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PRESS RELEASE

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Structural reform of the EU banking sector

Today, the European Commission has proposed new rules to stop the biggest and most complex banks from engaging in the risky activity of proprietary trading. The new rules would also give supervisors the power to require those banks to separate certain potentially risky trading activities from their deposit-taking business if the pursuit of such activities compromises financial stability. Alongside this proposal, the Commission has adopted accompanying measures aimed at increasing transparency of certain transactions in the shadow banking sector. These measures complement the overarching reforms already undertaken to strengthen the EU financial sector.

In drafting its proposals, the Commission has taken into account the useful report by the High Level Group chaired by the Governor of the Bank of Finland, Erkki Liikanen (IP/12/1048), as well as existing national rules in some Member States, global thinking on the issue (Financial Stability Board principles) and developments in other jurisdictions.

Michel Barnier, Commissioner for internal market and services said: *"Today's proposals are the final cogs in the wheel to complete the regulatory overhaul of the European banking system. This legislation deals with the small number of very large banks which otherwise might still be too-big-to-fail, too-costly-to save, too-complex-to-resolve. The proposed measures will further strengthen financial stability and ensure taxpayers don't end up paying for the mistakes of banks. Today's proposals will provide a common framework at EU level - necessary to ensure that divergent national solutions do not create fault-lines in the Banking Union or undermine the functioning of the single market. The proposals are carefully calibrated to ensure a delicate balance between financial stability and creating the right conditions for lending to the real economy, particularly important for competitiveness and growth."*

Since the start of the financial crisis, the European Union and its Member States have engaged in a fundamental overhaul of bank regulation and supervision. The EU has introduced reforms to reduce the impact of potential bank failures with the objectives of creating a safer, sounder, more transparent and responsible financial system that works for the economy and for society as a whole. To increase the resilience of banks and to reduce the impact of potential bank failures, new rules on capital requirements for banks (MEMO/13/690) and bank recovery and resolution (MEMO/13/1140) have been adopted. The Banking Union has been launched. Nevertheless, some EU banks may still remain too-big-to-fail, too-big-to-save and too-complex-to-resolve. Further measures are therefore needed, notably a structural separation of the risks associated with banks' trading activities from its deposit-taking function. Today's proposals aim to strengthen the resilience of the EU banking sector while ensuring that banks continue to finance economic activity and growth.

The proposal on structural reform of EU banks will apply only to the largest and most complex EU banks with significant trading activities. It will:

1. Ban proprietary trading in financial instruments and commodities, i.e. trading on own account for the sole purpose of making profit for the bank. This activity entails many risks but no tangible benefits for the bank's clients or the wider economy.
2. Grant supervisors the power and, in certain instances, the obligation to require the transfer of other high-risk trading activities (such as market-making, complex derivatives and securitisation operations) to separate legal trading entities within the group ("subsidiarisation"). This aims to avoid the risk that banks would get around the ban on the prohibition of certain trading activities by engaging in hidden proprietary trading activities which become too significant or highly leveraged and potentially put the whole bank and wider financial system at risk. Banks will have the possibility of not separating activities if they can show to the satisfaction of their supervisor that the risks generated are mitigated by other means.
3. Provide rules on the economic, legal, governance, and operational links between the separated trading entity and the rest of the banking group.

To prevent banks from attempting to circumvent these rules by shifting parts of their activities to the less-regulated shadow banking sector, structural separation measures must be accompanied by provisions improving the transparency of shadow banking. The accompanying transparency proposal will therefore provide a set of measures aiming to enhance regulators' and investors' understanding of securities financing transactions (STFs). These transactions have been a source of contagion, leverage and procyclicality during the financial crisis. A better monitoring of these transactions is necessary to prevent the systemic risk inherent to their use.

Background

Within the context of national initiatives and an increasing global debate on the merits of bank structural reform, Commissioner Barnier announced in November 2011 the setting up of a High-level Expert Group ("HLEG") with a mandate to assess the need for structural reform of the EU banking sector, chaired by Erkki Liikanen, Governor of the Bank of Finland. The Group delivered its report in October 2012, recommending mandatory separation of certain high-risk trading activities for banks whose trading activities exceeded certain thresholds (IP/12/1048).

As regards shadow banking, the Financial Stability Board proposed a series of recommendations in 2013 to regulate the sector. Those recommendations were endorsed at the St-Petersburg G20 Summit in September 2013.

See also MEMO/14/63 and MEMO/14/64

For more information

http://ec.europa.eu/internal_market/bank/structural-reform/index_en.htm

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