REPORT

on reforming the structure of the EU banking sector
(2013/2021(INI))

Committee on Economic and Monetary Affairs

Rapporteur: Arlene McCarthy
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MOTION FOR A EUROPEAN PARLIAMENT RESOLUTION

on reforming the structure of the EU banking sector
(2013/2021(INI))

The European Parliament,

– having regard to Rule 120 of its Rules of Procedure,


– having regard to the report of 2 October 2012 of the High-level Expert Group on Reforms of the Structure of the EU Banking Sector (HLEG)¹,

– having regard to the conclusions of the G20 meetings held in London in 2009, in Cannes in 2011 and in Moscow in 2013,


– having regard to the European Council conclusions of 13 and 14 December 2012,

– having regard to the Financial Stability Board recommendations of October 2011 on ‘Key Attributes of Effective Resolution Regimes for Financial Institutions’ and of November 2010 on ‘Intensity and Effectiveness of SIFI Supervision’,

– having regard to the consultative document of the Basel Committee on Banking Supervision of November 2011 entitled ‘Global systemically important Banks: assessment methodology and the additional loss absorbency requirement’,

– having regard to Member State and international initiatives for structural reform of the

banking sector, including the French *Loi de séparation et de régulation des activités bancaires*, the German *Trennbankengesetz*, the report of the Independent Commission on Banking and the Vickers reforms in the UK, and the Volcker rules in the United States,

- having regard to the 2012 report of the Organisation for Economic Cooperation and Development (OECD) entitled ‘Implicit Guarantees for Bank Debt: Where Do We Stand?’¹ and to the 2009 report of the OECD entitled ‘The Elephant in the Room: The Need to Deal with What Banks Do’²;

- having regard to its resolution of 20 November 2012 on Shadow Banking³,

- having regard to the Eurogroup Statement of 25 March 2013 regarding the crisis in Cyprus⁴,

- having regard to Rule 48 of its Rules of Procedure,

- having regard to the report of the Committee on Economic and Monetary Affairs (A7-0231/2013),

A. whereas, since the beginning of the crisis, state aid of more than EUR 1.6 trillion (12.8 % of EU GDP) was granted to the financial sector between 2008 and the end of 2011 (including the recapitalisation of Northern Rock in 2007), some EUR 1 080 billion of which went on guarantees, EUR 320 billion on recapitalisation measures, EUR 120 billion on impaired assets and EUR 90 billion on liquidity measures⁵; whereas the Commission required substantial restructuring of banks receiving aid, including cutting of certain activities, to ensure their future viability without further public support and to offset distortions of competition caused by the subsidies received;

B. whereas these state financed bailouts has led to a massive increase of public indebtedness in the Member States;

C. whereas in the five years since the 2008 global economic and financial crisis, the EU economy has remained in a state of recession, with Member States providing subsidies and implicit guarantees to banks, in part owing to inadequate implementation of the economic and fiscal framework;

D. whereas the OECD in its 2012 report estimates the value of implicit state guarantees in 2012, in terms of cost savings to EU banks, at around USD 100 billion, with wide variations between banks and Member States and the greatest benefit accruing to the banks of greatest size, particularly if they are perceived to be weak, and to banks based in the Member States with the highest sovereign credit rating; whereas the report finds that such guarantees extend beyond those banks classified as SIFIs (‘systemically important financial institution’) under the Financial Stability Board’s methodology;

⁵ COM(2012)0778.
E. whereas a weak European regulatory framework with excessive risk-taking, excessive leverage, inadequate equity capital and liquidity requirements, excessive complexity in the overall banking system, excessively-large banking sectors in small economies, a lack of checks and supervision, excessive expansion of trading in derivatives, incorrect rating assessments, excessive bonus systems and inadequate risk management were at the root of the financial crisis, which had largely been fuelled by excessive real-estate exposures, rather than capital market activities, and by insufficient supervision;

F. whereas the loss of prudence in accounting standards as a consequence of the adoption of international financial reporting standards played, and continues to play, a central role in allowing banks to give a view of their accounts that was not, and is not, always true and fair, with particular reference to IAS 39 on loan loss provisioning;

