A EUROPEAN FRAMEWORK

FOR

A MORE RESILIENT BANKING SYSTEM

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European Commission

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Internal Market and Services

Disclaimer

The remarks in this presentation are the author's and should not be attributed to the European Commission.

European Commission

- ✓1.7 trillion €
- ✓13.4%

- ✓4.9 trillion €
- ✓38.8%

- ✓349%

What is Europe doing about this?

Overwiew

1. State of Play Post Crisis
2. Deposit Guarantees
3. Capital Requirements
4. Bank Resolution
5. Liikanen Group
6. Banking Union

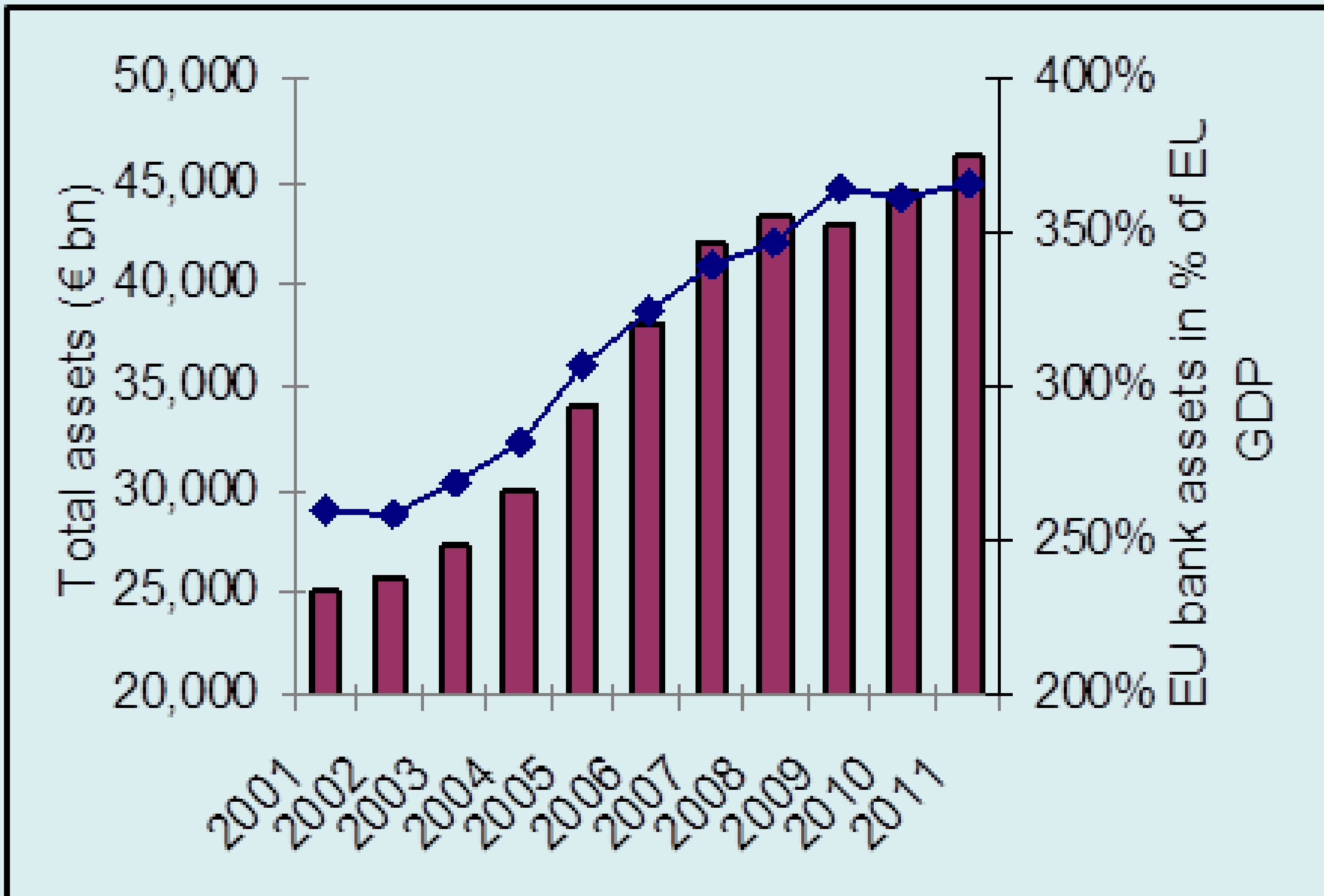
Overwiew

1. State of Play Post Crisis

European Commission

Rapid growth in the EU banking sector

