Press release

New rules for banks to avoid a future financial crisis

Improving the transparency and the supervision of the financial system to ensure proper risk management in the banking sector is the aim of legislation approved on Monday by the Economic and Monetary Affairs Committee.

A report by Othmar Karas (EPP-ED, AT), approved with 21 votes in favour, 4 against and 8 abstentions, amends the "Capital Requirements" Directives. It seeks to improve risk management and avoid a repetition in future of the current banking crisis, with bank failures putting pressure on other banks and leaving the whole financial system at risk.

More transparency on large exposure

As the current turmoil showed, in cases where financial institutions are widely exposed to a single client, a bank or insurer could incur large losses as a result of the failure of an individual client or a group of connected clients. The same can happen when banks trade their exposures between them: the failure of one institution can cause the failure of others.

MEPs in the committee support reinforcing the existing rules on the large exposure regime, including interbank trading. A bank would not be able to expose more than Euro 150 million or more than 25% of its own funds to a client or a group of clients, if the proposed legislation enters into force.

Member States will have to require all credit institutions to report to the supervisory authorities on their large exposure, according to an amendment approved by the committee. Members also agreed to ask the Committee of European Banking Supervisors to provide national authorities with uniform guidelines so as to introduce a uniform reporting format before end of 2011.

Supervision: College only a temporary step towards an EU system

To strengthen the crisis management framework over EU banking sector, Members in committee voted to establish the colleges of supervisors to facilitate cooperation among national authorities dealing with cross-border financial institutions.

MEPs in the committee believe this should only be a temporary step towards a more integrated system of supervision since national authorities my not be able to handle cross-border crises. They ask the Commission to put forward a legislative proposal to address supervisory concerns with "a stronger role for an EU level supervisory system" by the end of the current year.

Firms and banks to better understand risks

Liquidity is a key factor for the soundness of the banking sector. Therefore, the economics committee supports the Commission's proposal to develop sound principles for liquidity risk management.

The approved provisions will give incentives to banks and other credit institutions to improve their understanding of their liquidity risk profile.

Securitisation: 5% of retention approved

The current crisis has also showed that risks are not always correctly assessed by the institutions proposing an investment, such as when mortgages are packaged into investment products and sold on by the original lender.

The committee agreed with the Commission's proposal to ensure that an institution issuing an investment retains a material interest in the performance of the proposed investment. The retention rate is, as a general rule, at least 5% of the total value of the securitised exposures.

In addition, the committee proposes an "explicit and unconditional warranty" to be issued by the originator of the securitisation, to prove respect for due diligence criteria. This would work as an alternative solution to the 5% retention limit, to ensure the retention of an economic interest by the institution.

Credit Default Swaps: call for an EU clearing house

Credit Default Swaps (CDS), the most traded derivative in recent years, also need to be regulated, according to the Economics Committee. An amendment adopted on Monday calls on the Commission to put forward, by the end of 2009, legislative proposals to regulate the CDS market and set up a central counterpart (CCP) or clearing house, supervised by the EU, to reduce the risks of these instruments.

Entry into force

Finally, according to the MEPs vote, national governments will have to transpose the proposed legislation by 31 October 2010 and apply the new provisions from the beginning of 2011.

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