

**Bank activity in the EU**  
**Overview of some legislative**  
**developments in the European Union**

MOCOMILA Spring 2011 meeting,  
New York, NY, 29-30 April 2011

Professor René Smits  
University of Amsterdam

© 2011 René Smits

## Not covered: institutional arrangements

European System of Financial Supervision (ESFS), not to be confused with EFSF (temporary bail-out fund for euro area States), including European Systemic Risk Board (ESRB)

- important and innovative even though
- not going far enough in addressing crisis issues
- or in attributing powers to Union level of government
- EU-wide supervisory arrangements are needed

# Not covered: resolution regimes

- EU consultation on-going
- Plans for resolution schemes in each Member State, to be aligned and harmonised and, perhaps, replaced by an EU-wide arrangement by 2014?
- UK legislative changes in 2009 already – FSA decides to apply S(pecial) R(esolution) R(egime) – transfer to private purchaser, transfer to bridge bank (BoE subsidiary), T.P.O. (nationalisation), liquidation
- Netherlands Intervention Bill, 2011 – main elements: ‘transfer powers’ for central bank permitting transfer of deposit agreements, assets and liabilities, shares in a ‘problem institution’ (i.e. financial institution experiencing ‘irreversible problems’) – no prior notification of problem institution required – limited judicial review of central bank’s assessment

# Major legislative change

- 1) Capital requirements – implementing Basle-III
- 2) Deposit Guarantee Directive
- 3) Crisis management – ‘Living Wills’  
NB Transparent corporate structure requirement  
(Article 22 Banking Directive)
- 4) Bank remuneration and bonus policy

# CRD amendments

- Capital Requirements Directive: implementing Basle into EU law – CRD to be implemented at State level; often sub-delegated regulation by national supervisor, aligned by ESAs (ESFS)
- Consultations, latest closed early March 2011:
- Possible measures to strengthen bank capital requirements for counterparty credit risk
- Previous consultations
  - on countercyclical capital buffer - internal market specifics
  - CRD IV consultation

# Deposit Guarantee Directive - 1

- Completely recast system of *national* (i.e., State) deposit guarantee schemes aligned following these rules:
- All credit institutions, all schemes included - no exemptions
- Clearer definition of deposits - only entirely repayable instruments deemed deposits, not structured products, certificates or bonds – “prevents DGSs from taking unpredictable risks with investment products”
- Depositors’ eligibility simplified and harmonised – mandatory exclusions, e.g. authorities, financial institutions
- Deposits in non-EU currencies covered
- Deposits of all non-financial companies covered
- Coverage level of EUR 100,000 (due to be implemented by end-2010 under Directive 2009/14/EC) unaltered
- DGS must act to repay depositors within one week - without submission of an application

# Deposit Guarantee Directive - 2

- DGSs' available financial means to be proportionate to potential liabilities (after 10 years):
  1. 1.5 % of eligible deposits on hand after a transition period of 10 years ( 'target level'). If insufficient 2<sup>nd</sup> and 3<sup>d</sup> steps to be taken:
    2. banks to pay extraordinary ('ex-post') contributions
      - up to 0.5 % of eligible deposits
      - > ex-ante funds account for 75 % of DGSs' financing
      - > ex-post contributions account for 25 % of DGSs' financing
    3. mutual borrowing facility: DGS in need may borrow from all other DGSs in EU
    4. DGSs must have in place alternative funding arrangements, compliant with monetary financing prohibition - Art.123 TFEU

# Deposit Guarantee Directive - 3

- Changes to take effect by
  - General implementation deadline 31.12.2012
  - Simplification, harmonisation scope & eligibility 31.12.2012
  - One-week payout delay 31.12.2013
  - Report on pan-EU schemes 31.12.2014
  - Reaching the target funding level 31.12.2020
  - Mutual borrowing facility functioning 31.12.2020
- By 31 December 2015 Commission to report, and “if appropriate” propose legislation to determine whether existing DGSs should be replaced by a single scheme for the whole EU



# RRPs or 'Living Wills' - 1

- G20 Leaders, Pittsburgh, September 2009 called upon “[SIFFs to] develop internationally consistent firm-specific contingency and resolution plans”
- FSB role
- Consultations in EU on resolution regimes
- Aim includes diminishing, or at least identifying in advance, corporate structure complexity ahead of recovery or resolution

## RRPs or 'Living Wills' - 2

Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast)

preamble

(60) The Member States should be able to refuse or withdraw banking authorisation in the case of certain group structures considered inappropriate for carrying on banking activities, in particular because such structures could not be supervised effectively. In this respect the competent authorities should have the necessary powers to ensure the sound and prudent management of credit institutions.

## RRPs or 'Living Wills' - 3

Article 22 (1) and (2) Consolidated Banking Directive 2006/48/EC  
(text as of 1 January 2011, after amendment inserted by Directive 2010/76/EU)  
Home Member State competent authorities shall require that every credit institution have robust governance arrangements, which include a clear organisational structure with well defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks it is or might be exposed to, adequate internal control mechanisms, including sound administration and accounting procedures and remuneration policies and practices that are consistent with and promote sound and effective risk management.

