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To:	Mr Uwe CORSEPIUS, Secretary-General of the Council of the European Union
No. prev. doc.:	6020/14, 6022/14
Subject:	Opinion of the Committee of the Regions - Structural reforms of EU banks and transparency in shadow banking

Delegations will find attached the above mentioned opinion. The opinion will shortly be available in all languages on the web site (http://coropinions.cor.europa.eu/COROpinions.aspx, (opinion number 1321, year 2014).

Encl.:

EUROPEAN UNION

Committee of the Regions

20 YEARS

ECOS-V-055

107th plenary session, 25-26 June 2014

OPINION

Structural reforms of EU banks and transparency in shadow banking

THE COMMITTEE OF THE REGIONS

- welcomes the Commission's proposals for regulations on Structural measures improving the resilience of EU credit institutions and on Reporting and transparency of securities financing transactions;
- regrets however that the scope and ambition of the suggestions made by the High-level Expert Group appointed by the Commission in February 2012 have been significantly reduced;
- reiterates the importance of credit for financing public investment by local and regional authorities in projects of general interest such as infrastructure, research and education; observes that these investments represent a substantial share of public spending and are vital for the growth and well-being of citizens;
- draws attention to the fact that some local and regional authorities issue financial instruments such as bonds as a means to finance their activities and policies;
- agrees with the objective of strengthening banks' stability and resilience by banning proprietary trading and providing the capacity to separate risky trading activities;
- welcomes the proposed obligation to report all transactions to a common database and considers that this will help to improve the monitoring of the risks and exposures associated with SFTs;
- suggests legislative amendments to several articles of the proposal on Structural measures improving the resilience of EU credit institutions.

Rapporteur

Henk Kool (NL/PES), Alderman of The Hague

Reference documents

Proposals for regulations of the European Parliament and of the Council on:
– Structural measures improving the resilience of EU credit institutions
  COM(2014) 43 final
– Reporting and transparency of securities financing transactions
  COM(2014) 40 final

Opinion of the Committee of the Regions - Structural reforms of EU banks and transparency in shadow banking

I. GENERAL COMMENTS

THE COMMITTEE OF THE REGIONS

1. points out that local and regional authorities (LRAs) cooperate closely with banking institutions to finance their medium- and long-term projects. Given that LRAs are responsible for two thirds of all public investment in the EU and that, for 2011 alone, this represented 179 billion euros or 1.4% of the EU's GDP, more than the Union's overall budget (1%), it is very clear that banks' resilience is of prime interest for LRAs and that the ongoing banking regulation reform will have a strong impact on them;

2. highlights the broad political and economic/academic support for the view that supervising banks and overseeing reforms would be more effective if implemented at European level than at national level;

3. welcomes the Commission regulations on Structural measures improving the resilience of EU credit institutions and on Reporting and transparency of securities financing transactions; underlines that it is of crucial importance to avoid creating regulatory and administrative burdens;

4. regrets however that the scope and ambition of the suggestions made by the High-level Expert Group (HLEG) appointed by the Commission in February 2012 have been significantly reduced; notes that the proposals will have little impact on the targeted banks, considering in particular that France, Germany and the UK have already adopted national reforms of a similar nature[1];

Subsidiarity and proportionality

5. notes that the two draft regulations presented by the Commission both intend to harmonise certain rules aiming at strengthening the regulatory framework on banking and financial institutions. Due to the vast interconnections between the targeted entities and the systemic risk they could represent, these Regulations can only be implemented at the level of the European Union. The CoR therefore believes that the legal basis (Article 114 TFEU) is correct and that the proposed legislation complies with the principle of subsidiarity;

[1] These three countries account for 16 of the 30 largest EU banks ranked by total assets (the regulation covers around 30 banks).