Total assets of MFIs in EU 2001-2011

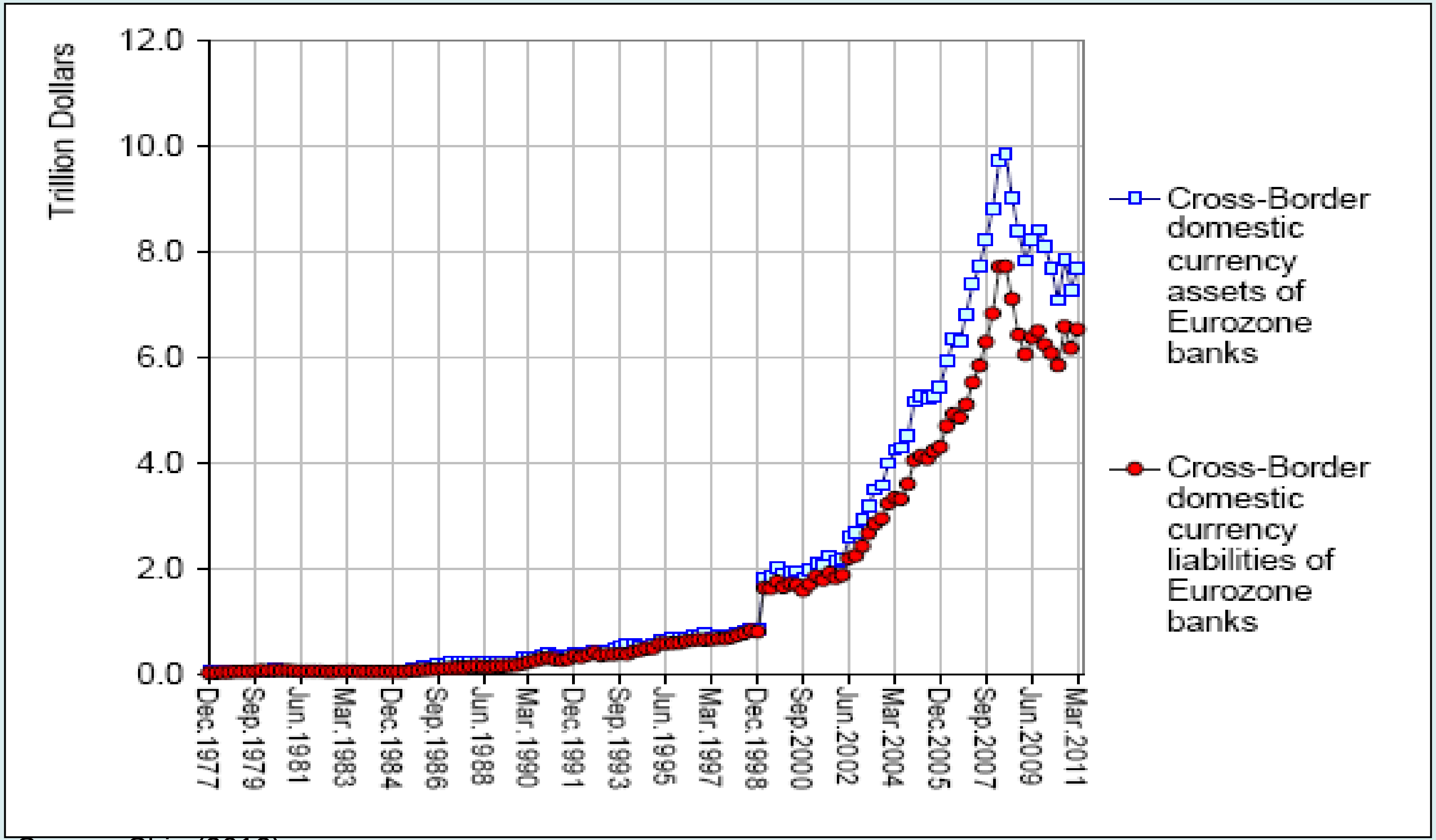


Note: Bar charts show total assets, dotted line shows assets in % of GDP.
Source: ECB data.

Internal Market and Services

Also strong cross-border growth

Cross-border assets and liabilities of euro area banks 1977-2011



Source: Shin (2012).

European Commission

EU banking sector is larger than those of US and Japan

Size of EU, US and Japanese banking sectors (2010)

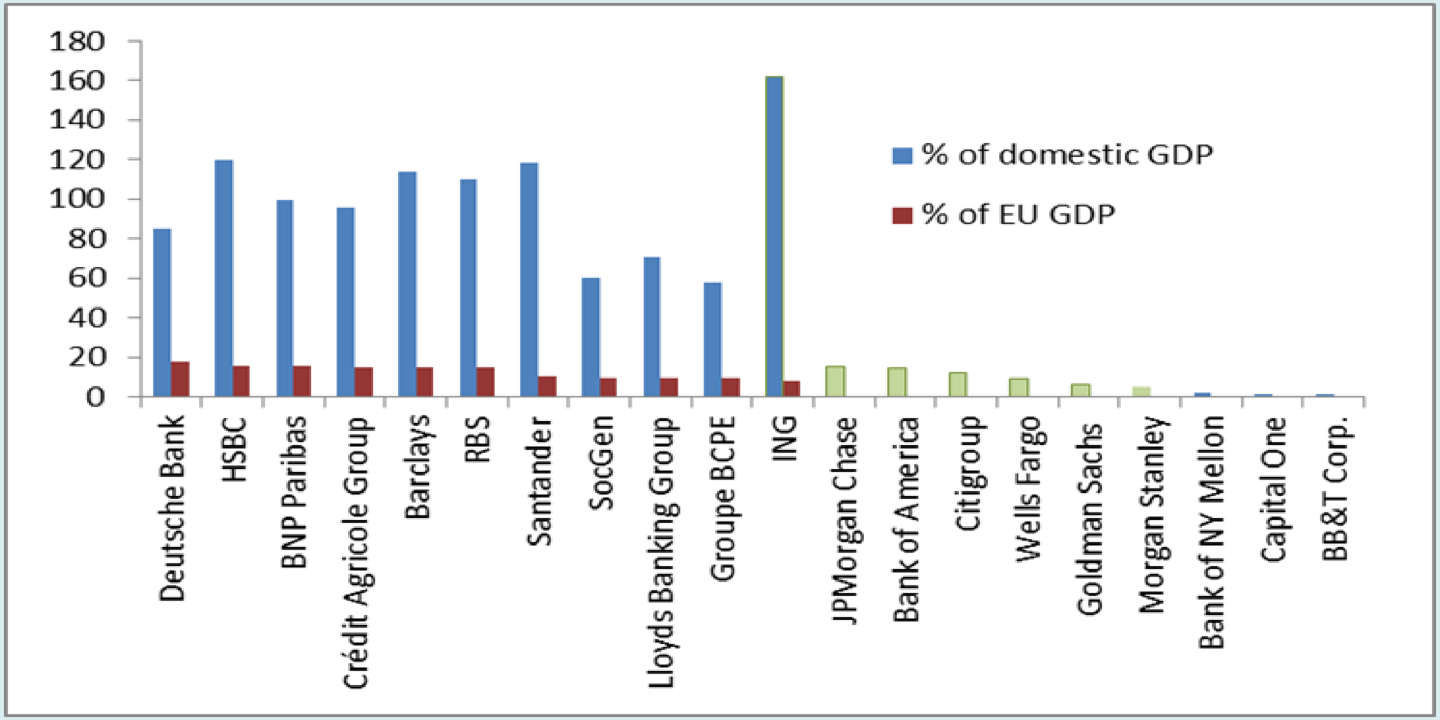
	EU	*USA*	*Japan*
Total bank sector assets (€ trillion)	*42.9*	*8.6*	*7.1*
Total bank sector assets/GDP	*349%*	*78%*	*174%*
Top 10 bank assets (€ trillion)	*15.0*	*4.8*	*3.7*
Top 10 bank assets/GDP	*122%*	*44%*	*91%*