G. whereas in Europe, risks were also accumulated by commercial banks, which issued loans in the real-estate sector on the basis of short-sighted, defective risk management;

H. whereas, as highlighted in the HLEG's analysis, no particular business model did particularly well or particularly poorly during the financial crisis;

I. whereas profits in the financial sector were often privatised while risks and losses were nationalised; whereas in a social market economy, risk and liability must go hand in hand;

J. whereas the current post-crisis weakness of the European banking system demonstrates the need for reinforcing the architecture of European financial supervision and crisis management, including structural reforms for certain banks in order to serve the wider needs of the economy;

K. whereas banks should not be sovereign over public interest;

L. whereas the 1933 US Glass-Steagall Act on banking separation helped to provide a way out of the worst global financial crisis to have occurred before the present crisis, and whereas there has been a considerable increase in speculative bank investment and financial failures since the Act was repealed in 1999;

M. whereas a number of important EU initiatives have been taken to prevent a new banking crisis, increase protection of taxpayers and retail clients and create robust and sustainable payment systems.

N. whereas the eighth edition of the Commission’s Consumer Markets Scoreboard (from December 2012) clearly indicates that consumer trust in the EU in banking services is at an all-time low;

O. whereas the recent bailout package in Cyprus originally included a tax on all bank deposits, thereby undermining confidence in the deposit guarantee scheme of that country;

P. whereas a study by the Bank of International Settlements (BIS) suggests that once the volume of private sector loans exceeds a country’s GDP as a measure of the size of the financial sector, and relative employment in that sector rises rapidly, an excessively large financial sector can have a negative effect on the increase in productivity, as human and
financial resources are drained from other areas of economic activity\(^1\); 

Q. whereas, in relation to the crisis in Cyprus, the Eurogroup has confirmed the principle that the size of the banking sector relative to a Member State’s GDP should be limited in order to address banking sector imbalances and promote financial stability, from which it follows that, in the absence of substantial EU-level funds for resolution, limits on the size, complexity and interconnectedness of banks will be beneficial to systemic stability;

R. whereas the pure separation of financial institutions into investment- and retail branches does not address the problem concerning SIFIs and the relation between the volume of the recovery and resolution fund, on the one hand, and the balance of institutions systemically relevant for credit, payment and deposit, on the other;

S. whereas the transformation process towards a more sustainable, less systemic and viable banking sector seems to differ between Member States.

T. whereas the HLEG concludes that the financial crisis has demonstrated that no particular business model fared particularly well, or particularly poorly in the European banking sector; whereas the HLEG analysis revealed excessive risk-taking, often in trading highly complex instruments or in real-estate related lending not matched with adequate capital protection, and excessive reliance on short-term funding and strong linkages between financial institutions, causing a high level of systemic risk in the run-up to the financial crisis;

U. whereas the HLEG underlines that simple labels, such as ‘retail bank’ or ‘investment bank’, do not adequately describe the business model of a bank and its performance and propensity to take risk; whereas business models are diverse along different key dimensions, such as size, activities, income model, capital and funding structure, ownership, corporate structure, and geographic scope, and have evolved substantially over time;

V. whereas it has become clear that risks can originate in the retail as well as in the investment part of the bank;

W. whereas the Commission proposal should provide for a principles-based approach to structural reforms of the European banking sector that is consistent with, and complementary to, already existing and forthcoming Union legislation for financial services; whereas the European Banking Authority (EBA) should play a key role by developing relevant technical standards to ensure consistent application and enforcement by the competent authorities, including the European Central Bank (ECB), across the Union;

X. whereas decentralised local and regional institutions within the banking sector in the Member States have shown themselves to be stable and beneficial in terms of financing the real economy;

Y. whereas it is necessary that banks hold higher levels and better quality of capital, and have greater liquidity buffers and longer-term funding.

