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***Set up in 1960, the European Banking Federation is the voice of the European banking sector (European Union & European Free Trade Association countries). The EBF represents the interests of some 5000 European banks: large and small, wholesale and retail, local and cross-border financial institutions.***

***The EBF is committed to supporting EU policies to promote the single market in financial services in general and in banking activities in particular. It advocates free and fair competition in the EU and world markets and supports the banks' efforts to increase their efficiency and competitiveness.***

# The European Banking Federation's answer to the Consultation by the Liikanen High-level Expert Group on possible reforms to the structure of the EU banking sector

## Introduction

The European Banking Federation (EBF) welcomes the possibility to give the view of our organisation to the consultation issued by the High Level Expert Group (HLEG) over the potential need to reform the structure of the EU banking sector, chaired by Mr Erkki Liikanen.

The EBF shares the overall aim put forth in the HLEG mandate of ensuring *a safe, stable and efficient banking sector serving the need of citizens, the EU economy and the internal market*. In the following EBF will provide answers to the questions addressed to banks in its capacity of representing the European banking sector.

**Question 1:**

***To what extent are the current and ongoing regulatory reforms sufficient to ensure a stable and efficient banking system and avoid systemic crises?***

It is the view of EBF that the finalisation of the on-going international regulatory reform agenda – including important measures still in the pipeline – will help reach the regulatory objectives mentioned in the mandate of the HLEG, e.g. i) to increase the stability of the European financial sector by reducing risk both at micro and macro level; ii) to ensure orderly resolution of financial institutions – also for systemically important banks (SIB's) – without having to call on taxpayers; iii) to maintain the integrity of the Internal Market and iii) ensure the ability of banks to serve the real economy.

The current international approach to ensuring stability, safety and efficiency in the banking sector is based on better capturing and pricing of risk and adjusting regulation concurrently. The EBF is convinced that such an incentive-based approach is an apt answer. It focuses on the identification of negative externalities and the creation of tailored responses, which maintain the overall efficiency of the financial system and ensure consistency across the

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financial sector (both banking and non-banking sectors). By contrast structural reform attempts to do the reverse. Instead of adapting regulation to emerging risks, it attempts to change the system itself to avoid the emergence of risks in parts of the system. This is fundamentally an interventionist solution based on prohibition rather than creating incentives to avoid excessive build-up of risk across certain activities.

It should be kept in mind that the ongoing regulatory reform is in itself to be considered a structural change that already has - and will lead to - further restructuring of the European banking sector. Among other things the new liquidity and capital requirements as well as the expected bank resolution measures will pressure banks to raise cost-effectiveness, improve their capital levels and at times lead to further divestment away from non-core assets. The European Commission in its recent Financial Integration report[1] shares this forecast of further restructuring of banks spurred by the ongoing regulatory reforms.

The current examples of structural reform in the UK and US were commenced earlier and therefore have neither been able to take the breadth of the international regulatory reform process nor this re-structuring process of the European Banking sector into consideration. The success or not of those examples of structural reform are still unknown.

The same applies to the regulatory reform agenda in Europe. It must be stressed that we still need to see the full impact and practical functioning of the regulatory reform agenda. Many of the proposals – some of them with considerable effect on the European financial sector, as for example MIFID/MIFIR and CRD IV/CRR – are still in process. And further proposals are still to come – for example on SIFIs, another revision of the trading book and crisis management – that are critical to the attainment of a more stable financial sector.

Therefore, EBF finds that there is a need to implement the upcoming regulations first, before pressing ahead with discussions on possible additional structural reforms. A premature decision on structural reforms is likely to complicate and distract from the implementation of ongoing regulatory reforms and will also make it more difficult to evaluate the impact of regulatory reform. Furthermore EBF firmly believes that the finalisation of the regulatory reform agenda will reach the objectives mentioned in the mandate of the HLEG fully without the necessity of any additional structural measures.

It is already clear that the reform measures proposed in a period of economic downturn across the EU are dampening the capacity to generate growth through lending to households and enterprises. It is clear that all measures that regulate economic activity carry an impact and must be carefully weighed in terms of cost/benefit.

