 2 — Kick-starting the economy and private investment** by: introducing a new Solvency Support Instrument of €31 billion to mobilise private resources to support companies; strengthening InvestEU by more than doubling its capacity; and creating a new Strategic Investment Facility within InvestEU worth €15 billion to increase EU resilience and strategic autonomy across key technologies and value chains; and  
  - **Pillar 3 — Learning lessons from the crisis** by: proposing to set up a new EU4Health programme worth €9.4 billion to increase EU preparedness for a health crisis; reinforcing the rescEU programme and Horizon Europe; and strengthening both the Neighbourhood, Development and International Cooperation Instrument and the Humanitarian Aid Instrument. |
| **Coronavirus Response Investment Initiative** | Initiatives designed to support the most affected sectors and most exposed regions in Member States. It allocates €37 billion of the European Structural Investment Funds.  
  The Coronavirus Response Investment Initiative Plus additionally increased the flexibility in using the EU budget, complemented by:  
  - €28 billion from 2014-2020 Structural funds which have not yet been allocated to specific projects; and  
  - Up to €800 million from EU Solidarity funds, which will be made available to the hardest hit Member States. | **Temporary Framework for State aid measures**  
  Includes five types of aid: (1) direct grants, selective tax advantages and advance payments; (2) state guarantees; (3) subsidised public loans to companies; (4) safeguards for banks that channel State aid to the real economy; and (5) short-term export credit insurance. |
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<tr>
<th>Institution</th>
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<tbody>
<tr>
<td>Guarantee to the European Investment Fund (EIF)</td>
<td>€1 billion to be made available from the EU budget as a guarantee to the EIF, to ensure that banks provide sufficient liquidity to bridge the capital needs of small and medium enterprises (SMEs) and small mid-caps in particular:</td>
<td>Measures were complemented by support to Coronavirus-related research and development, construction and upscaling of testing facilities, production of relevant products to tackle the Coronavirus outbreak, targeted measures for deferral of tax payments and/or suspensions of social security contributions and targeted measures for wage subsidies for employees.</td>
</tr>
<tr>
<td>Fiscal rules</td>
<td>Support for Member States by ensuring they have sufficient liquidity and by using the flexibility available within the EU fiscal rules, in particular by:</td>
<td>Fiscal rules</td>
</tr>
<tr>
<td>Support mitigating Unemployment Risks in Emergency (SURE)</td>
<td>A new initiative to provide financial assistance of up to €100 billion in total in the form of loans to all Member States, backed by a system of guarantees from Member States. SURE will help Member States finance primarily national short-term work schemes and similar measures against the risks of unemployment and loss of income, as well as, as an ancillary, some health-related measures, in particular in the workplace.</td>
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<tr>
<td>Institution</td>
<td>Measure</td>
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<tr>
<td><strong>European Central Bank</strong></td>
<td><strong>Pandemic Emergency Purchase Programme (PEPP)</strong></td>
<td>A temporary programme for purchasing private and public-sector securities in a flexible manner to counter the economic effects of the COVID-19 crisis. The PEPP totals €750 billion and complements the additional asset purchasing measures of €120 billion.</td>
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<tr>
<td></td>
<td><strong>Purchase of commercial papers</strong></td>
<td>Purchasing papers of sufficient credit quality to expand the eligible collateral in the ECB’s refinancing operations.</td>
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<td></td>
<td><strong>Refinancing operations</strong></td>
<td>Making up to €3 trillion in liquidity available through refinancing operations, in particular cheap loans to banks, known as long-term refinancing operations (LTROs) and eased conditions on an existing “targeted” lending programme.</td>
</tr>
<tr>
<td><strong>European banking supervisors</strong></td>
<td></td>
<td>Freeing up an estimated €120 billion of extra bank capital, which can support considerable capacity for euro area banks: o <strong>Capital and liquidity buffers</strong> – the ECB will allow banks to operate temporarily below the level of capital defined by the Pillar 2 Guidance, the capital conservation buffer and the LCR; o <strong>Composition of capital for Pillar 2 Requirements</strong> – banks will be allowed partially to use capital instruments that do not qualify as Common Equity Tier 1 capital to meet the Pillar 2 Requirements. This brings forward a measure that was scheduled to come into effect in January 2021 with the revision of the Capital Requirements Directive (CRD V); o <strong>Supervisory measures</strong> – the ECB will also consider operational flexibility in the implementation of bank-specific supervisory measures.</td>
</tr>
<tr>
<td><strong>European Investment Bank</strong></td>
<td><strong>Support for SMEs</strong></td>
<td>The EIB(EIF) aim to bridge SMEs’ short-term financing needs caused by COVID-19 by means of: o <strong>Guarantee schemes</strong> to banks, based on existing programmes for immediate deployment, mobilising up to €8 billion of financing; o <strong>Liquidity lines to banks</strong> to ensure additional working capital support for SMEs and mid-caps of €10 billion; o <strong>Asset-backed securities purchasing programmes</strong> to transfer risk on portfolios of SME loans, mobilising another €10 billion of support.</td>
</tr>
<tr>
<td></td>
<td><strong>EIB guarantee fund</strong></td>
<td>Creating a Pan-European Guarantee fund of €25 billion to mobilise up to 200 billion in investment to support the real economy through local banks and other financial intermediaries. The fund will be financed by EU Member States in proportion to their shareholding in the EIB.</td>
</tr>
<tr>
<td>Institution</td>
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<td>Description</td>
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</tr>
<tr>
<td>European Insurance and Occupational Pensions Authority</td>
<td>Measures to ensure business continuity, financial stability and consumer protection</td>
<td>Measures, such as recommendations on supervisory flexibility regarding deadlines of reporting and public disclosure are aimed to help insurers continuing to serve their customers. Furthermore, given the overall uncertainty of the scale and duration of the crisis, EIOPA has urged insurers and pension funds to adopt a prudent approach and mitigate the impact of COVID-19, for example by temporarily suspending all discretionary dividend distributions and share buy backs, with the objective to preserve capital and contribute to financial stability. Finally, EIOPA has asked insurers to identify their products affected because of COVID-19 and consider proportionate remedial measures in cases in which there are possible unfair treatment of customers.</td>
</tr>
</tbody>
</table>