Notes: Top 6 banks for Japan. Source: European Banking Federation (2011).

European Commission

EU bank assets are sizable compared to home country GDP

Total assets of EU and US banking groups (2011, in % of GDP)



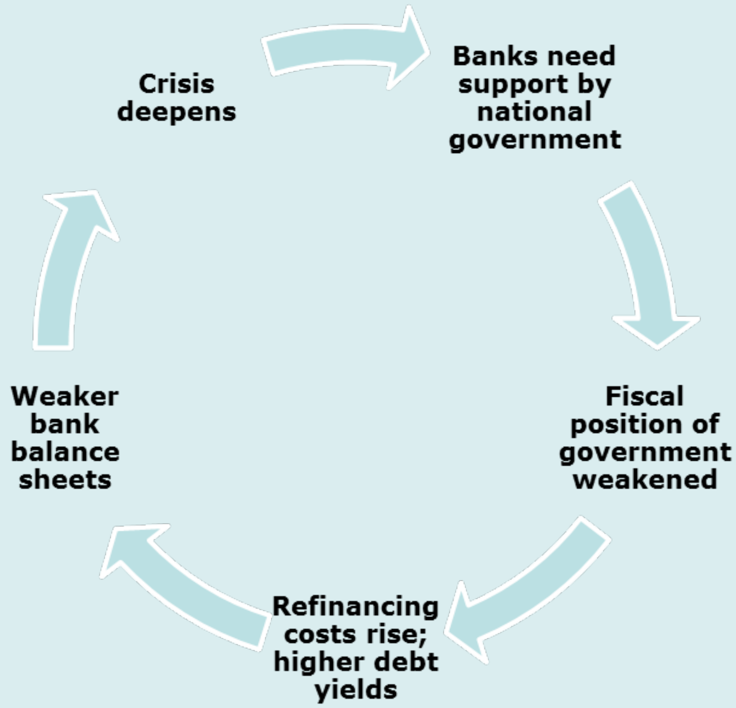
Source: Data from SNL Financial. Eurostat for GDP data.

Unprecedented state support to banks

- ***€1.688 trillion*** *of total state aid used to support banks during 2007 and 2011 or* ***13.4% of EU GDP***

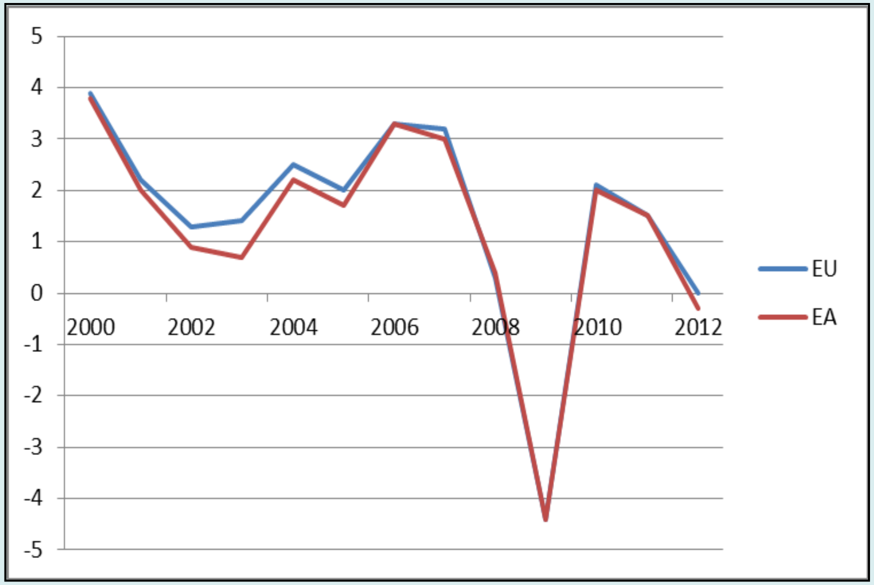
- *Committed or approved amounts :* ***€ 4.897 trillion*** *or* ***38.8% of EU GDP***

Unhealthy relation of banks and sovereigns



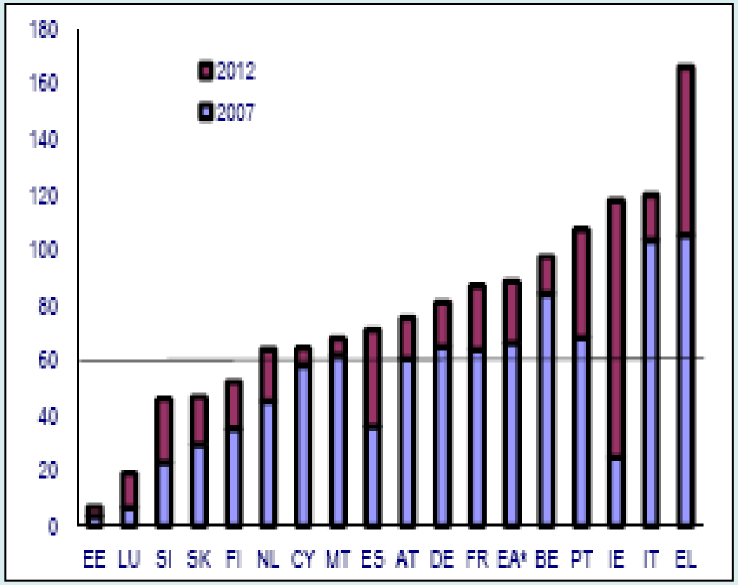
Crisis impact on the real economy

GDP growth rate (% p.a.)