2. The arrangements, processes and mechanisms referred to in paragraph 1 shall be comprehensive and proportionate to the nature, scale and complexity of the credit institution's activities. The technical criteria laid down in Annex V shall be taken into account.

# Europe's Volcker: Vickers

- Independent Commission on Banking: proposals on separation between retail banking and wholesale and investment banking and on fostering more competition
- Members ICB: **Martin Wolf** (FT), **Bill Winters** (ex JP Morgan), **Martin Taylor** (banking, agri-business), **Clare Spottiswoode** (former Director General of Ofgas), **Sir John Vickers** (former economic professor, former Chief Economist Bank of England, former Chair, Office of Fair Trading)
- ICB to “consider the structure of the UK banking sector, and look at structural and non-structural measures to reform the banking system and promote competition”
- To formulate policy recommendations on reducing systemic risk, mitigating moral hazard, reducing likelihood and impact of firm failure, promoting competition (notably tackling TBTF advantage)

# ICB Interim report (11.04.11)

- Financial stability, competitive conditions
- Preliminary conclusions: separating retail and investment banking; encouraging competition
- Savings deposits to be separated from more risky investment banking through:
  - 'Ringfencing', e.g. acting through a separate subsidiary
- SIFIs to be subject to 10% capital requirement – all major British banks should meet this requirement – elevation to EU level?
- Lloyds Banking Group recommended to divest more business than required by European Commission
- Further competition-related recommendations: easier switching between financial institutions // future conduct of business supervisor, Financial Conduct Authority, should have priority task to further competition

# Project Merlin (February 2011)

- Agreement between UK Government and major banks on lending and on remuneration practices
- 4 biggest UK banks (RBS, HSBC, Lloyds and Barclays) plus Santander commit to make available £ 190 (€ 215 bn; \$ 310) bn of credit to business in 2011 (up from £ 179 bn in 2010)
- Further commitments include lending to SMEs, capital of Big Society Bank financing community projects
- Bank of England to monitor on quarterly basis
- Performance criteria for remuneration to include meeting Merlin lending targets
- Cutting bonuses to commercial bank executives
- Publishing pay of 5 highest paid executives below board level
- Compatible with EU internal market and competition rules?  
[www.hm-treasury.gov.uk/d/bank\\_agreement\\_090211.pdf](http://www.hm-treasury.gov.uk/d/bank_agreement_090211.pdf)

# EU remuneration policy rules - 1

Commission Recommendation of 30 April 2009 on remuneration policies in financial services sector, OJ EU L 120/22, 15.5.2009

- “MS to ensure that financial undertakings establish, implement and maintain a remuneration policy which is consistent with and promotes sound and effective risk management and which does not induce excessive risk-taking”
- appropriate balance of fixed / variable remuneration
- major part bonus to be deferred with minimum deferment period
- bonus to take into account outstanding risks associated with the performance to which the bonus relates
- bonus to be related to performance of Individual, business unit, financial undertaking
- disclosure requirements

# EU remuneration policy rules - 2

Annex XII, Part 2 Directive 2006/48/EC, point 15, inserted by CRD-III (Directive 2010/76/EU, 24.11.10)

- remuneration policy consistent with and promotes sound and effective risk management and does not encourage risk-taking that exceeds the level of tolerated risk of the credit institution
- serves bank's long-term interests - includes measures to avoid conflicts of interest
- related to performance of Individual, business unit, bank
- actual payment of performance-based components of remuneration is spread over period which takes account of underlying business cycle of [bank] and business risks
- $\geq 50\%$  of variable remuneration in shares or similar ownership rights
- $\geq 40\%$  of variable remuneration deferred over 3-5 years
- remuneration committee (members without executive function) prepare remuneration policy



# Notices on State aid measures

- Temporary Union framework for State aid measures to support access to finance in the current financial and economic crisis; (**Support Access Paper**) Communication, OJ C 6/5, 11.01.2011
- The application, from 1 January 2011, of State aid rules to support measures in favour of banks in the context of the financial crisis; (**Support Measures Paper**) Communication, OJ C 329/7, 07.12.2010
- The return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules (**Restructuring Aid Paper**) Communication, 22.07.2009, OJ C 195/9, 19.08.2009
- Treatment of impaired assets in the Community banking sector, **Communication, 25.02.2009** (**Impaired Assets Paper**) OJ C 72, 26.03.2009
- The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition, Communication, 05.12.2008 (**Recapitalisation Paper**) OJ C10/03, 15.01.2009
- The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis, Communication, 13.10.2008 (**Banking Guarantee Communication Guidance Paper**) OJ 270/8, 25.10.2008

# Concluding critical remarks

- State-centred solutions: diversity in rules, in spite of efforts towards common rule book
- Continued reliance on state aid, and resulting restructuring requirements (Communications from Commission)
- Consequences for competitive conditions
- Restructurings and appeals (ING)
- Link with sovereign debt crisis