II. POLICY RECOMMENDATIONS

II.A. Common recommendations

Banks' role in financing local development

6. reiterates the importance of credit for financing public investment by local and regional authorities in projects of general interest such as infrastructure, research and education; observes that these investments represent a substantial share of public spending and are vital for the growth and well-being of citizens;

7. underlines the specificity of loans contracted by local and regional authorities. LRAs can by no means be assimilated to private or business customers and the nature, amounts and duration of these loans therefore require specific targeted expertise from the banks;

8. recognises the key role of local, regional and LRA-specialised banks in the development and financing of regions and municipalities. They ensure fundamental support for local economic development by supporting SMEs, associations, and the social economy;

9. calls on the Member States and the European Commission to protect and reinforce the local business model of mutual, cooperative and savings institutions, especially small banks, which play an essential role in the real economy thanks to their dense and balanced presence in local and regional communities;

10. disapproves of the disproportionate and uncontrolled expansion of some local and regional banks, whose acquisition of toxic assets has severely endangered the economies of their territories of origin;

Credit crunch consequences for local development

11. notes a contraction of the supply of bank lending to LRAs, as expressed not only in lower volumes and higher margins but also in a worrying lessening of the length of loans; this may reflect a vicious circle in which universal banks reduce their involvement in the real economy and are therefore more likely to engage in trading and shadow banking activities;

12. is concerned about the significant interest rate spread between the ECB bank rate (0.25% as from November 2013) and the rates offered by the banks to LRAs, considering that this spread is not based on an objective assessment of the financial situation of the locality concerned, whereas the default risk remains fairly low;

13. considers that these tightening conditions put significant pressure on local and regional authorities' budgets, making it increasingly difficult for them to balance their budgets, achieve a good absorption capacity and finance long-term projects that help to provide growth and employment;

14. therefore invites the Commission to present, at a subsequent stage, a legislative proposal to introduce effective measures to tackle the credit crunch for SMEs and LRAs;

Financial instruments issued by local and regional authorities

15. draws attention to the fact that some local and regional authorities issue financial instruments such as bonds as a means to finance their activities and policies;

16. deplores the fact that some banks have encouraged local and regional authorities to buy toxic and complex financial products in inordinate proportions, in full knowledge of the risks involved; underlines that, due to a lack of adequate expertise, most LRAs do not possess the requisite technical knowledge to understand these products fully; therefore regrets that the burden resulting from the failure of these assets falls entirely upon local and regional authorities and their taxpayers;

17. calls on the Member States and the European Commission to encourage the banks to adopt a comprehensive, fair and responsible approach towards local and regional authorities when advising them on the risks incurred; also calls for the development of simple and transparent financial instruments for local and regional authorities, whose terms and conditions must be clearly defined when a contract is signed; requests that these instruments offer legible rates in order to reach transparency in the democratic decision-making process of LRAs;

II.B. Structural measures to improve the resilience of EU credit institutions

18. agrees with the objective of strengthening banks' stability and resilience by banning proprietary trading and providing the capacity to separate risky trading activities;

19. endorses the objectives, as stated in Article 1, for preventing systemic risk, financial stress and the failure of large, complex and interconnected entities in the financial system;

20. invites the Commission to study the feasibility of extending the application of similar rules to banks of all sizes, taking into account the administrative burden and cost, as such initiatives could potentially make smaller banks safer as well;

21. supports the Commission's proposal on a ban for proprietary trading in financial instruments and commodities, i.e. trading with the sole purpose of making a profit for the bank, considering that the directive on markets in financial instruments (COM(2011)0656) (so-called MiFiD II) did not specifically address proprietary trading. The issuing of these instruments should be strictly reserved to market operators able to demonstrate that these products will be used to cover their own commercial or industrial risks. Otherwise, there would be a risk of confusion of roles between the advising and the investment activities of banks, thereby also creating an incentive for increased speculation and volatility of prices and systemic risks for the banking system;

22. has concerns about high-frequency trading, which might give rise to serious risks to the banking system, and asks the Member States and the Commission to implement effective measures to regulate this domain;