Source: Eurostat data.

Public debt (% of GDP)



Source: European Commission (2011c).

Latest IMF Figures (2012)

For the (aggregate, average) (GDP roughly 9.5 trillion euro):

- ✓ Output loss: **23% of GDP** (this is the estimated net present value of all output losses relative to trend output).
- ✓ Fiscal cost: **3.9% of GDP**
- ✓ Increase in debt: **19.9% of GDP**

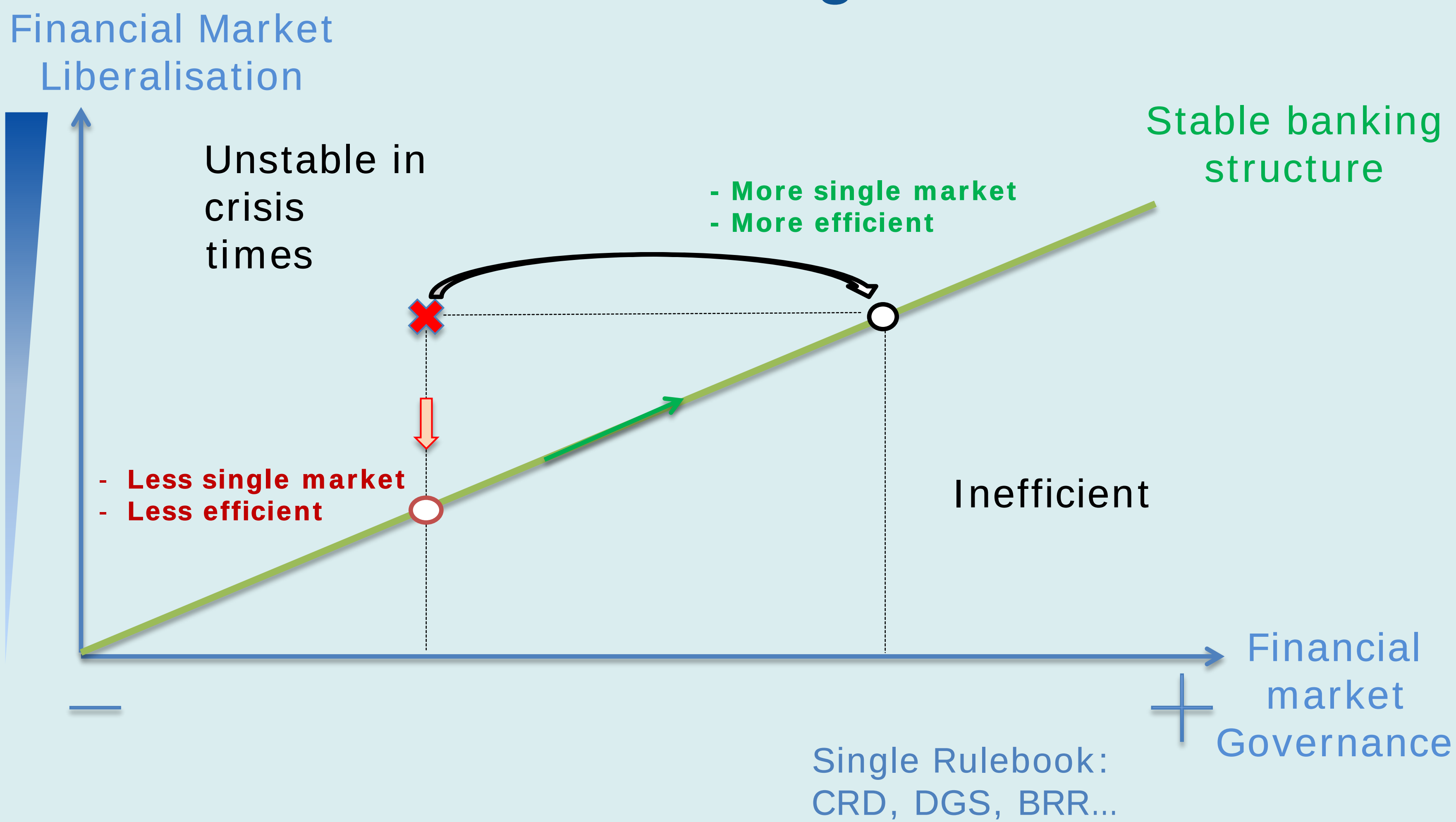
European Commission

Trend towards unravelling the single market

- ✓ Financial integration increased until the crisis.
- ✓ Currently rising fragmentation, in particular in the Euro area:
  - ✓ **Significant renationalisation of banks' funding markets.**
  - ✓ **Cross-border capital flows have fallen sharply.**

→ ***Less single market, less growth and prosperity.***

Liberalisation vs. governance



Current regulatory reforms

Capital, leverage	CRD IV / CRR G-SIB requirements
Liquidity	CRD IV / CRR
Reducing contagion, complexity	EMIR, MiFID II, proposals on CSDs and securities law, shadow banking
Corporate governance	CRD III, CRD IV
Transparency, data quality	Review of IFRS standards, audit proposals, rating agency regulation
Supervision	SSM proposals, towards Banking Union
Recovery and resolution	Resolution and crisis management proposal
Depositor protection	DGS proposal

