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From: The President of the European Economic and Social Committee, Mr Henri Malosse

To: Mr Uwe CORSEPIUS, Secretary-General of the Council of the European Union

Subject: OPINION of the European Economic and Social Committee on the Proposal for a Regulation of the European Parliament and of the Council on structural measures improving the resilience of EU credit institutions
COM(2014) 43 final – 2014/0020 (COD)

Delegations will find attached the above mentioned document. Please note that other language versions should be available at:

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European Economic and Social Committee

INT/717
Structural reform of EU
banks

Brussels, 9 July 2014

OPINION

of the
European Economic and Social Committee
on the

**Proposal for a Regulation of the European Parliament and of the Council on structural
measures improving the resilience of EU credit institutions**

COM(2014) 43 final – 2014/0020 (COD)

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On 25 February and 27 March 2014 respectively, the European Parliament and the Council decided to consult the European Economic and Social Committee, under Article 114 of the Treaty on the Functioning of the European Union, on the

Proposal for a Regulation of the European Parliament and of the Council on structural measures improving the resilience of EU credit institutions
COM(2014) 43 final - 2014/0020 (COD).

The Section for the Single Market, Production and Consumption, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 23 June 2014.

At its 500th plenary session, held on 9 and 10 July 2014 (meeting of 9 July), the European Economic and Social Committee adopted the following opinion by 97 votes to one with four abstentions.

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1. **Conclusions and recommendations**

- 1.1 The European Economic and Social Committee (EESC) expresses its firm support for the structural reform of the banking system, considering it to be the most crucial of the many legislative initiatives introduced as a consequence of the financial crisis. The EESC stresses the fact that this reform is the first to undertake a deep regulatory overhaul at the heart of the banking system and to complete the banking union. Moreover, it can make an important contribution to restoring confidence among businesses and the public, and, in the interests of proper financing for the economy, to strengthening the European banking system and reducing the risk of contagion.
- 1.2 The EESC is convinced of the absolute necessity of this regulation, which will redefine the management of a complex range of banking and financial services. It is clear to the Committee that the proposed regulation will not be enough to avoid another crisis. This requires a major change in financial culture and the endorsement of ethical principles in the everyday activities of the financial sector. All direct stakeholders should be involved in the construction of a new financial and economic system in order to create a sustainable and resilient finance sector and to find the best balance possible between the interests of all concerned. To this end, the EESC supports and encourages a broad agreement to boost the economy and restore trust in the financial institutions, and calls on the Commission to promote a European Social Pact for Sustainable Finance. Employees, management, shareholders, investors, families, SME's, industries, commercial customers should find a stable and fair agreement in order to create a financial services industry that is geared to developing prosperity, supporting the real economy, growth and good jobs, and to respecting the environment and avoiding undesirable negative social consequences.

- 1.3 The EESC draws attention to the need to ensure that the national authorities use uniform criteria and recommends that this legislation be applied uniformly at EU level, and possibly be agreed with the national authorities of third countries.
- 1.4 The Committee expresses doubts about the decision to allow the coexistence of various national regulations and, at the same time, the EU regulation. The EESC believes that such a framework might not guarantee the uniform application of the new rules. It welcomes the fact that this derogation has been established solely for legislation that pre-exists the proposal for a regulation, provided that complete equivalence with the regulation under consideration is guaranteed.
- 1.5 The EESC considers the Commission's proposal for a regulation to be a valid and effective response aimed at separating commercial banking activities from investment activities. Indeed, the chosen solution, as compared with the alternatives taken by some countries, is based on dialogue and assessment, which makes it possible to avoid contradiction with the universal banking model by preserving it and acting solely on the excessive risks associated with this model.
- 1.6 The EESC stresses that the impact of the proposed legislation on jobs has not been given appropriate consideration. Hundreds of thousands of jobs could be lost due to the overall regulation of financial services and it is unacceptable that no measures have been planned to reduce the substantial direct and indirect social impact. This regulation may have a limited direct impact but the influence it could have on the assets of businesses would reverberate throughout the financial system. However, it has to be acknowledged that the reduced banking risk would benefit the real economy as a whole, with unquestionable benefits for employment in general.
- 1.7 There are serious concerns that the costs will be passed on to employees. Although the Commission has taken this aspect into account in its impact assessment, it seems to have given little space to this problem in the reform. Although it is true that the activities affected by the reform are the least labour intensive, the indirect effects of the reform will lead to cost-cutting policies that could result in further job cuts, as key banks have forewarned.
- 1.8 There are many forces (financial lobbies, large Member States, consumers and investors, households, large and small businesses, associations, etc.) and widely differing interests at play. The lesson derived from a time when the financial system's rules prevailed should be clear by now: it is the public interest that must prevail. The Committee therefore advocates a change of tack that places the common interest at the centre, in a way that balances the interests of all stakeholders, since it is convinced that this is the only way in which the reform can work effectively.
- 1.9 The EESC is convinced that in order to ensure a sustainable financial system, we need "patient finance" which stops seeking short-term profits at all costs and prioritises efficiency and long-term stability. This regulation proposes a change in the business model.