## Current and ongoing regulatory reforms will help reach the objectives

The international regulatory reform agenda initiated – and not yet completed – as a response to the financial crisis in 2008 is targeted to address the objectives mentioned in the mandate of the HLEG of ensuring a more stable financial sector by de-risking of the financial system and

[1] http://ec.europa.eu/internal_market/economic_analysis/docs/financial_integration_reports/20120426-efsir_en.pdf

protecting European taxpayers from having to step in to shore up banks. This ambitious regulatory reform package consists of a multitude of initiatives; among others prudential reform measures (capital requirements, liquidity standards), enhanced supervision (micro & macro), crisis intervention (DGS, crisis management, incl. recovery and resolutions plans - RRPs - and bail-in), capital markets reforms (reform of OTC derivatives, short selling & CDS and MIFID incl. investor protection) and remuneration policies, sanctions and governance. An overall view of how these initiatives address the objectives of the HLEG mandate is provided in **annex 1**.

In **annex 2** EBF describes the measures of the ongoing regulatory reform agenda that most effectively target the objectives mentioned in the mandate of the HLEG and which are indispensable to address the aim of the HLEG: strengthened prudential measures, enhanced supervision, crisis management, RRPs and bail-in.

EBF finds that the EU can do more, without negative impacts on the economy, by completing the proposed EU-wide crisis management framework, including RRPs and bail-in, and by a further strengthening of supervision, where the foundation already has been laid by the implementation of a new supervisory architecture. Regarding the latter, macro prudential oversight has the potential to contribute to the objectives mentioned in the Liikanen Group's mandate while not undermining competitiveness of the EU and without restricting activities that are integral to the Single Market (i.e. freedom of movement of capital between Member States via wholesale markets).

**Question 2:**
***Which structural reforms would improve the safety and efficiency of the banking system in the EU in the near term? In the long term?***

As stated in the answer to question 1 the European Banking Federation considers the ongoing regulatory reform in itself a change of structural nature that already has - and will lead to - further restructuring of the European banking sector. EBF is therefore not convinced that structural reform will improve the safety and efficiency of the EU banking system.

The EBF believes that in the short-term it is indispensable that Europe agrees on an EU wide crisis management regime that is consistent with the internationally applicable principles. This crisis management regime should put forward the elements for crisis prevention to include bank resolution in an orderly manner. EBF supports the emphasis that is being placed on the use of recovery and resolutions plans and debt write-down (bail-in) instruments to restrict the contagion effects of lingering uncertainty over an institution under market suspicion. An EU-wide framework would overcome the difficulty that not all Member States currently have bank-specific resolution regimes and further harmonization of legal insolvency regimes may be required.

Resumption of the stalled financial integration process will be necessary for benefits in the longer term. It has, however, become clear throughout the financial crisis that further integration of macroeconomic and fiscal policies is called for. Member States have commenced to follow this road but more needs to be done.

**Question 3:**

***What are your views on the structural reform proposals to date (e.g. US Volcker Rule, UK ICB proposal)? What would be the implications of these proposals on your institution and the financial system as a whole?***

## A. View on structural reform proposals

The recommendations made by the Vickers Commission in the UK and the so-called Volcker rule in the USA need to be understood in their context and time. After the introduction of the aforementioned structural measures in the UK and the USA, there has been a large number of regulatory initiatives that will significantly strengthen the resilience of the EU banking sector and more measures are still to come

There is no evidence that the financial crisis was driven by the structure of the EU banking sector or the business models in use. Bank failures did not concentrate on certain types of banking structures or models. This needs to be borne in mind when determining what further steps are appropriate at the EU level.

There is no convincing evidence that structural reform measures have a direct influence on systemic risk and would make restructuring or resolution easier in the event of a crisis. The fact is that structural reform will not be able to totally eliminate interconnectedness, and thus channels of contagion, in the banking sector. Systemic risk is largely independent of a bank's business model or the structure of the banking sector. This view is backed up by a recent ECB study[2], which finds that a bank's business model cannot protect it from getting into financial difficulties. On the contrary, the study demonstrates that all business models contain parameters with the potential to make banking more or less risky. The solution is therefore not to prescribe certain business models.

It must be kept in mind that all banking activity *involves risk taking by a bank*. Banks by their very nature, therefore, must carry and manage that risk in order to meet the needs of their customers and the economy. Removing that risk from banks implies either removing it from the economy or placing it outside of the regulated banking sector, i.e. to the shadow banking sector.