Z. whereas, since it is neither feasible nor desirable to effect a bank separation post-failure, an effective recovery and resolution regime is needed in order to provide authorities with a credible set of tools, including a bridge bank, so that they can intervene sufficiently early and quickly in an unsound or failing bank to enable its essential financial and economic functions to continue, while minimising the impact on financial stability and ensuring that appropriate losses are imposed on the shareholders and creditors who bore the risk of investing in the institution in question, and not by taxpayers or depositors; whereas such recovery and resolution plans are not necessary for other types of private company, suggesting that there is a specific problem with the market in financial services; whereas if the market were functioning properly, financial institutions would be able to fail without any need for a recovery and resolution plan, signifying that the problem lies within the structures of, and the interconnections between, financial institutions;

AA. whereas supervisory and resolution authorities must be given the requisite authority to be able effectively to remove impediments to the resolvability of credit institutions, and whereas the banks must be forced to prove their resolvability; whereas the introduction of compulsory recovery and resolutions regimes provides an opportunity to influence the banking structure, reduce the complexity of institutions and restrict or terminate business sectors and products;

AB. whereas, with regard to ending the implicit guarantee that many banks enjoy, one of the most important tools in the recovery and resolution regime proposed by the Commission is the power for authorities to intervene early, well before the point of non-viability, to require banks to change their business strategy, size or risk profile so that they can be resolved without recourse to extraordinary public financial support;

AC. whereas banks should never again be allowed to become so large that their failure causes systemic risks for the entire economy, obliging the government and the taxpayers to rescue them, and whereas the too-big-to-fail problem should thereby be brought to an end;

AD. whereas banks must no longer reach such a size – even in a single Member State – that they constitute a systemic risk in a nation state, with taxpayers having to bear the cost of losses;

AE. whereas the EU banking sector remains highly concentrated: 14 European banking groups are SIFIs, and 15 European banks own 43% of the market (in terms of asset size) and represent 150% of EU-27 GDP, with individual Member States citing even higher ratios; whereas the ratio of bank size to GDP has tripled since 2000; whereas the ratio of bank size to GDP has quadrupled in Luxembourg, Ireland, Cyprus, Malta and Great Britain; whereas there is a huge degree of diversity in the European banking sector, both in terms of size and business model;

AF. whereas there is no evidence from the past that a separation model could contribute in a positive way to avoiding a future financial crisis or to diminishing the risk of it;

AG. whereas currently the state guarantees and implicitly subsidises the whole financial
system via liquidity support, deposit guarantee schemes and nationalisation programmes; whereas it is only appropriate for the state to guarantee essential services that ensure the smooth running of the real economy, such as payment systems and overdraft facilities; whereas structural reform is simply about ensuring that the state only guarantees essential services and that non-essential services are priced by the market;

AH. whereas capital markets need to be able to meet European financial needs at a time of very constrained bank lending; whereas there is a need in Europe to increase the availability of alternative financing sources, in particular through the development of capital market alternatives, in order to decrease the dependency on bank funding, as identified in the Commission's green paper on Long-Term Financing of the European Economy;

AI. whereas the funding of the real economy by banks is significantly higher in most of the Member States than it is in the UK or the USA;

AJ. whereas enhanced competition in the European banking industry is highly desirable; whereas the aggregated amount of legislative and regulatory requirements on banks, although indeed warranted for many reasons, risks creating barriers to entry and, in so doing, facilitates the cementation of the current banking groups' dominant positions;

AK. whereas the EU banking sector faces far-reaching structural changes resulting from changes in the market situation and comprehensive regulatory reforms such as implementation of the Basel III rules;

AL. whereas the report of the Independent Commission on Banking and the Vickers reforms in the UK state several times that its recommendations are a policy approach for UK banks;

1. Welcomes the HLEG's analysis and recommendations on banking reform and considers them a useful contribution to initiate reforms;

2. Welcomes the Commission’s Consultation on Structural reform of the EU Banking Sector of 16 May 2013;

3. Takes the view that national initiatives for structural reform require an EU framework to preserve and prevent the fragmentation of the EU’s single market, while respecting the diversity of national banking models;

4. Takes the view that existing reforms of the EU banking sector (including the Capital Requirements Directives and Regulation, the Recovery and Resolution Directive, the Single Supervisory Mechanism, the Deposit Guarantee Schemes, the Markets in Financial Instruments Directive and Regulation, and shadow banking initiatives) are vital; welcomes the Commission’s intention to bring forward a directive for structural reform of the EU banking sector in order to tackle problems arising from banks being “too big to fail”, and underlines that it must be complementary to the aforementioned reforms;