1.
2. Deposit Guarantees

Internal Market and Services

European Commission

- ✓ 1994 first Directive on Deposit Guarantee Schemes (DGS) unchanged for 15 years
- ✓ Financial crisis Member States raised unilaterally and significantly their coverage levels – disorder and financial stability.
- ✓ 2009: €100 000 per depositor per bank.
- ✓ 2010 review of the DGS Directive
  - ✓ Maximum harmonisation
  - ✓ DGS financing as a key pillar

European Commission

- ✓ Negotiations between the EP and Council
- ✓ Key issues:
  - ✓Scope of the Directive
  - ✓Pay-out deadline
  - ✓Financing (target level, risk-based contributions, mutual borrowing)
  - ✓Use of funds – links to BRR Directive

The maximum length of the payout delay		
Past	prior to the financial crisis of 2008	3-9 months
Past	from mid-2009	3 months
Present	from 2011	4-6 weeks
Future	from 2014 (Commission proposal) or 2017 (EP proposal)	one week

European Commission

DGS financing: four-step approach

Ex-ante funding (1.5% of eligible deposits)
to be reached by Member States within 10 years

↓

Extraordinary (ex-post) contributions
(up to 0.5% of eligible deposits)

↓

Mutual borrowing facility
(up to 0.5% of eligible deposits of the borrowing scheme)

↓

Additional / alternative financing sources
(e.g. borrowing from financial markets) – no limits

Commission legislative proposal, July 2010

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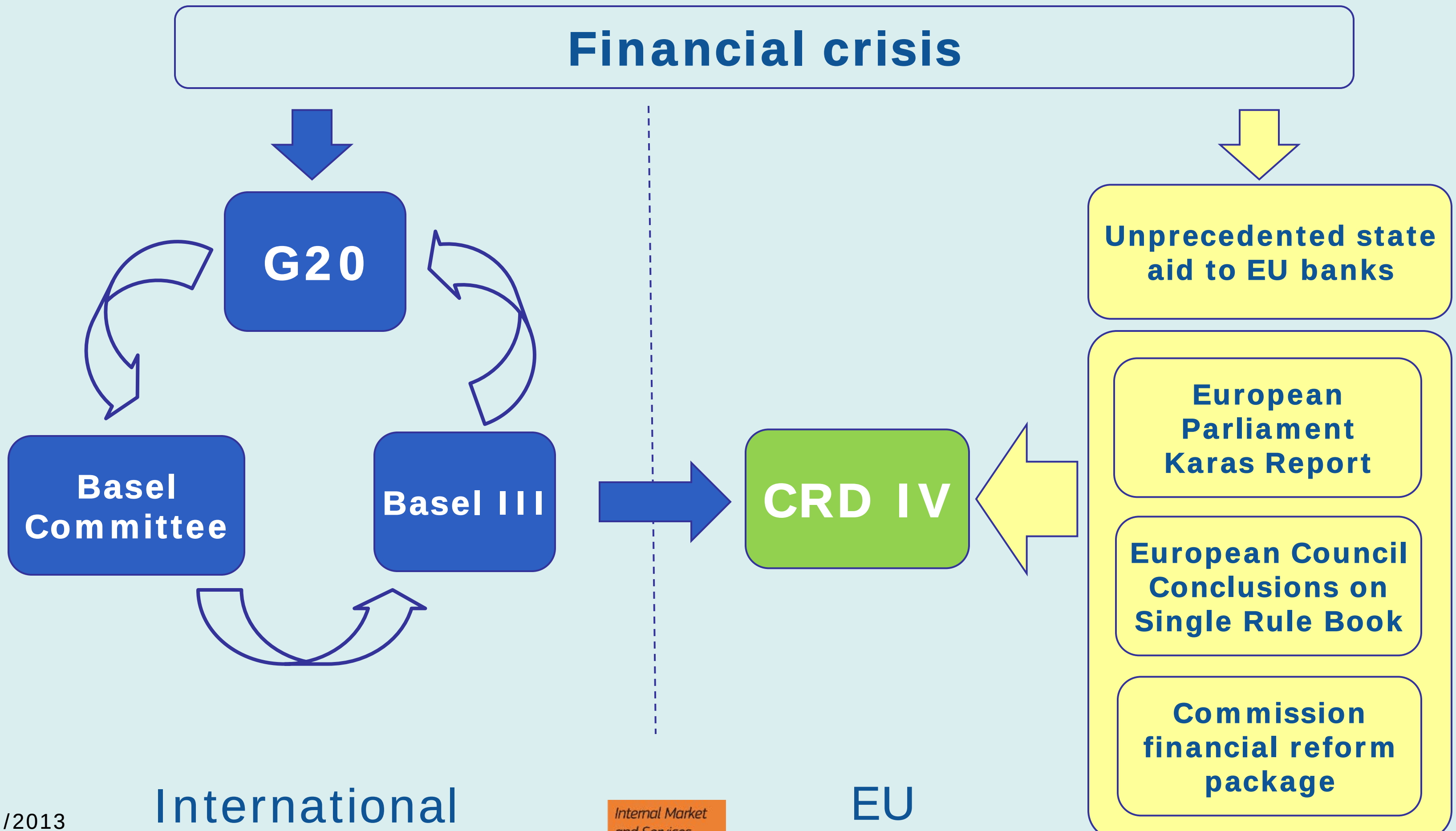
2.
3. Capital Requirements


Financial crisis
G20
Basel
Committee
Basel III
CRD IV
Unprecedented state
aid to EU banks
European
Parliament
Karas Report
European Council
Conclusions on
Single Rule Book
Commission
financial reform
package
International
EU

Basel III / CRD IV: key elements

Capital

- *More and better capital*
- *Higher risk weights*
- *Conservation buffer*
- *Countercyclical buffer*