## B. Implication of structural reforms on financial institutions

One of the main implications, common to both the Vickers report and the Volcker rule, is that these proposals will intervene in the structure of a banking model that has been developing across Europe: that of diversified banks (i.e. banks that combine different banking activities; for example investment banking and corporate banking[3]).

However, the financial crisis did not demonstrate the weakness of diversified banks and it would therefore be wrong to consider the concept of diversified banks as one of the main causes of the crisis, which has to be tackled with "structural" measures.

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[2] http://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1394.pdf

[3] *Definition used in the ECB's report on EU Banking Structures published in September 2010.*

On the contrary, a balanced diversification of sources of revenues and of funding represents a clear asset to preserve the stability of financial institutions, having the capacity to absorb external shocks in a much more resilient way than a specialized entity could do. Any intervention that would severely impact on the organization and functioning of diversified banks needs to be assessed against the potential impact on the stability of these banks.

The ECB's report on EU Banking Structures[4] provides empirical evidence that diversified banks have been less affected by the financial crisis and argues that diversified banks have a greater resilience based on clear synergies between private banking, retail and corporate banking and investment banking. Diversified full-service banks are diversified by geography, product lines and customers and this helps to diversify risk and reduce concentrations. Overall, this is beneficial to financial stability.

This being said, diversified banks have certain characteristics in terms of risk, which have to be reflected in regulation, supervision and internal risk management.

However, as mentioned in the answer to question 1 a possible way to keep risks under control for diversified banks is strong supervision, systematically based on scenario analysis and stress tests, coordinated by EBA, and based on the input of the ESRB. Such an approach allows the universal banks to benefit as much as possible from optimal diversification, which is also good for financial stability, while eliminating the risk of extreme strategies. Hence the aim of the supervision should be to pursue a "balanced" diversified bank, which profits to a maximum degree from diversification between market segments.

Many of the arguments mentioned above, whilst being formulated in the context of the potential impact on the business model of diversified banks, most common in the EU, are nonetheless also valid to more specialized business models.

For example, even "pure" retail banks have to adjust their risk profiles, taking positions in the wholesale markets since interest rate risk, credit risk, etc. have to be continuously and dynamically managed. Limiting the possibility of banks to manage actively their risk profile using transactions on wholesale markets would increase their risks considerably.

Also it should be kept in mind that separation of structures would lead to a profound reorganisation of banks generating high organizational and administrative costs and reduction of economies of scale (and scope) and efficiency.

## C. Implication on financial system as a whole

Structural reform measures risk having a detrimental impact on the European financial sector by increasing the overall risk of the sector instead of decreasing it. Apart from limiting banks in their risk management – and thereby raising the overall risk level – structural reform measures would also harm the role of European banks as "adjusters" of the balance between structural surpluses and deficits in EU member states. For example, Belgium has a cumulated surplus of savings, which has to be invested outside the country. On the other hand, the Netherlands have a structural deficit of deposits in comparison to the demand of credit which make Dutch banks net importers of foreign capital. Cross border flows of funds are essential

[4] *Ibid.*

for open economies. They are one of the major reasons for the creation of the European internal financial market. Banks are the natural intermediaries to bring demand and supply of funds in balance through importing or exporting capital by using wholesale financial markets. A restriction on banks fulfilling that role would increase the risk of credit crunches in some Member States, and overheated asset markets in others.

Furthermore structural measures would affect the current heterogeneity of the European banking sector negatively. A diversified banking landscape is in itself already a strong protection against financial shocks as different banking types react differently to specific events. Having small and large banks, domestic and international banks, specialised and diversified banks contributes to a diversified, competitive and stable banking sector.

In addition structural measures would make banks unable to serve adequately the growing demand for integrated services, especially from the European small and medium-sized enterprise (SME) segment. In many markets there is a significant, and growing, demand from SME customers for investment banking products - for example for hedging purposes. These factors are widely observable in the EU where companies, including SMEs, act increasingly across borders within the EU and globally. Preventing European banks from providing this one-stop function will raise the administrative burden for especially SMEs, and also risks harming the competitiveness of European banks and their customers vis-à-vis third countries not affected by such constraints.

