Citizens' summary

EU proposal for stricter capital requirements and better corporate governance for banks and investment firms

WHAT'S THE ISSUE?

- The financial crisis revealed weaknesses in the way banks had been operating:
  - they held too little capital and the capital they held was of poor quality and in effect not able to cover the losses banks were facing. As a result, when banks faced losses they had to be bailed out by tax payers.
  - banks were not holding enough liquid funds and so faced a shortage of cash when they needed it most.
  - banks took on too many assets compared to their capital. When the crisis hit, many of these assets fell in value. When banks tried to sell these assets at the same time, prices fell further and this contributed to making the crisis worse.
- The ways banks are managed (corporate governance) has to improve - so that they do not take such high risks again.
- More effective penalties are needed to deter banks from infringing rules on capital requirements.

WHAT EXACTLY WILL CHANGE?

- Banks and investment firms will have to hold **more capital** that is of **better quality** thereby making sure they can absorb losses.
- Banks will have to build up **'capital buffers'** as a further cushion against losses.
- Banks will need to manage their cash flow to ensure that they have reliable **liquidity** available in both the short term and longer term.
- Banks will have to respect limits on how much assets they can take on compared to the capital they hold (**leverage**).
- Banks will have to hold more capital if they trade in complex financial products like **derivatives** (financial instruments that are used to manage risk).
- **Corporate governance** of banks and investment firms will be improved.
- If banks and investment firms do not abide by the rules, there will be penalties – which will also serve as an effective deterrent.

WHO WILL BENEFIT AND HOW?

- **Depositors –** if banks have to meet stricter requirements on capital, there is less risk they will fail, so deposits will be better protected.
- **Borrowers** – banks will no longer need to cut back on loans to creditworthy businesses, home-buyers and other borrowers in an economic downturn.
- **Banks** will be able to offer competitive products throughout the EU without being hampered by national differences in banking supervision.
- **Taxpayers** will be less likely to have to bail out failed banks, as they did in the recent past.

WHY DOES ACTION HAVE TO BE TAKEN BY THE EU?

- Europe's banks trade across the EU and depend on each other and on the overall health of the financial system. New rules – recommended by the Basel Committee for Banking Supervision – will only be effective if introduced throughout the EU.

WHEN WOULD THE PROPOSAL COME INTO EFFECT?

- The new rules (an EU Regulation and an EU Directive implemented through national law) should be in place by the end of 2012.
- Many rules will be phased in gradually to give banks and investment firms time to adjust and the rules will be fully effective from 2019.

Data for search engines	
Title tag	EU – proposal on capital & corporate governance for banks 2011 – citizens' summary
Description	Explained – new stricter rules on capital, liquidity and governance proposed for banks and investment firms, with penalties.
Link name	Summary – proposed banking rules on capital, liquidity & governance
Keywords for url/filename	banks, investment firms, capital requirements, corporate governance, sanctions, liquidity, leverage ratio