*Source: ECA.*
## Annex V — Overview of main types of State aid measures in response to the COVID-19 crisis

<table>
<thead>
<tr>
<th>Measure</th>
<th>Description</th>
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<tbody>
<tr>
<td><strong>Grants and equity injections</strong></td>
<td><strong>Objective:</strong> addressing companies’ urgent liquidity needs. <strong>Threshold:</strong> €800 000 per company (total nominal value of measures)/ €120 000 per company active in fisheries and aquaculture/€100 000 per company active in the production of agricultural products.</td>
</tr>
<tr>
<td><strong>Subsidised (public) loans</strong></td>
<td><strong>Objective:</strong> ensuring that banks keep providing loans to businesses in order for them to cover immediate working capital and investment needs. <strong>Threshold:</strong> zero-interest rates only for loans of up to €800 000 (nominal amount).</td>
</tr>
<tr>
<td><strong>Guarantees</strong></td>
<td><strong>Objective:</strong> supporting companies in need. <strong>Threshold:</strong> for loans of up to €800 000 (nominal), guarantees can cover up to 100 %.</td>
</tr>
<tr>
<td><strong>Credit insurance</strong></td>
<td><strong>Objective:</strong> protecting European exporters against the risk of non-payment by a foreign buyer. <strong>Threshold:</strong> due to the Coronavirus outbreak, all Member States are temporarily removed from the list of “marketable risk” countries.</td>
</tr>
<tr>
<td><strong>Tax advantages and repayable advances</strong></td>
<td><strong>Objective:</strong> supporting sectors, regions and types of companies most affected by the crisis. <strong>Threshold:</strong> see grants and equity injections.</td>
</tr>
<tr>
<td><strong>Wage subsidies and deferral of social security contributions</strong></td>
<td><strong>Objective:</strong> support companies in sectors or regions that are affected by the ongoing crisis the most, and would otherwise have to lay off employees. <strong>Threshold:</strong> No EU limits set.</td>
</tr>
<tr>
<td><strong>Sector-specific measures: banks</strong></td>
<td><strong>Objective:</strong> incentivising credit institutions that play the crucial role in supporting the EU economic activity. <strong>Threshold:</strong> No EU limits set</td>
</tr>
<tr>
<td><strong>Measures for private households</strong></td>
<td><strong>Objective:</strong> replacing lost income. <strong>Threshold:</strong> No EU limits set</td>
</tr>
</tbody>
</table>

*Source:* European Commission.
Glossary

**Banks:** In this review, credit institutions and investment firms subject to the relevant EU law are considered banks.

**Banking supervision:** Monitoring of banks and taking supervisory action as appropriate to ensure that they are operating safely, soundly and in compliance with applicable rules and regulations.

**Capital requirement:** The amount of own funds a bank is required to have, relative to its risk-weighted assets, so that it is better prepared to withstand unexpected losses.

**Eurosystem:** Collective term used for the ECB and the national central banks of countries that have adopted the euro.

**Failing or likely to fail assessment (FOLTF assessment):** A banking supervisor's assessment that a bank is in one or more of the following situations: (i) it is infringing, or is likely soon to infringe, certain regulatory requirements in a way that would justify the withdrawal of authorisation to operate; (ii) its assets are less than its liabilities, or are likely to be so in the near future; (iii) it is unable, or is likely soon to be unable, to pay its debts or other liabilities as they fall due; (iv) it needs extraordinary public financial support.

**Financial assistance:** EU financial support (such as loans) provided to countries in financial distress in order to restore them to macroeconomic or financial health and ensure they are able to meet their public-sector or balance-of-payments obligations.