Separation of trading activities

23. reiterates that the scope of the proposed regulation has been reduced considerably given that Member States have already passed or are considering the adoption of national rules of a similar nature and that the recommendations made by the Liikanen group have been noticeably lowered;

24. stresses the importance of ensuring uniformity at EU level in such a highly-integrated sector, in order to keep the compliance burden and costs down to a minimum, ensure a level playing-field and prevent distortions in competition and the functioning of the internal market in this sector;

25. welcomes the Commission's indication that these rules would be subject to review after implementation, and calls for thorough investigation of potential negative repercussions, in particular on financing of the real economy in the EU's cities and regions;

26. wonders if the fact that the decision on the separation of certain trading activities consists of a narrow test will provide sufficient legal means to achieve the regulation's general objectives, and whether they would not have been better addressed through a broader test that included all the objectives;

27. questions the effectiveness of the highly complex approach adopted, which may, on the one hand, make it difficult and costly to assess and monitor the implementation of the rules, and on the other, allow exemptions from regulation and opportunities for carrying out regulatory arbitrage;

28. deplores the reduced scope of the application of the draft regulation, chiefly the exclusion of derivatives trading from the decision-making process. Indeed, there are concerns that excessive speculative trading is resulting in oversized markets and generating distortions in both the financial market and the real economy. These distortions may well cause the mispricing of agricultural, energy and metals commodities derivatives markets, which are vital to the local and regional economy;

29. invites the Commission to exclude long term holding of securities (so-called buy and hold) from the definition given in Article 5.4 of the regulation on structural measures improving the resilience of EU credit institutions, as they are part of core banking activities.

Principle of Symmetry

30. invites the Commission to include the principle of symmetry in their banking resolution mechanisms. That is to say, resolution authorities would be granted the possibility of making creditors bear losses, just as they would have benefited from any gains; this should apply equally to all types of creditor;

II.C. Reporting and transparency of Securities Financing Transactions

31. endorses the Regulation on reporting and transparency of Securities Financing Transactions (SFTs) and identifies these measures as complementary to structural bank reforms that are essential to plug a legal loophole that has already been identified;

32. recognises that regulation is necessary, given the close connections between traditional banks and shadow banking and the fact that the latter performs the same economic functions as the banks, namely: credit intermediation, credit risk transfer, liquidity transformation and maturity transformation, without adequate control;

33. urges the ECB, the Commission, the Parliament and the Member States to intensively pursue their efforts to ensure that they get sufficient and comprehensive information on shadow banking. Information is the key factor that ought to allow the public authorities to be sufficiently responsive when it comes to regulating the system, despite the frenetic pace of evolution and attempts to circumvent the law;

Registration and supervision of a trade repository

34. welcomes the proposed obligation to report all transactions to a common database and considers that this will help to improve the monitoring of the risks and exposures associated with SFTs; welcomes the fact that these measures will also improve transparency for investors and provide them with tools to take investment decisions based on greater awareness of the characteristics of SFTs;

Transparency of rehypothecation

35. supports the setting of minimum conditions that will improve the transparency of rehypothecation by ensuring that clients give their consent and that they make their decisions based on full knowledge on the risks that they might entail;

III. RECOMMENDATIONS FOR AMENDMENTS

III.A. Structural measures improving the resilience of EU credit institutions - COM(2014) 43

Amendment 1

New Recital after Recital 21

Text proposed by the Commission	*CoR amendment*
	The issuing and selling of financial instruments linked to trading in raw materials should be strictly reserved to consumers and producers who can demonstrate that these products will be used to cover their own commercial or industrial risks.

Amendment 2

New Recital after Recital 24

Text proposed by the Commission	*CoR amendment*
	The case of High-Frequency Trading (HFT) raises particular concerns as it appears that it can evaporate instantly and that some trading firms take the risks incurred too lightly by constantly and promptly issuing sloppy new trading algorithms. The lack of rigour of some actors that rely on other trading stakeholders to compensate for their erroneous trade or uncontrollable algorithms shows that risk management remains essential to protect the banks from bad tweaks of their own products and therefore obliges the public authorities to take measures. Member States or the competent authorities should decide to impose further regulatory measures in order to control this market.