- 1.10 The EESC believes that the Commission should give greater attention to investors and employees, who have hitherto received little attention in the reform. In the long term, the system's sustainability is ensured by the renewed confidence injected by a more secure environment for investors as well as employees, who play an active part in the risk management process.
- 1.11 The EESC believes that flexibility in the application of the regulation is a valid and appropriate principle. The "biodiversity"¹ of banking businesses is in fact a guarantee of the system's stability and efficiency. Nevertheless, the EESC would point out that this must not be confused with the arbitrary application of rules.
- 1.12 The EESC advises the Commission to include in its Impact Assessment a detailed assessment of the interaction of the key proposals of the current regulation with other recently undertaken initiatives such as CRDIV, BRRD, SRM, etc., as well as an assessment of the risks of migration towards shadow banks.
- 1.13 The EESC recommends that oversight activities be carried out in close cooperation and coordination between the EBA and the national authorities, which are well-acquainted with the markets and which will play a key role in managing the new reformed European finance.

2. **The proposal for a regulation**

- 2.1 According to the Commission, this proposal represents a critical part of the Union response to tackling the "Too-Big-To-Fail" dilemma. It aims at preventing unmonitored and unmanaged risks in the Union banking system. It will curtail the expansion of activities of a purely speculative nature.
- 2.2 The regulation seeks to prevent systemic risk, financial stress or failure of large, complex and interconnected entities in the financial system, in particular credit institutions, and to meet the following objectives:
- (a) to reduce excessive risk-taking within the credit institution;
 - (b) to remove material conflicts of interest between the different parts of the credit institution;
 - (c) to avoid misallocation of resources and to encourage lending to the real economy;
 - (d) to contribute to undistorted conditions of competition for all credit institutions within the internal market;
 - (e) to reduce interconnectedness within the financial sector leading to systemic risk;
 - (f) to facilitate efficient management, monitoring and supervision of a credit institution;
 - (g) to facilitate the orderly resolution and recovery of the group.

¹

[OJ C 100, 30.4.2009, p. 84.](#)

This proposal for a regulation lays down rules on:

- (h) the prohibition of proprietary trading;
- (i) the separation of certain trading activities.

2.3 Other types of additional financial services/products (securitisation, corporate bonds, derivatives, etc.) should therefore continue to be allowed.

3. **Preliminary considerations**

3.1 The Commission estimates that the financial crisis cost EU governments around EUR 1.6 trillion (13% of EU GDP) in state aid as a result of bailouts in the financial sector.

3.2 The EU banking sector is highly concentrated: 14 European banking groups are listed as global systemically important financial institutions (SIFIs), and 15 European banking groups own 43% of the market, in terms of asset size, and represent 150% of EU-27 GDP, with 65% in the hands of the first 30 groups!

3.3 The financial crisis, which began in the United States but had a tsunami effect on the European system, had many causes, but the main ones may be considered to be excessive risk-taking, excessive leverage, inadequate capital and liquidity requirements and the complexity of the overall banking system.

3.3.1 In October 2012, the Liikanen group made the following statement: "It is necessary to require legal separation of certain particularly risky financial activities from deposit taking banks within the banking group. The activities to be separated would include proprietary trading of securities and derivatives, and certain other activities closely linked with securities and derivatives markets"².

3.4 Through this proposal, the Commission seeks to reduce risk margins in the banking system and bring potentially speculative operations under control. This should be considered jointly with the related regulation on securities financing transactions³, which seeks to make so-called "shadow banking" less opaque. At the end of 2012, global shadow banking assets accounted for EUR 53 trillion, representing about half the assets of the international banking system, and were mainly concentrated in Europe, with around EUR 23 trillion, and in the United States, with around EUR 19.3 trillion. These figures are impressive when compared to the total EU-28 GDP, which did not exceed EUR 13.071 trillion in 2013 (Eurostat).

² http://ec.europa.eu/internal_market/bank/docs/high-level_expert_group/report_en.pdf.

³ COM(2014) 40 final.

- 3.5 The European Parliament's McCarthy resolution⁴ sets out a number of key principles, and states, inter alia, that "the core principle of banking reform must be to deliver a safe, stable and efficient banking system that serves the needs of the real economy, customers and consumers (...) structural reform must stimulate economic growth by supporting the provision of credit to the economy, in particular to SMEs and start-ups, provide greater resilience against potential financial crises, restore trust and confidence in banks and remove risks to public finances; (...) an effective banking system must deliver a change in banking culture in order to reduce complexity, enhance competition, limit interconnectedness between risky and commercial activities, improve corporate governance, create a responsible remuneration system, allow effective bank resolution and recovery, reinforce bank capital and deliver credit to the real economy".