**Financial market:** Market for the sale and purchase of financial assets, such as shares, bonds, currencies and derivatives.

**Leverage ratio:** The size of a bank's assets and off-balance sheet obligations, without risk-weighting, relative to its own funds (defined as Tier 1 capital).

**Macro-prudential supervision:** Supervision concerned with the stability of a financial system as a whole.

**Micro-prudential supervision:** Supervision focusing on individual financial institutions as component parts of a financial system.

**Non-performing loan (NPL):** A loan on which payments have been overdue for a specified time span (usually 90 days), or where there is evidence that full repayment is unlikely.
**National competent authority (NCA):** A national body responsible for the supervision of certain financial entities and markets (such as banks, insurers, pension funds, investment funds and market infrastructures), with the power to perform certain functions.

**Recapitalisation:** Injection of capital into a company to improve its equity/debt ratio.

**Resolution:** The orderly winding-up of a failing financial institution to ensure the continuity of its essential functions, preserve financial stability, and protect public funds by minimising the need for public financial support.

**Solvency capital requirement:** The amount of own funds that insurance and reinsurance companies in the EU are required to have.

**Sovereign debt:** Money owed by central government, sometimes including the debt of state-owned enterprises and social security schemes, to domestic and foreign lenders.

**State aid:** Direct or indirect government support to a business or an organisation, putting it at an advantage over its competitors.

**Stress testing:** A simulation to assess a financial institution’s ability to withstand different crisis scenarios.
List of abbreviations

AIF: Alternative Investment Fund

AIFMD: Alternative Investment Funds Managers Directive

BU: Banking Union

CCP: Central Counterparty

CMU: Capital Markets Union

CRAs: Credit Rating Agencies

CRD: Capital Requirements Directive

CRR: Capital Requirements Regulation

CRR/CRD IV: Capital Requirements Regulation and Capital Requirements Directive IV

CRR II: Revised Capital Requirements Regulation

DG: Directorate General

EBA: European Banking Authority

ECB: European Central Bank

ECFIN: Directorate-General for Economic and Financial Affairs of the Commission

EDIS: European Deposit Insurance Scheme

EDP: Excessive Deficit Procedure

EFB: European Fiscal Board

EFSF: European Financial Stability Facility

EFSI: European Fund for Strategic Investments

EFSM: European Financial Stability Mechanism

EIF: European Investment Fund

EIOPA: European Insurance and Occupational Pensions Authority

EIP: Excessive Imbalance Procedure
**EMIR:** European Market Infrastructure Regulation

**EMU:** Economic and Monetary Union

**ESAs:** European Supervisory Authorities

**ESFS:** European System of Financial Supervision

**ESM:** European Stability Mechanism

**ESMA:** European Securities and Markets Authority

**ESRB:** European Systemic Risk Board

**EU:** European Union

**FISMA:** Directorate-General for Financial Stability, Financial Services and Capital Markets Union of the Commission

**FOLTF:** Failing or Likely to Fail

**FSB:** Financial Stability Board

**GDP:** Gross Domestic Product

**IAIS:** International Association of Insurance Supervisors

**IFRS:** International Financial Reporting Standards

**IGS:** Insurance Guarantee Scheme

**IMF:** International Monetary Fund

**IORP II:** Activities and Supervision of Institutions for Occupational Retirement Provision Directive

**IORPs:** Institutions for Occupational Retirement Provision

**LCR:** Liquidity Coverage Ratio

**MiFID:** Markets in Financial Instruments Directive

**MiFIR:** Markets in Financial Instruments Regulation

**MIP:** Macroeconomic Imbalance Procedure

**NCAs:** National Competent Authorities
**NPLs:** Non-Performing Loans

**NRAs:** National Resolution Authorities

**OMT:** Outright Monetary Transactions

**OTC:** Over-the-Counter

**PCS:** Pandemic Crisis Support

**PEPP:** Pandemic Emergency Purchase Programme

**SCPs:** Stability and Convergence Programmes

**SGP:** Stability and Growth Pact

**SMEs:** Small and Medium Enterprises

**Solvency II:** Taking-up and pursuit of the business of Insurance and Reinsurance Directive

**SRB:** Single Resolution Board

**SRF:** Single Resolution Fund

**SRM:** Single Resolution Mechanism

**SSM:** Single Supervisory Mechanism

**SURE:** Support to mitigate Unemployment Risks in an Emergency
ECA team

ECA Review – How the EU took account of lessons learned from the 2008-2012 financial and sovereign debt crises

This review was adopted by Chamber IV, headed by ECA Member Alex Brenninkmeijer. The task was led by ECA Member Ivana Maletić, supported by Sandra Diering, Head of Private Office; Tea Japunčić, Private Office Assistant; Paul Stafford, Principal Manager; Jacques Sciberras, Head of Task; Mathias Blaas, Auditor; Adrian Savin, Auditor.

As a consequence of the COVID-19 pandemic and the strict confinement conditions, no picture of the audit team could be provided.
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