Reason

Self-explanatory.

Amendment 3

Recital 27

Text proposed by the Commission	*CoR amendment*
Groups that qualify as mutuals, cooperatives, savings institutions or similar have a specific ownership and economic structure. Imposing some of the rules related to separation could require far-reaching changes to the structural organisation of those entities the costs of which could be disproportionate to the benefits. To the extent that those groups fall within the scope of the Regulation, the competent authority may decide to allow core credit institutions that meet the requirements set out in Article 49(3)(a) or (b) of Regulation (EU) No 575/2013 to hold capital instruments or voting rights in a trading entity where the competent authority considers that holding such capital instruments or voting rights is indispensable for the functioning of the group and that the core credit institution has taken sufficient measures in order to appropriately mitigate the relevant risks.	Groups ~~that~~ whose business models are by nature ~~qualify as~~ mutuals, cooperatives or savings institutions ~~or similar~~ have a specific ownership and economic structure. Imposing some of the rules related to separation could require far-reaching changes to the structural organisation of those entities the costs of which could be disproportionate to the benefits. To the extent that those groups fall within the scope of the Regulation, the competent authority may decide to allow core credit institutions that meet the requirements set out in Article 49(3)(a) or (b) of Regulation (EU) No 575/2013 to hold capital instruments or voting rights in a trading entity where the competent authority considers that holding such capital instruments or voting rights is indispensable for the functioning of the group and that the core credit institution has taken sufficient measures in order to appropriately mitigate the relevant risks.

Reason

It is important to make sure that these institutions do not hide behind their statutes to practice activities similar to their counterparts that are ineffective in the real economy, therefore undermining the purposes of the proposed regulation.

Amendment 4

Recital 29

Text proposed by the Commission	*CoR amendment*
Irrespective of separation, the core credit institution should still be able to manage its own risk. Certain trading activities should therefore be allowed to the extent that they are aimed at the prudent management of the core credit institution's capital, liquidity and funding and do not pose concerns to its financial stability. Similarly, the core credit institutions needs to be able to provide certain necessary risk management services to its clients. However, that should be done without exposing the core credit institution to unnecessary risk and without posing concerns to its financial stability. Hedging activities eligible for the purpose of prudently managing own risk and for the provision of risk management services to clients can, but does not have to, qualify as hedge accounting under the International Financial Reporting Standards.	Irrespective of separation, the core credit institution should still be able to manage its own risk. Certain trading activities should therefore be allowed to the extent that they are aimed at the prudent management of the core credit institution's capital, liquidity and funding and do not pose concerns to its financial stability. Similarly, the core credit institutions needs to be able to provide certain necessary risk management services to its clients. However, that should be done without exposing the core credit institution to unnecessary risk and without posing concerns to its financial stability. Furthermore, in application of the principle of symmetry, resolution authorities are granted the possibility of making creditors of all types bear losses, just as they would have benefited from any gains. Hedging activities eligible for the purpose of prudently managing own risk and for the provision of risk management services to clients can, but does not have to, qualify as hedge accounting under the International Financial Reporting Standards.

Reason

Self-explanatory.

Amendment 5

Article 2

Text proposed by the Commission	*CoR amendment*
This Regulation lays down rules on: (a) the prohibition of proprietary trading; (b) the separation of certain trading activities.	This Regulation lays down rules on: (a) the prohibition of proprietary trading; (b) the prohibition of speculation in raw materials; ~~(b)~~ (c) the separation of certain trading activities.