5. Insists that the Commission’s impact assessment include assessments of the HLEG, Volker, Vickers, French and German proposals for structural reform, that it list the costs,
both to public finances and to financial stability, incurred by the failure of an EU-based bank during the current crisis, as well as the potential costs to the EU banking sector and the possible positive and negative consequences for the real economy, and that it provides information on the nature of the EU’s current universal banking model, including the size and balance sheets of the retail and investment activities of relevant universal banks operating in the EU and on possible implicit guarantees provided by Member States to banks; insists that the Commission should supplement its assessment with quantitative analysis where possible, taking into account the diversity of national banking systems.

6. Reminds the Commission of the warning issued by the EBA and the ECB that financial innovation can undermine the objectives of structural reforms, and insists that structural reforms be subject to periodic review;

7. Urges the Commission to bring forward a legislative proposal on the regulation of the shadow banking sector that takes into account the principles of the ongoing banking structure reform;

8. Considers that the objective of all banking structure reform must be to deliver a safe, stable, effective and efficient banking system that operates in a competitive market economy and serves the needs of the real economy, and of customers and consumers through the economic cycle; takes the view that 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, remove risks to public finances and deliver a change in banking culture;

A. Principles for structural reform

9. Considers that structural reform must be based on the following principles:

- excessive risks must be reduced, competition ensured, complexity reduced and interconnectedness limited by providing for the separate operation of essential activities, including credit, payment, deposit and other customer-related activities and non-essential risky activities;

- corporate governance must be improved and incentives created for banks to establish transparent organisational structures, increase accountability and reinforce a responsible and sustainable remuneration system;

- effective bank resolution and recovery must be enabled by ensuring that when banks become untenable they can be allowed to fail and/or resolved in an orderly manner without the need for taxpayer bailouts.

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• delivery of essential credit, deposit and payment services must be ensured in a manner unaffected by operational problems, financial losses, funding shortages or reputational damage resulting from the resolution or insolvency;

• the rules of a competitive market economy must be respected such that risky trading and investment activities do not benefit from implicit guarantees or subsidies, the use of insured deposits or tax payer bailouts, and that the trading and investment activities, not the credit and deposit activities, bear the risks and costs associated with those activities;

• adequate capital, leverage and liquidity must be available for all banking activities;

• the separated entities must have different sources of funding, with no undue or unnecessary shifting of capital and liquidity between these activities; the provision of adequate capital, leverage and liquidity rules must be calibrated to the business models of the activities, including separate balance sheets, and provide limits on the exposure of essential credit and deposit activities to non-essential trading and investment activities, in or outside a banking group;

10. Urges the Commission to take into account the ECB’s proposal to establish clear and enforceable criteria for separation; stresses that separation should preserve the EU’s single market and prevent its fragmentation, while respecting the diversity of national banking models.

11. Underlines the necessity of assessing the systemic risk presented both by the separated entities and by the group as a whole, taking off-balance sheet exposures fully into account;

12. Urges the Commission and the Member States to make sure that the Recovery and Resolution Directive is fully implemented; urges the Commission, the EBA and the Member States to ascertain that banks have in place clear and credible crisis management frameworks that include sufficient capital for credit, payment and deposit activities, bail-in-able liabilities and liquid assets to enable them, in the event of failure, to maintain depositors’ access to funds, protect essential services – in particular credit, payment and deposit activities – from the risk of disorderly failure, pay out depositors in a timely fashion and avoid adverse effects on financial stability;

13. Urges the Commission, the EBA and the competent authorities, on the basis of the Capital Requirements and Recovery and Resolution legislative framework to ensure that adequate differentiation exists – in terms of capital, leverage, bail-in-able liabilities, appropriate capital buffers and liquidity requirements – between the separated entities, with an emphasis on higher capital requirements for non-essential risky activities;