The new oversight of international markets has emerged stronger, more far-reaching and, above all, with more powers than previously held, with less discretion and better guarantees for the market and end users.

4. **The key points of the hearing**

- 4.1 The Committee believes that the Commission is on the right track but thinks that it would be useful to present it with certain views that emerged during discussions with the various stakeholders and which may not have been given sufficient thought. The EESC therefore draws its attention to some of the key points raised by stakeholders. These do not fully represent the views of the EESC but nevertheless deserve to be reported faithfully.
- 4.2 The reform under consideration was generally well-received. In fact the majority considered the prohibition of proprietary trading and the separation of traditional activities from trading to be the right instruments to curb speculation on financial products and to boost bank lending, a key source of finance for SMEs which has fallen considerably in recent years due to policies concerning speculation on trading.
- 4.3 It is important for the application of the reform to accommodate the wide range of business models in order to ensure that local banks can continue to serve local economies.
- 4.4 The business model of mutual and cooperative banks deserves special consideration. The reform is not believed to be particularly adapted or adaptable to their specific network. The main concern expressed was that the reform could impair the way they worked and their capacity to be present on the ground on a daily basis in order to support the real economy. The recommendation is therefore to preserve their specific character and different ways of doing business.

⁴ <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+COMPARL+PE-506.244+01+DOC+PDF+V0//EN&language=EN> (2013/2021(INI)).

- 4.5 The reform, alongside the numerous measures taken by the Commission in recent years, will improve the transparency of individual transactions and the banking system in general, but will also increase their overall costs at various levels. In this regard, the discussion clearly revealed the need for an overall impact assessment of the financial regulatory reforms despite awareness of the complexity of such an evaluation.
- 4.6 There were concerns that these costs would, as often occurs, be passed on to the end consumer of financial services. There was discussion as to whether the positive effects which the new measures were expected to have, for instance in terms of the banking system's stability, might be outweighed by the detrimental effects.
- 4.7 Regarding the whistleblower protection system, the Committee and those social partners that mentioned the issue praised the Commission for the system of rules which it had put forward. There were calls for the term "appropriate protection" to be more clearly defined (Article 30) and to clarify the extension of the proposed rules to all employees, encouraging and motivating them to report any breaches.
- 4.8 With regard to the sanctions referred to in Articles 28 and 29, it is advocated that liability for any breaches should be established primarily at the level of the institution, in relation to governance, and not the individual.
- 4.9 On the other hand, with respect to the remuneration system, an explicit reference to the provisions of Article 69 of the Capital Requirements Directive (CRD) IV is advocated.

5. **EESC comments**

- 5.1 The EESC welcomes the measures set out in the Commission's proposal and agrees that a regulation is the right choice of legal instrument since it fits the purpose of harmonising the single market in order to avoid regulatory arbitrage and return to an efficient and productive banking system which serves the public and the community, supports the real economy, households and balanced and sustainable social development and which is far-sighted and knows how to combine innovation with security.
- 5.2 The EESC has been determined in its support of the ensuing reforms, which have started to bear their first fruit. The regulation under consideration addresses one of the most complex and sensitive aspects of the entire system: the resilience and legal structure of financial firms, some of which have assets that exceed the GDP of many Member States. The total assets of the top ten European banks exceed the GDP of EU-28⁵ (over EUR 15 trillion).

⁵ <http://www.relbanks.com/top-european-banks/assets>.

