ROADMAP			
TITLE OF THE INITIATIVE	Proposal for a structural reform of EU banks		
LEAD DG – RESPONSIBLE UNIT	DG MARKT – BANKS AND FINANCIAL CONGLOMERATES II (H2)	**DATE OF ROADMAP**	04 / 2013
This indicative roadmap is provided for information purposes only and is subject to change. It does not prejudge the final decision of the Commission on whether this initiative will be pursued or on its final content and structure.			

A. Context and problem definition

(1) What is the political context of the initiative?

There are concerns that large EU banking groups, are difficult to manage, monitor, and supervise. Furthermore, they may also be difficult to resolve, due to their complexity, interconnectedness, geographic scope, and ability to expand rapidly. Also, the unrestricted co-mingling of deposits subject to government guarantees with market and trading activities may subject depositors to additional risks.

The broad-based international reform agenda was initially focused on urgent measures to stabilise the financial system (see point 2 below). However, attention is turning towards structural reforms in order to mitigate moral hazard arising from the needs to provide a safety net to depositors, to address inherent conflicts of interest and excessive complexity of the modern banking system, to ensure that the banking sector serves the financing needs of the real economy as a precondition for sustainable growth, and to prevent or at least minimise the incidence and depth of any future crisis. As a result, international institutions such as the Financial Stability Board (FSB), the International Monetary Fund (IMF), and the OECD have called for a broad and global debate on bank business models. In addition to supranational calls for action, several EU Member States (UK, FR, DE, NL, etc.) as well as third countries (US) have already embarked on structural reforms.

The High-level expert group (HLEG) on reforming the structure of the EU banking sector, chaired by Erkki Liikanen, has set the tone for this debate at European level in its report published in October 2012. It concluded that the on-going reforms do not address all the underlying problems in the EU banking sector, as they do not fully correct incentives for excessive risk-taking, complexity, interconnectedness and intra-group subsidies. The group's report accordingly states that reforming the structure of banks is necessary to complement the existing reforms. The Commission accordingly considers it urgent to assess the different structural reform options to address the aforementioned issues and to devise a European framework for action to preserve the integrity of the single market.

(2) How does it relate to past and possible future initiatives, and to other EU policies?

The EU and its Member States have engaged in a fundamental overhaul of bank regulation and supervision. This overhaul exercise is based, to a large extent, on the reforms to strengthen global financial markets agreed upon by global leaders at the G20 summits in London in April 2009 and thereafter, and implemented in cooperation with the Financial Stability Board (FSB) and the Basel Committee of Banking Supervisors (Basel Committee).

In the area of banking, the EU has initiated a number of reforms to increase the resilience of banks and to reduce the impact of potential bank failure. These reforms include in particular the capital and liquidity requirements to be implemented as part of the new Capital Requirement Regulation and Directive (CRR/CRDIV) and the proposed Bank Recovery and Resolution Directive (BRR). Additionally, in order to break the negative feedback cycle between sovereign and banking risks and restore confidence in the euro and the banking system, the Commission has called for further development of Banking Union, building on the single rule book that will be applicable to all banks in the whole EU. This progress would take the form of a Single Supervisory Mechanism and a Single Resolution Mechanism, which would be mandatory for members of the euro area, but open to voluntary participation of all other Member States.

Structural bank reform would take place in addition to the on-going reform measures.

What are the main problems which this initiative will address?

The EU banking sector remains affected by several problems/shortcomings: implicit bail-out expectations, moral hazard, excessive leverage and balance sheet expansion, lack of market discipline, lack of bank resolvability, economy-wide resource misallocation, competition distortions, etc. These problems add to public concerns with the fact that whereas profits in the banking system are privatised, losses incurred during the current crisis have been largely socialised.

Given that insured deposit-taking banks are currently largely unrestrained in the scope of their activities and unrestricted in their intra-group legal and economic structures, a reform of large banking groups' structures will aim at addressing the above problems and at enhancing the effectiveness of existing and forthcoming reform proposals.

Who will be affected by it?

The relevant banking groups, bank creditors and investors, the customers of banking services (depositors, borrowers, retail and corporate clients, including SMEs etc.), supervisors and resolution authorities, central banks and governments (as providers of the public safety net), taxpayers, and the wider economy (including real economy). The vast majority of the approximately 8000 banks authorised in the EU will not be affected by the legislation, as they will fall below de minimis thresholds.