Therefore, it is the view of EBF that given the nature of the banking sector in the EU, the lessons that can be drawn from the financial crisis and the structure of economies of the EU countries, the disadvantages deriving from a potential adoption of UK- or US-style structural reforms for the EU would be much larger than the eventual benefits that they would generate.

**Question 4 :**

***What are the main challenges of your financial institution as regards resolvability? Are you implementing structural changes to your institution in the framework of your recovery and resolution planning?***

The main challenge for European banks in regard to resolvability is that there is still no common legal framework for resolution of banks in EU – or globally. Hence, reaching agreement on the EU crisis management framework is absolutely key to strengthening the arrangements for cross-border resolution. While many individual Member States now have bank-specific resolution measures in place on a domestic basis (but not all), there is much to be achieved from the adoption of a harmonised regime which could sit at the heart of enhanced supervisory cooperation across Member States. An EU-level approach would also encourage further progress on the putting in place of reciprocal arrangements on common lines in third countries.

As mentioned in the answer to questions 1 and 2, the European Banking Federation views the use of RRPs as important for resolvability without detrimental side-effects upon the functioning of the Single Market and banks' ability to serve the wider economy. RRPs are preventative in nature and result in structural questions being considered in a close dialogue between individual banks and their lead supervisory authority. A pre-requisite to the drawing up of RRPs is the establishment of an appropriate crisis management regime in which the authorities have clear resolution powers. These exist in some Member States but have not as yet been introduced across all in a consistent manner. It is for this reason that the proposed EU Crisis Management Directive is seen as being of vital importance.

The drawing up of an RRP can be a substantial task since they require a thorough understanding of a bank's structure and of the degree of reliance which can be placed upon centralized functions such as IT, HR and other shared services. This requires a close understanding of how critical economic functions will be supported both in the event of a bank in financial difficulty following its recovery path and in the event of the banking supervisors triggering resolution. RRPs could also carry an additional advantage by getting banks to look at their legal structure, which can in cross-border groups become quite complex without the bank necessarily having chosen for such complexities. The supervisory community across Europe has different preferences for activities and structures that do not always simplify the overall structure of a cross-border bank.

A further key challenge arises from the lack of clarity about how different resolution authorities might act in the case of failure of an internationally active bank.  Our preferred approach is based on crisis management colleges, with test running supported by comprehensive MOUs, with the aim of avoiding or minimising trapped pools of liquidity and capital.

However, it must be stressed that RRPs or other preventive measures should not be used for supervisory intervention in the structure or operation of healthy financial institutions.

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## Annex 1: Overview table of regulatory reform measures and correspondence with objectives in HLEG mandate

| Objectives mentioned in HLEG mandate / Regulatory measures | Financial stability (micro) | Financial stability (macro) | Orderly resolution/( avoid call on taxpayers) | Consumer & investor protection | Maintain integrity of internal market |
|---|---|---|---|---|---|
| Capital requirements | + (enhanced loss absorbency significantly reduces micro-risk) | + (financial sector better to absorb shocks from financial + economic stress thereby reducing spill-over to real economy) | + (more resilient banking sector prevent taxpayer to step in) | | |
| Liquidity | + (better liquidity risk management/ liquidity buffers increase resilience of banks in situations of stress) | + (reduce probability of liquidity shortage/liquidity stress situation in the financial system) | + (more resilient banking sector prevent taxpayer stepping in) | | |
| SIB regulation | + (G-SIB buffer) | + (enhanced supervision + more loss absorbency decrease contribution to systemic risk) | + (resolvability assessment + RRPs for G-SIBS) | | |
| Enhanced supervision | + (ESAs + strengthened cross-border supervisory cooperation + broadened pillar II mandate for national regulators) | + (ESRB – identifying + addressing systemic risk) | + (enhanced supervisory cooperation on cross-border banks + EBA coordinate, participate and ensure consistency in resolution) | + (ESAs tasked with promoting transparency, simplicity and fairness for customers) | + (ESAs to ensure regulatory level playing field) |
| DGS | + (minimize probability of bank-runs, better DGS information) | + (depositor confidence in system, reduce bankruptcy spill-over) | + (contributes to orderly resolution both case of resolution and failure) | + (enhanced depositor protection) | |
| Crisis management | + (sufficient tools for national supervisors to | + (no interruption of vital bank services, avoid rubbing off | + (enhanced prevention measures, early intervention, | + (access to essential financial functions is | |