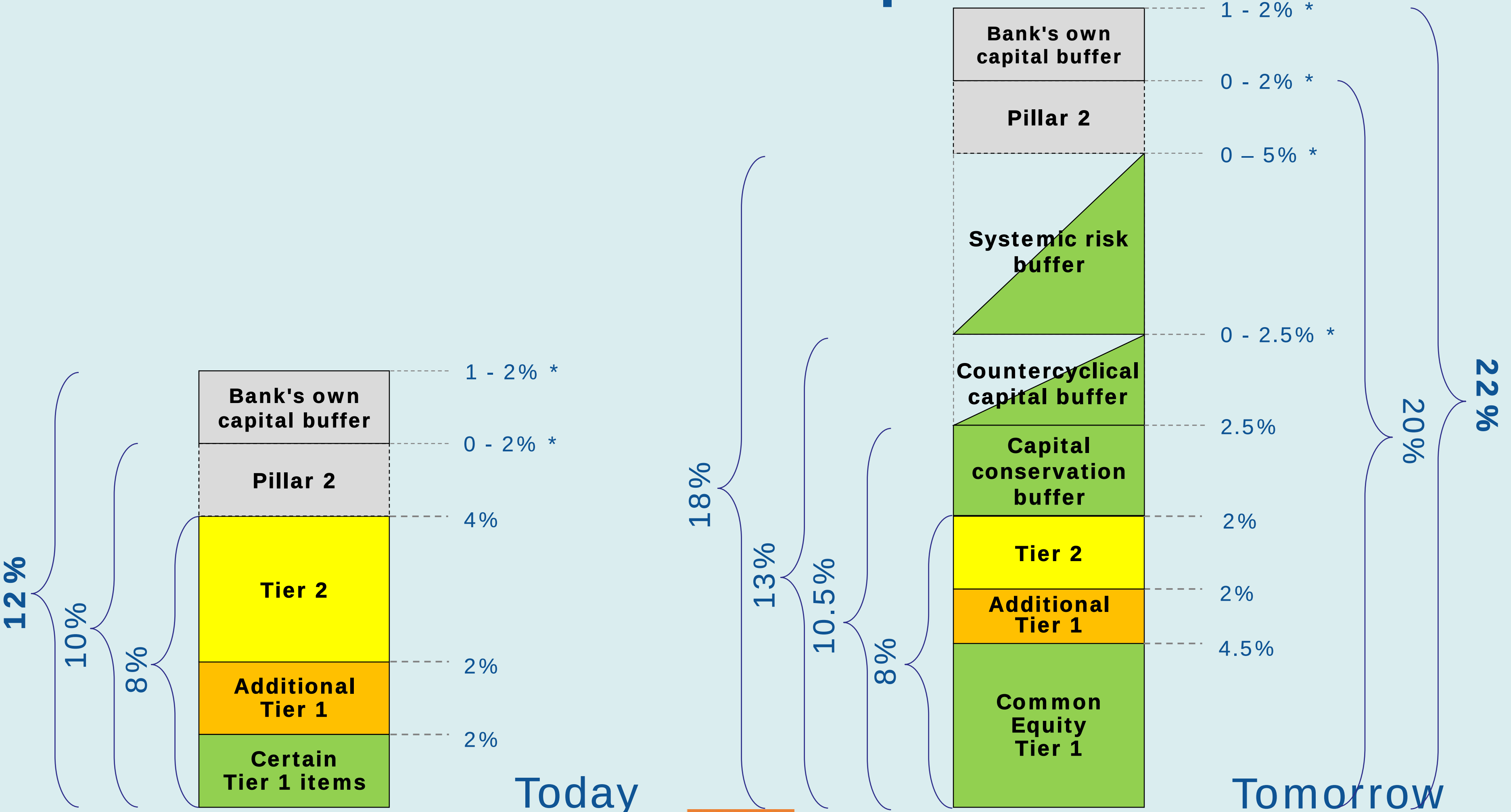
Liquidity

- ➢ *Short-term stress Liquidity Coverage Ratio – 2015*
- ➢ *Longer term stress Net Stable Funding Ratio – 2018*

Leverage

- ➢ *Leverage Ratio – back stop (with a view to migration to a binding measure in 2018)*

CRDIV: more and better capital



* Assumed upper bounds (values can be higher)

European Commission

Overwiew

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4. Bank Resolution

Single Market – Common Framework

- **"Global in life national in death"**
- National legislation ill-suited to deal with **cross-border dimension**.

  - EU framework required
    - **effectiveness and coherence**
    - **strengthen the Single Market**.
  - International commitments: **FSB Key Attributes**

Why a specific resolution regime?

- ✓ **Maintain financial stability** continuity of critical banking functions
- ✓ **Minimise costs for taxpayers** losses borne by bank shareholders and creditors
- ✓ **Avoid disorderly insolvency** (e.g. Lehman Brothers) and loss of value due to delays

Main features

- **Comprehensive**: three phases
  - **Prevention**
  - **Early intervention** – act before bank's viability is compromised
  - **Resolution** – restructure failing banks and preserve critical functions.

- **Flexibility**: Powers for use by national resolution authorities applied proportionately depending on banks and crises.
- Build on powers already used in various **Member States**.

Prevention

Recovery Plans drawn up by banks outlining options to regain long-term viability.

Resolution Plans drawn up by authorities to restructure banks and secure critical functions.

Assessment of **resolvability –** impose restrictions on activities and changes to structure.

Early Intervention

In case of breach of prudential requirements and **deteriorating solvency**, authorities can require:

- ✓ **Action program**
- ✓ **Shareholders' meeting**, to adopt decisions
- ✓ **Debt restructuring plan** agreed with its creditors
- ✓ **Appoint a temporary special manager**

Resolution trigger

Three conditions:

- ✓ the bank is **failing or likely to fail**,
- ✓ there is **no reasonable prospect that any alternative** within reasonable timeframe, and
- ✓ resolution is **necessary in the public interest** to preserve financial stability.