Is EU action justified on grounds of subsidiarity? Why can Member States not achieve the objectives of the proposed action sufficiently by themselves? Can the EU achieve the objectives better?

Structural reform proposals are intrinsically linked to the regulatory overhaul of bank regulation and the wider financial system that is currently underway at EU and international level. An EU-wide approach to regulation and international coordination is necessary given the cross-border operations of many banks and the global nature of the financial system.

Diverging proposals of structural reforms of banks are already apparent in different Member States, and there is a lack of coordination, which may lead to competitive distortions inside and out of the EU. A common framework for structural reform at European level is therefore required to reinforce the foundations of an effective banking union and preserve the integrity of the internal market in financial services.

B. Objectives of the initiative

What are the main policy objectives?

The general objectives are to establish a stable and efficient banking system, preserving its diversity, that serves the needs of EU citizens and the economy, to increase economic growth by reducing financial instability and improving the allocation of scarce capital to its best use, and to provide a EU-coordinated response to eliminate the risks of fragmentation of financial markets.

Some of the more specific objectives will address the conduct-related problems (excessive risk-taking, conflicts of interest, etc.), aim at reducing risk of failure and enhancing effective resolution in the event of failure, and prevent excessive balance sheet growth and resource misallocation.

Do the objectives imply developing EU policy in new areas?

Yes. The proposal on bank recovery and resolution would empower resolution authorities to require an individual bank to change its legal and operational structure if deemed necessary to improve resolvability. However, the EU regulatory framework does not include provisions that directly affect the organisational structure of a broader set of banks and that targets a broader set of policy objectives, such as the need to set the appropriate economic incentives to ensure that banks contribute in an optimal way to the finance the real sector of the economy, thus enhancing economic growth.

C. Options

(1) What are the policy options being (including exemptions/adapted regimes e.g. for SMEs) considered?

The "baseline scenario or “no policy action" option will be compared and evaluated against the option of pursuing bank structural reform. As such, the "no action" option represents the baseline against which the value-added or incremental impact of structural reform will be evaluated. This baseline reflects the current regulatory and supervisory framework as well as on-going reforms, based on expected implementation of CRR/CRDIV, BRR and other outstanding reform proposals, as well as structural reforms being pursued in an independent manner in different Member States.

At the general level, structural reform refers to the separation (or prohibition) of different banking activities that can be conducted within a banking group. However, a number of different options will be considered that vary along various dimensions. At this stage, three main dimensions are considered of particular relevance:

<u>Definition of relevant activities to be separated:</u> subject to further legal specification and calibrations, the options to be considered include the separation of certain activities from deposit-taking entities currently engaging in retail and commercial banking activities. These activities could include, amongst others, proprietary trading, market-making activities more generally, securities underwriting, and potentially other activities. Consideration will also be given to the treatment of derivatives business (as principal or as agent), the treatment of non-EU assets (and other jurisdictional considerations), as well as exposures to hedge funds, private equity funds, etc.

<u>Nature and extent of separation and governance of separated entities:</u> the main option to be considered is separation in the form of “functional separation”, also referred to as "ring-fencing" or "subsidiarisation", whereby the activities to be separated can still be conducted within a banking group. These activities would then be conducted in a separate legal entity that is explicitly limited in the economic and financial links it can maintain with the deposit-taking entity in the group, and that is separately capitalised and funded. Other forms of separation will be considered against which to benchmark ring-fencing/subsidiarisation, ranging from accounting separation to full ownership separation, whereby the relevant activities to be separated are effectively prohibited and cannot be undertaken within a banking group that is authorised to take customer deposits.

<u>Thresholds and de minimis exemptions:</u> reflecting the proportionality principle, banks may be exempted from separation requirements if they meet certain de minimis criteria and conduct the relevant activities at a level that falls below a certain threshold, e.g. bank balance sheet size or share of trading activities within the bank’s balance sheet. The vast majority of the approximately 8000 banks authorised in the EU will not be affected by this initiative, as they will fall below de minimis thresholds. In particular, small regional and local banks offering services to local economy would not be subject to separation.

(2) What legislative or 'soft law' instruments could be considered?