Amendment 6

Article 5.4

Text proposed by the Commission	*CoR amendment*
"proprietary trading" means using own capital or borrowed money to take positions in any type of transaction to purchase, sell or otherwise acquire or dispose of any financial instrument or commodities for the sole purpose of making a profit for own account, and without any connection to actual or anticipated client activity or for the purpose of hedging the entity's risk as result of actual or anticipated client activity, through the use of desks, units, divisions or individual traders specifically dedicated to such position taking and profit making, including through dedicated web-based proprietary trading platforms;	"proprietary trading" means using own capital or borrowed money to take positions in any type of transaction to purchase, sell or otherwise acquire or dispose of any financial instrument or commodities for the sole purpose of making a short-term profit for own account, and without any connection to actual or anticipated client activity or for the purpose of hedging the entity's risk as result of actual or anticipated client activity, through the use of desks, units, divisions or individual traders specifically dedicated to such position taking and profit making, including through dedicated web-based proprietary trading platforms;

Reason

As long term holding of securities (so called buy and hold) is part of core banking activities, it should be excluded from the given definition.

Amendment 7

Article 5.4

Text proposed by the Commission	*CoR amendment*
	"speculation in raw materials" through proprietary trading by banks means using trading of future contracts for the sole purpose of making a profit; this excludes direct or indirect activities between producers and consumers who can demonstrate that these products will be used to cover commercial or industrial risks;

Amendment 8

Article 6 – Paragraph 1

Text proposed by the Commission	*CoR amendment*
1. Entities referred to in Article 3 shall not:	1. Entities referred to in Article 3 shall not:
(a) engage in proprietary trading;	(a) engage in proprietary trading;
(b) with its own capital or borrowed money and for the sole purpose of making a profit for own account:	(b) speculate in raw agricultural materials;
	~~(b)~~(c) with its own capital or borrowed money and for the sole purpose of making a profit for own account:
(i) acquire or retain units or shares of AIFs as defined by Article 4(1)(a) of Directive 2011/61/EU;	(i) acquire or retain units or shares of AIFs as defined by Article 4(1)(a) of Directive 2011/61/EU;
(ii) invest in derivatives, certificates, indices or any other financial instrument the performance of which is linked to shares or units of AIFs;	(ii) invest in derivatives, certificates, indices or any other financial instrument the performance of which is linked to shares or units of AIFs;
(iii) hold any units or shares in an entity that engages in proprietary trading or acquires units or shares in AIFs.	(iii) hold any units or shares in an entity that engages in proprietary trading or acquires units or shares in AIFs.

Amendment 9

Article 6 – Paragraph 2

Text proposed by the Commission	*CoR amendment*
2. The prohibition in point (a) of paragraph 1 shall not apply to:	2. The prohibition in point (a) of paragraph 1 shall not apply to:
(a) financial instruments issued by Member States central governments or by entities listed in point (2) of Article 117 and in Article 118 of Regulation (EU) No 575/2013;	(a) financial instruments issued by Member States central governments, financial instruments issued by Member States' regional governments, exposures to which are assigned a 0 per cent risk weight in accordance with Article 115 of Regulation (EU) No 575/2013 or by entities listed in point (2) of Article 117 and in Article 118 of Regulation (EU) No 575/2013;
(b) a situation where an entity referred to in Article 3 meets all of the following conditions:	(b) a situation where an entity referred to in Article 3 meets all of the following conditions:
(i) it uses its own capital as part of its cash management processes;	(i) it uses its own capital as part of its cash management processes;
(ii) it exclusively holds, purchases sells or otherwise acquires or disposes of cash or cash equivalent assets. Cash equivalent assets must be highly liquid investments held in the base currency of the own capital, be readily convertible to a known amount of cash, be subject to an insignificant risk of a change in value, have maturity which does not exceed 397 days and provide a return no greater than the rate of return of a three-month high quality government bond.	(ii) it exclusively holds, purchases sells or otherwise acquires or disposes of cash or cash equivalent assets. Cash equivalent assets must be highly liquid investments held in the base currency of the own capital, be readily convertible to a known amount of cash, be subject to an insignificant risk of a change in value, have maturity which does not exceed 397 days and provide a return no greater than the rate of return of a three-month high quality government bond.