Resolution tools

1. **Sale of business** – Total or partial sale to another commercial entity

2. **Bridge bank** – Transfer all or part of the business to a publicly controlled temporary entity

3. **Asset separation / Bad bank** – Transfer of assets whose liquidation could cause market disruption to an asset management vehicle

4. Bail In

- ✓ The **power to write down the claims of unsecured creditors** of a failing bank
  - ✓ to **recapitalise and restructure** a failing bank or
  - ✓ capitalise **a new institution** to harbour essential functions by converting the claims of transferred creditors to equity in the new bridge bank
- ✓ Bail-in **not for recapitalising inefficient banks** at the cost of debt-holders but to maintain essential functions

Features of bail-in

- ✓ **Broad scope**
- ✓ **Harmonised hierarchy of claims** according to seniority
- ✓ **Sufficient capital and "bail-in-able" liabilities**
  - ✓ **issuance of specific subordinated instruments**
  - ✓ **consistency across similar banks (based on size, risk profile, resolvability etc.)**
- ✓ **Deposit Guarantee Scheme (DGS) to contribute** for the amount it would have had to bear under insolvency
- ✓ Entry into force **2018** (unless MS apply before)

Financing

- ✓ For short-term assistance to ensure successful outcome
- ✓ **Not a bail-out or recapitalisation fund** for inefficient banks!
- ✓ **Ex-ante contributions from banks** based on liabilities, to be raised to a target level of 1% of covered deposits over 10 years
- ✓ **Synergy with deposit guarantee scheme (DGS).** Two options:
  - ✓ DGS and a separate resolution fund
  - ✓ Maximum synergy: use DGS for resolution purposes with safeguards to ensure depositor protection

Financing

- ✓ **Loans from other funds if needed**
  - ✓ unless it would impede lending fund to finance domestic crisis
  - ✓ cannot exceed 50% of the lending fund
- ✓ **Financing arrangements for groups**
  - ✓ corresponding national fund contributes for each sub-entity
  - ✓ according to a financing plan pre-agreed between relevant resolution authorities

Next steps

- ✓ Council and Parliament
- ✓ Consistency between proposed Directive and DGS – package
- ✓ Agreement next year
- ✓ Critical component towards banking union

Overwiew

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5. Liikanen Group

European Commission

Mandate

- ✓ Whether there is a need for **structural reforms** of the EU banking sector
- ✓ Objective*:*
  - ✓ **safe, stable and efficient banks**
  - ✓ **serving the needs of citizens, the EU economy and the internal market**
- ✓ Recommendations to address*:*
  - ✓ **risks of the banking system and individual firms,**
  - ✓ **moral hazard, too big to fail**

- ✓ Chaired by **Erkki Liikanen**, Governor of the Bank of Finland
- ✓ 10 other members:

  Hugo Bänzinger, José Manuel Campa, Louis Gallois, Monique Goyens, Jan-Pieter Krahnen, Marco Mazzucchelli, Carol Sergeant, Zdenek Tuma, Jan Vanhevel and Herman Wijffels.
- ✓ Report published on 2 October 2012

European Commission

Summary of recommendations

1. Mandatory **separation** of proprietary and significant other trading activities
2. **Additional** separation of other activities conditional on the recovery and resolution plan
3. Possible amendments to the use of **bail-in** instruments as a resolution tool
4. A review of **capital requirements** on trading assets and real estate related loans
5. Strengthening the **governance** and control of banks

European Commission

"Volcker Banking Group"

Prop trading+ Market making

Swaps push-out

Investment and commercial banking

"HLEG Banking Group"

Prop trading+ Mkt making

Investment and commercial banking

"Vickers Banking Group"

Investment and commercial banking (prop trading, mkt making, large corporate lending)

Retail banking with higher capital requirements

Next steps

- ✓ Consultation
- ✓ Possibly proposals in 2013

Overwiew

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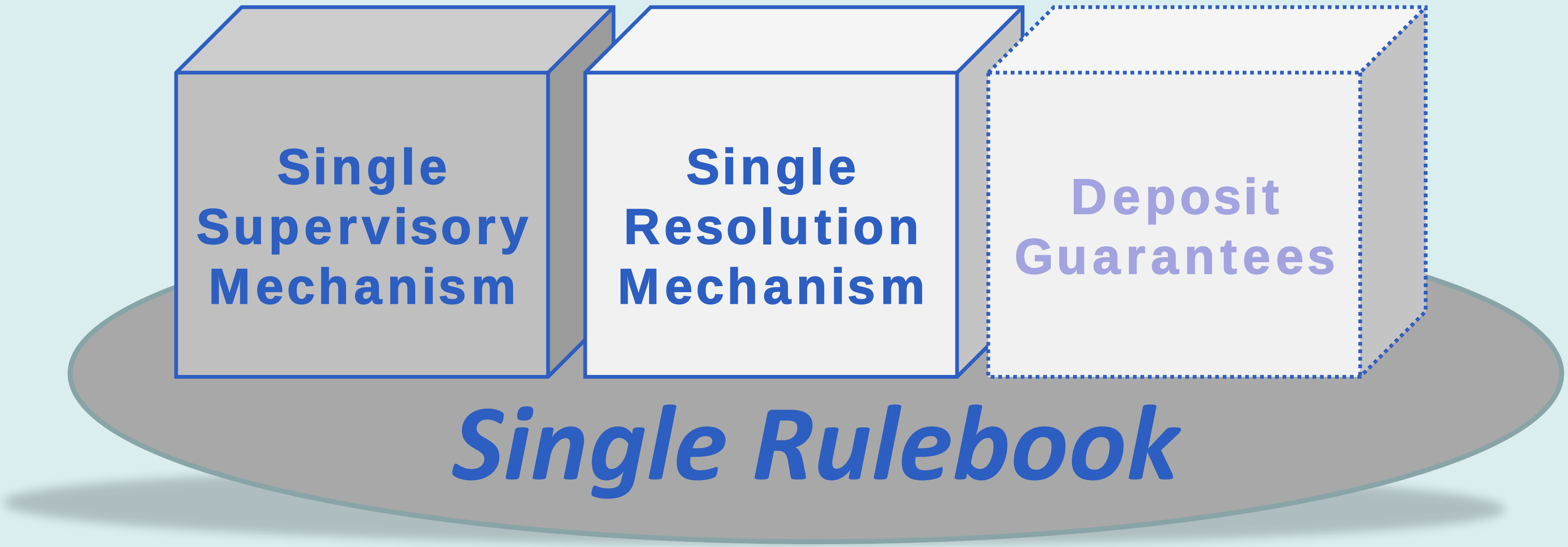
6. Banking Union

Why do we need a Banking Union?