Soft law policy instruments, such as recommendation, are not considered sufficient, given their non-binding nature and the close link between structural reform and the regulatory and supervisory framework (including on-going legislative reforms). The appropriate legal instrument i.e. whether to use a regulation or a directive, or a combination of both, will be assessed in the Impact Assessment. In this assessment, particular attention needs to be paid to the preservation of the Single Market.

(3) How do the options respect the proportionality principle?

EU action will not go beyond what is necessary to achieve the objective to establish a stable and effective banking system and to protect and enhance the functioning of the Single Market. In addition, a de minimis criterion exempting banks under a certain threshold from the separation requirements will be considered.

D. Initial assessment of impacts

What are the benefits and costs of each of the policy options?

At a general level, bank structural reforms would yield benefits in terms of financial stability, as it would reduce intra-group subsidies that have fuelled excessive trading activity, thus contributing to banks being too-big-to-fail. Bank structural reform will also align economic incentives to ensure that banks contribute in an optimal way to the finance the real sector of the economy, thus enhancing economic growth. Such reforms could also yield costs, if they would unduly restrict banks’ ability to provide services that are useful for the real economy. The balance between these benefits and costs depends on choices made as regards e.g. the scope of activities subject to separation, the strength of separation, and the number of banks required to separate. Whereas separating a large scope of activities to a strong degree of separation and applying this separation to a large number of banks could produce significant benefits in terms of financial stability, it could also unduly impact the provision of real economy services and thus increase costs. The impact assessment will weigh the costs and benefits in order to identify a balanced package. At a more detailed level, it is premature at this stage to report the precise benefits and costs for the different policy options. There is a large and expanding literature on this topic that Commission Services are currently analysing, and Commission Services are also performing their own qualitative and quantitative analysis.

Could any or all of the options have significant impacts on (i) simplification, (ii) administrative burden and (iii) on relations with other countries, (iv) implementation arrangements? And (v) could any be difficult to transpose for certain Member States?

It is premature to report impacts of different options on these issues. The chosen scope of application, level of harmonisation and degree of details will have an effect on the impact on relations with other countries and the potential transposition difficulties for certain Member States. As an example it needs to be assessed how the EU initiative affects the on-going national reforms.

(1) Will an IA be carried out for this initiative and/or possible follow-up initiatives?

(2) When will the IA work start?

(3) When will you set up the IA Steering Group and how often will it meet?

(4) **What DGs will be invited?**

The initiative on structural reform will be accompanied by an IA. Preparation started following the publication of the Liikanen report. The first two meetings of the steering group were held on 20 March and 26 April 2013. The Steering Group is expected to meet at least three times. Directorates general and services invited include: Competition, Economic and Financial Affairs, Employment, Health and Consumers, Enterprise and Industry, Joint Research Centre, Justice, Taxation and Customs Union, Trade, Secretariat General and Legal Service.

Is any option likely to have impacts on the EU budget above € 5m?

At this stage it is foreseen that the options will not have such impacts on the EU budget.

E. Evidence base, planning of further work and consultation

(1) What information and data are already available? Will existing IA and evaluation work be used?

(2) What further information needs to be gathered, how will this be done (e.g. internally or by an external contractor), and by when?

(3) What is the timing for the procurement process & the contract for any external contracts that you are planning (e.g. for analytical studies, information gathering, etc.)?

(4) Is any particular communication or information activity foreseen? If so, what, and by when?

Commission Services will draw upon publicly-available (notably public balance sheet data) analysis and research (academic, industry) and will conduct their own qualitative and, to the extent possible, quantitative analysis.

The Commission Services will not rely on external contractors to gather information. Quantitative analysis of the impacts of the different policy options will be done with the help of JRC using available databases.

Which stakeholders & experts have been or will be consulted, how, and at what stage?

The High-level expert group chaired by Erkki Liikanen organised hearings with a large number of stakeholders, who represented providers of banking services, consumers of such services, investors in banks, policy makers, and academics. The Group furthermore held a public consultation of stakeholders, the responses to which are published together with the Group's report.[1]

The Commission services held a stakeholder consultation on the Group's recommendations. The individual responses received, as well as a summary of responses, were published in December 2012.[2] A further public consultation will be launched in early May. Stakeholders will also have the opportunity to voice their views at a meeting organised by the Commission services on 17 May.

[1] http://ec.europa.eu/internal_market/consultations/2012/banking_sector_en.htm
[2] http://ec.europa.eu/internal_market/consultations/2012/hleg-banking_en.htm