Reason

There is no objective reason for treating financial instruments issued by central government differently from financial instruments issued by Member States' regional governments, exposures to which are assigned a 0 per cent risk weight in accordance with Article 115 of Regulation (EU) No 575/2013.

Amendment 10

Article 6 – Paragraph 4 new

Text proposed by the Commission	*CoR amendment*
	4. Neither shall the limitations laid down in point (b) of paragraph 1 apply to market operators able to demonstrate that their trading of raw agricultural products will be used to cover commercial or industrial risks;

Amendment 11

Article 6 – Paragraph 6

Text proposed by the Commission	*CoR amendment*
6. The Commission shall be empowered to adopt delegated acts in accordance with Article 36 to exempt from the prohibition referred to in point (a) of paragraph 1:	6. The Commission shall be empowered to adopt delegated acts in accordance with Article 36 to exempt from the prohibition referred to in point (a) of paragraph 1:
(a) financial instruments other than those referred to in point (a) of paragraph 2 issued by governments of third countries that apply supervisory and regulatory arrangements at least equivalent to those applied within the Union, exposures to which are assigned a 0 per cent risk weight in accordance with Article 115 of Regulation (EU) No 575/2013;	(a) financial instruments other than those referred to in point (a) of paragraph 2 issued by governments of third countries that apply supervisory and regulatory arrangements at least equivalent to those applied within the Union, exposures to which are assigned a 0 per cent risk weight in accordance with Article 115 of Regulation (EU) No 575/2013;
(b) financial instruments issued by Member States' regional governments, exposures to which are assigned a 0 per cent risk weight in accordance with Article 115 of Regulation (EU) No 575/2013.	~~(b) financial instruments issued by Member States' regional governments, exposures to which are assigned a 0 per cent risk weight in accordance with Article 115 of Regulation (EU) No 575/2013.~~

Reason

There is no objective reason for treating financial instruments issued by central government differently from financial instruments issued by Member States' regional governments, exposures to which are assigned a 0 per cent risk weight in accordance with Article 115 of Regulation (EU) No 575/2013.

III.B. Reporting and transparency of securities financing transactions - COM(2014) 40

Amendment 1

New Recital after Recital 12

Text proposed by the Commission	*CoR amendment*
	Furthermore, as SFTs could be indirectly sold to SMEs, LRAs and individuals through financial instruments, it is indispensable that bank and shadow-banking entities adopt a comprehensive, fair and responsible approach towards those bodies when advising them on the risks incurred.

Reason

As sophisticated stakeholders are involved, the SMEs, LRAs and individuals could be indirectly involved in these kinds of instruments. Providing proper information is a key role for the banks, and for the entities that might play the same role as banks.

Brussels, 26 June 2014

The president
of the Committee of the Regions

Michel Lebrun

The secretary-general ad interim
of the Committee of the Regions

Daniel Janssens

IV. PROCEDURE

Title	Structural reforms of the EU Banks and Transparency in shadow banking
Reference(s)	COM(2014) 40 final: Proposal for a Regulation of the European Parliament and of the Council on reporting and transparency of securities financing transactions COM(2014) 43 final: Proposal for a Regulation of the European Parliament and of the Council on structural measures improving the resilience of EU credit institutions
Legal basis	Article 114(1) TFEU
Procedural basis	Own initiative opinion (Rule 41(b)i)
Date of Commission letter	N/A
Date of Bureau/President's decision	7 March 2014
Commission responsible	Commission for Economic and Social Policy (ECOS)
Rapporteur	Henk Kool, Alderman of The Hague
Analysis	27 March 2014
Discussed in commission	16 May 2014
Adoption by commission	16 May 2014
Result of the vote in commission	Majority
Date adopted in plenary	26 June 2014
Previous Committee opinions	– Opinion on a Common System of Financial Transaction Tax (CDR 332/2011 fin) – Resolution of the Committee of the Regions on the Financial Crisis (CDR 379/2008 res)
Date of Subsidiarity Monitoring consultation	N/A