- ✓ Necessary for achieving a genuine **EMU**
- ✓ Break the negative **feedback loop** between sovereigns and banks
- ✓ Strengthen overall financial **stability**
- ✓ Precondition for **ESM** recapitalisation of banks

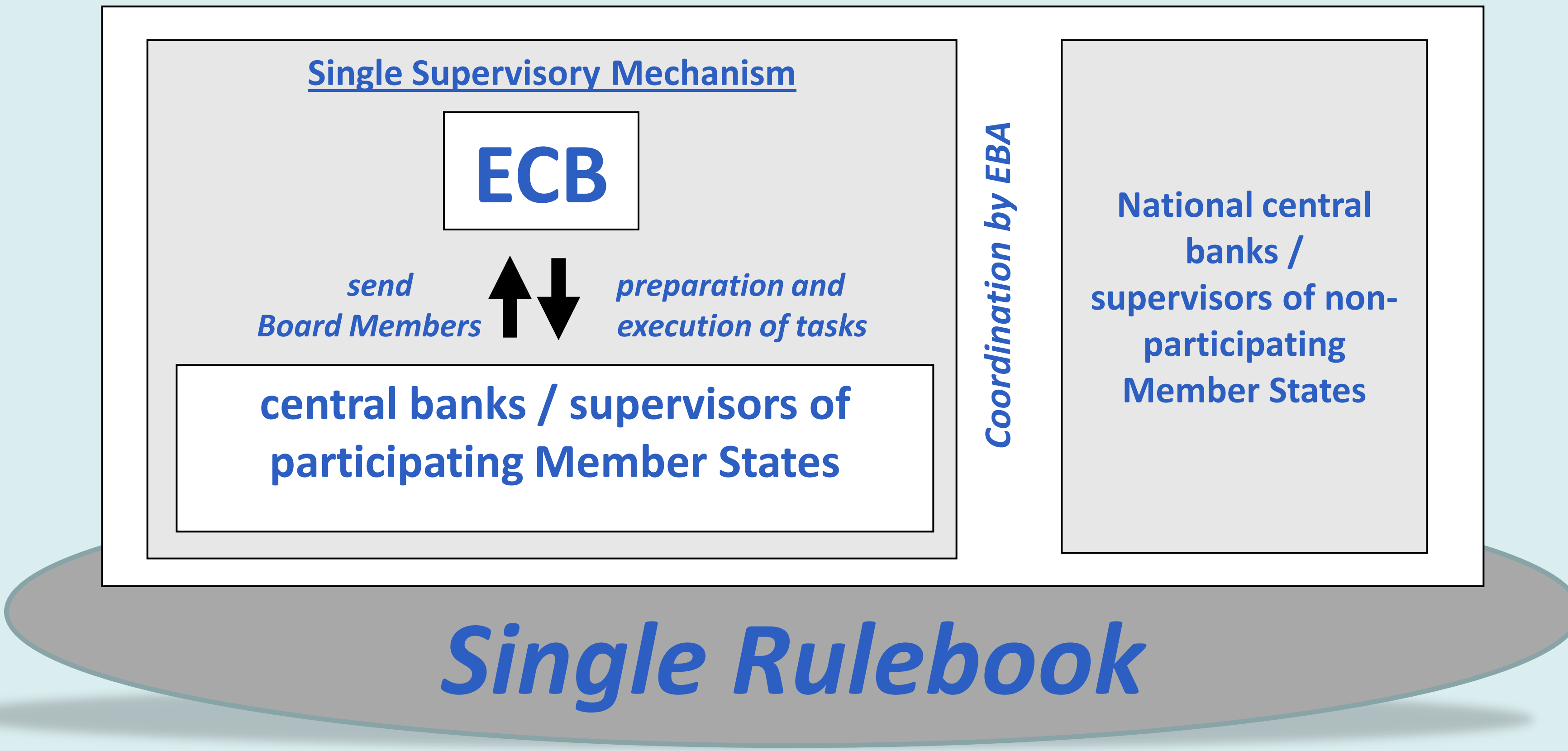
Key elements of the Banking Union



Single market

- ✓ **Preserve** single market through:
  - ✓ **Single rulebook**
  - ✓ **EBA** role to ensure convergence of supervisory practices
  - ✓ **Non-Euro area countries** voluntary close cooperation with the ECB

Single Supervisory Mechanism



Tasks of the ECB

- ✓ Tasks conferred on the ECB, notably:
  - ✓ **Authorize** banks
  - ✓ **Capital, leverage and liquidity**
  - ✓ **Supervisory review** of banks' risk profile
  - ✓ **Capital buffers**
  - ✓ **Early intervention**
- ✓ Other tasks remain with national supervisors.

Conclusion

Target Scenario

Restore confidence through:

- ✓ Better capitalised **DGS** and shorter pay-outs
- ✓ Safer, better capitalised **banks**
- ✓ **Bail-in**: No more bail-outs with taxpayers' money
- ✓ **No too big to fail**. No negative feedback loops **sovereigns and banks**.
- ✓ [Possibly] **structural** measures ensuring risky activities are not supported by deposits
- ✓ Higher integration of supervision and resolution of banks within the **Euro-area – preserving single market**