B. Corporate governance

14. Calls on the Commission to consider, in its thorough impact assessment of the potential separation of banks and alternatives, the proposals set out in the HLEG’s report in the area of corporate governance, including a) governance and control mechanisms, b) risk

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1 [http://www.ecb.int/pub/pdf/other/120128_eurosystem_contributionen.pdf]
management, c) incentive schemes, d) risk disclosure and e) sanctions;

15. Calls on the Commission to implement the proposals and recommendations set out in Parliament’s resolution of 11 May 2011 on corporate governance in financial institutions¹;

16. Is of the opinion that the recently adopted directive on prudential supervision of credit institutions and investment firms contains an appropriate framework of requirements on the governance of banks, including their executive and non-executive board members;

17. Calls on the Commission to include provisions establishing an obligation for all executive board members in an entity of a bank to have responsibility as executive board members only for this entity of the bank;

18. Urges the Commission to include provisions to strengthen personal accountability and liability for board members; suggests that in this context the Commission should explore how to encourage a return to the partnership model of company management, in particular for investment banking;

19. Urges the Commission and the EBA to ensure full and comprehensive implementation of the Capital Requirements legislative framework, with particular regard to the provisions on compensation and remuneration; calls on the EBA and the Commission to present an annual report to Parliament and the Council on the implementation and enforcement of the relevant provisions by the Member States; urges the Commission to continue the reform of banks’ compensation and remuneration culture by prioritising long-term incentives for variable remuneration with larger deferral periods up to retirement, and to promote transparency of remuneration policies including, but not limited to, explanations and assessments on internal remuneration spreads, relevant changes and comparative sectoral deviations;

20. Urges the Commission, the EBA and the competent authorities to ensure that remuneration systems prioritise the use of instruments such as bonds subject to bail-in, and shares, rather than cash, commissions or value-based items in line with the provisions of the Capital Requirements Directive;

21. Urges the Commission, the EBA and the competent authorities to ensure that compensation and remuneration systems at all levels of a bank reflect its overall performance and are focused on quality customer service and long-term financial stability rather than short-term profits, in line with the provisions of the Capital Requirements legislative framework;

22. Urges the Commission to make provision for effective, dissuasive and proportionate sanctioning regimes for legal and natural persons, and for the publication of sanction levels and of information on those in breach of the rules;

23. Urges the Commission to make provision for competent authorities, and as applicable the single supervisory mechanism (SSM), to comply with the principles of structural reform.

24. Asks the Commission to propose that adequate resources and powers be allocated to competent supervisory authorities, including SSMs;

25. Urges the Commission to conduct a study to ensure that accounting standards used by financial institutions give a genuinely true and fair view of banks’ financial health; points out that accounts are the main source of information for an investor to understand whether or not a company is a going concern or not; notes that auditors can only sign off accounts if they are true and fair, independent of the financial standards used by preparers of financial statements; believes that if auditors are unsure that a company is a going concern they should not sign off the company’s accounts, even if they have been drawn up in line with accounting standards; point out that this should, however, be a driver of better management of the company in question; suggests that international financial reporting standards do not necessarily give a true and fair view of accounts, as shown by numerous examples of banks collapsing despite their accounts having been signed off by auditors;

C. Enhancing fair and sustainable competition

26. Stresses that effective, fair and sustainable competition is necessary for maintaining a well-functioning and efficient banking sector that facilitates funding to the real economy by ensuring universal access to, and reducing the cost of, banking services; stresses, in this context, that supervisory rules, among other provisions, should take into account the risk profile, the regional scope and the business model of the respective institutions;

27. Urges the Commission and the Member States to work together to promote greater diversification of the EU’s banking sector by encouraging and facilitating more consumer-oriented banking, for example through cooperatives and building societies, and through peer-to-peer lending, crowd funding and saving-bank models, taking note that the different levels of risk that consumers are exposed to are disclosed in a transparent manner;

28. Notes that, in order to boost the competitiveness and stability of the European banking system, it is vital to address in an effective way the issue of SIFIs (i.e. banks that are too big to fail), the problems of which resulted in an escalation of the adverse effects of the financial crisis, by rationalising the scale of the activities of banking groups and by reducing interdependencies within groups;