- 5.3 The proposed regulation aims to cut right through the Gordian knot created by the size, interconnections and complexity of some so-called "systemic" institutions, meaning those that can trigger a systemic crisis. "Too-big-to-fail" has now become a mantra which conceals actions that are not only in breach of the most elementary ethical principles, but also constitute fraud and breaches of law, as recent and very recent financial scandals unfortunately continue to show. These practices are euphemistically covered by the term "moral hazard"!
- 5.4 Commissioner Barnier launched the proposal by announcing that the objective was to prevent the existence of banks that were "too-big-to-fail, too-costly-to save, too-complex-to-resolve".
- 5.5 The EESC believes the proposed measures are on the right track, reducing the risk that taxpayers will have to step in again to save failing banks. Following the repeated bailouts, the EESC had warned against the disastrous effects they would have on sovereign debts and consequently the harmful effects of a recession that was clearly inevitable. Unfortunately, these forecasts materialised with even worse consequences than had been predicted, due to the unbelievable mistakes over the impact of a growing number of budget consolidation policies resulting from national requirements or a short-sighted and misguided EU policy, which was blind to the need for flexibility and compensatory anti-recessionary measures.
- 5.5.1 It is only now that we can fully appreciate the damage caused by this policy and we must acknowledge that it was only the European Central Bank's enlightened management of the Eurozone that prevented the worst and saved the euro, and ultimately the Union. Had the EESC's advice been heeded, much of this damage might have been avoided!
- 5.6 The Commission has rightly given the European Banking Authority (EBA) a decisive role for the purposes of this regulation. The EBA will be consulted in the event that some of the decisions envisaged in this proposal need to be adopted. Furthermore, it will be tasked with preparing draft regulatory technical and implementing standards and will have to update the Commission on the implementation of the regulation by submitting reports. The EESC had on several occasions pointed out that despite the undisputed existence of expertise, the Commission was not providing this important authority with sufficient responsibilities and resources.
- 5.7 In 1999, a law was adopted in the United States repealing the Glass-Steagall Act, and in particular the separation between commercial and investment banking. Unfortunately, the EU also followed the US administration's disastrous decision. The EESC notes that the current provisions effectively reinstate the separation between these two areas of activity and go even further since, barring a few exceptions, they prohibit credit institutions that take deposits from dealing in investments as a principal and holding trading assets.
- 5.7.1 It is crucial that the EU works closely with third countries, especially the USA, in order to proceed to a common substantial approach to the regulation. The EESC urges the Commission to strengthen the international cooperation.

- 5.8 The proposal for a regulation leaves the relevant authorities considerable room for discretion. It is vital for them to take action and base their assessments on clear, harmonised and foreseeable criteria that define when a bank is no longer able to manage its own levels of high-risk trading activities. Without a common reference framework, the risk of subjective interpretations could lead to the opposite of the desired effects, which are consistent with the provisions of Article 114 of the TFEU.
- 5.9 The EESC welcomes the Commission's ultimate decision to opt for an ex-post rather than an ex-ante separation of market and other proprietary trading activities: the technical standards rightly entrusted to the EBA are therefore essential. In view of the application of the rules on resolution and, in particular, the establishment of the resolution authority, approved by the Ecofin Council in December 2013, the EESC advocates the immediate development of arrangements for the coordination and identification of the national and European authorities' responsibilities, in order to avoid the risk of duplicate decisions or, worse still, of conflicting interpretations and assessments by the relevant authorities. As soon as the single resolution authority is set up, it should participate in developing the mechanism, as well as in defining the technical standards alongside the EBA.
- 5.10 The EESC does not agree with the criticisms levelled at the Commission concerning the relative importance of activities that might be subject to separation. In some credit institutions, their weight was extremely substantial and the lack of specific rules exposed them to a very high risk that could have led to a systemic crisis far worse than the one that actually occurred, with predictably disastrous effects on settlement systems and the economy in general. Disaster was only averted by fresh injections of taxpayers' money and the ECB's reaction capacity.
- 5.11 The EESC welcomes and supports the Commission's inclusion of explicit provisions to protect financial sector professionals who are exposed to severe repercussions for making public interest disclosures of irregularities but are then faced with retaliatory mobbing or even dismissal. This internal monitoring, referred to as whistleblowing must be encouraged and supported. Regulatory compliance is often lax, circumvented or even breached, exposing banking institutions and their staff to incalculable risks. Recently exposed practices, which breach all standards or laws, by sometimes well-known and highly respected firms could only have happened with the active collaboration of people working for them!
- 5.11.1 The EESC calls on the Commission to develop specific monitoring of the Member States' obligations to adopt legislation providing adequate protection and to present a report on the issue within two years of the regulation's entry into force.
- 5.12 The EESC is very aware of the issues surrounding relations with third countries, especially with regard to reciprocity and regulatory compliance by all entities operating in the EU. It considers the Commission's approach to be balanced and supports the arrangements it puts forward in this connection. It advocates pursuing and stepping up cooperation with the United States, especially in the area of financial regulation, in order to develop systems that are as homogeneous as possible and which take a uniform approach to the same problems.

- 5.13 Furthermore, the EESC welcomes the fact that the Commission's regulations have started to provide an adequate response to one of the points that the Committee has frequently emphasised in the past, in this instance, with regard to administrative sanctions, since criminal sanctions are outside the Commission's scope of action. The Commission's proposals appear proportionate, appropriate and dissuasive.
- 5.14 The EESC has expressed its reservations about the use of delegated acts on many previous occasions. Although it acknowledges the importance of adapting legislation over the years, the EESC points out that the use of delegated acts introduces elements of uncertainty that are inadvisable in this area.

Brussels, 9 July 2014

The President
of the
European Economic and Social Committee

Henri Malosse