29. Urges the Commission to find ways to encourage and promote ‘relationship lending’ or ‘knowledge-based lending’ in legislative initiatives. These should aim to avoid a ‘tick box’ approach and focus instead on promoting vocational and ethical training for those who mediate and lend capital to businesses;

30. Urges the Member States, the Commission and the competent authorities to make it their clear objective to promote and ensure effective competition, and to encourage greater diversity and customer-orientation, in the EU banking sector;

31. Asks the Commission to bring forward measures to promote accessible websites that allow consumers to compare the prices and financial strengths of banks, which would encourage discipline as informed consumer switch between banks, and to assist in improving consumer choice in the banking sector by reducing barriers to entry and exit
and by applying proportionate rules to new entrants to the market;

32. Calls on the Commission to bring forward the necessary structural reforms outlined in this report, which, while maintaining the integrity of the internal market, respect the diversity of national banking systems and maintain a strong role for the EBA in ensuring correct application across the Union;

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33. Instructs its President to forward this resolution to the Council and the Commission.
EXPLANATORY STATEMENT

In February 2012, the Commission established a High Level Expert Group (HLEG) tasked with addressing the issue of whether additional reforms of the structure of the EU banking sector would reduce the probability and the impact of bank failure and ensure the continuation of vital economic functions upon failure in order to better protect retail clients.

The HLEG’s report found that excessive risk-taking, excessive leverage, inadequate capital and liquidity requirements and excessive complexity of the overall banking system was at the root of the financial crisis. While regulatory reforms are tackling these weaknesses, the Group came to the conclusion that further structural reforms are necessary, in particular the legal separation of certain risky financial activities from deposit-taking banks within a banking group. The objective of separation is to make the most socially vital parts safer and less connected to high-risk trading activities and limit taxpayer bailouts.

The HLEG argue that separation is the most effective way to make banking structures simpler, more transparent and to better facilitate recovery and resolution and supervision.

While banking must deliver greater resilience against potential financial crises and remove risks and costs from banking activities to public finances, it is essential that reform of the EU’s banking structure delivers a safe, stable and efficient banking system that serves the needs of the real economy, customers and consumers and supports the provision of credit to the economy, in particular to SMEs and start-ups.

This own initiative report sets out several core principles namely, reducing complexity, enhancing competition, limiting interconnectedness between risky and commercial activities, improving corporate governance, creating a responsible remuneration system, enabling effective bank resolution and recovery, reinforcing bank capital and providing credit to the real economy which, are essential to deliver a change in banking culture.

With the Commission’s December 2012 8th edition of the Consumer Markets Scoreboard indicating that consumer trust in the EU banking sector is at an all time low, the HLEG report is a sound and welcome basis for structural reform.
### RESULT OF FINAL VOTE IN COMMITTEE

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| Result of final vote | +: 36  
|                  | -: 3    
|                  | 0: 4    |
| Members present for the final vote | Jean-Paul Besset, Sharon Bowles, Udo Bullmann, George Sabin Cutaș, Leonardo Domenici, Derk Jan Eppink, Diogo Feio, Markus Ferber, Elisa Ferreira, Ildikó Gáll-Pelcz, Jean-Paul Gauzès, Sven Giegeld, Sylvie Goulard, Liem Hoang Ngoc, Syed Kamall, Othmar Karas, Wolf Klinz, Jürgen Klute, Philippe Lamberts, Werner Langen, Astrid Lulling, Hans-Peter Martin, Arlene McCarthy, Sławomir Nitra, Anni Podimata, Antolín Sánchez Presedo, Peter Simon, Theodor Dumitru Stolojan, Kay Swinburne, Sampo Terho, Marianne Thyssen, Ramon Tremosa i Balcells, Corien Wortmann-Kool, Pablo Zalba Bidegain |
| Substitute(s) present for the final vote | Herbert Dorfmann, Sari Essayah, Vicky Ford, Robert Goebbels, Krišjānis Kariņš, Mojca Kleva Kešuš, Olle Ludvigsson, Thomas Mann, Marisa Matias, Claudio Morganti, Nils Torvalds |