| Objectives mentioned in HLEG mandate / Regulatory measures | Financial stability (micro) | Financial stability (macro) | Orderly resolution/( avoid call on taxpayers) | Consumer & investor protection | Maintain integrity of internal market |
|---|---|---|---|---|---|
| | identify + handle problems in a bank) | effect on wider financial system) | crisis management tools, bail-in, resolution funding) | ensured, covered depositors protected) | |
| OTC derivates reform (EMIR) | + (increase transparency, mitigate risk, better supervision of CCP's + better OTC information) | + (increase transparency, mitigate risk, better supervision of CCP's + better OTC information) | | | |
| Short selling and CDS | + (Increase transparency by disclosure requirements, reduction of settlement risk etc.) | + (emergency powers for national regulators +ESMA as coordinator) | | | |
| MIFID (/MAD) | + (increase transparency of market segments, addressing HFT) | + (increase transparency of market segments, Extension of regulation to non-regulated trading platforms + extension of supervisory scope) | | + (enhance consumer protection by establishing a sound, effective and consistent level of regulation and supervision and foster public confidence) | + (guarantee competitiveness, efficiency + integrity of EU financial markets. Ex. provision on equal access +fees)<br>+ (ensure level playing field) |
| Credit rating agency reform | + (enhanced supervision, disclosure requirements, reduction of overreliance on ratings) | + (enhanced supervision, disclosure requirements, reduction of overreliance on ratings) | | | |
| Remuneration | + (avoid excessive risk-taking by individual credit institutions)<br>+ (reinforces the role of the supervisors and empowers them to assess the remuneration schemes in the broader context of sound risk management) | + (prevent also the accumulation of excessive risk in the financial system) | | | + (prevents also regulatory arbitrage in the single market) |

| Objectives mentioned in HLEG mandate / Regulatory measures | Financial stability (micro) | Financial stability (macro) | Orderly resolution/( avoid call on taxpayers) | Consumer & investor protection | Maintain integrity of internal market |
|---|---|---|---|---|---|
| Sanctions | + (expected to contribute to the consistent application and effective enforcement of the rules) | + (expected to improve the stability and the functioning of the financial system) | | + (tackles risks which could undermine consumer protection) | + (tackles risks which could undermine market integrity) |
| Corporate governance | + (it is expected that institutions will become more resilient against adverse market conditions) | + (the fact that institutions are more resilient will contribute to the stability of the financial sector) | | | |

## The European Banking Federation's answer to the Consultation by the Liikanen High-level Expert Group on possible reforms to the structure of the EU banking sector

## Annex 2: Description of prudential measures, supervision and crisis intervention measures

### Strengthened prudential reform measures

*Capital requirements*

Banking regulation and supervision in Europe - but also globally - is subject to a process of intense reform. The driver for that reform is the government-driven G20 roadmap. A number of remedial actions have already been taken in the past by the regulators/supervisors and the European banking industry in the aftermath of the crisis. As for the *Basel Accord*, new measures include:

- Strengthening the quantity and quality of capital, including an increase of the tranche of the highest quality capital (core equity tier 1) from 2% to 4.5% and the introduction of a capital conservation buffer of 2.5%; in addition, a new countercyclical buffer, meant to prevent excessive credit growth, could add up to 2.5% additional capital.
- A new framework for counterparty credit risk;
- The introduction of a leverage ratio as a backstop measure.
- A reassessment of capital treatment of banks' trading book ("Basel 2.5").

All of these measures are intended to increase the financial stability from a micro-prudential standpoint. They also contribute to a safer banking sector thus improving the resilience of the industry at large and further protecting the taxpayer from stepping in. However, the implementation of the Basel III framework - CRD IV/CRR in the EU - should be consistent across the EU; an uncoordinated implementation in different Member States could put at risk the objective of the Single rulebook.

In addition to the Basel III capital requirements, the G20 has agreed upon the implementation of a capital buffer for global systemically important banks from 1% to 2.5% of risk weighted assets, with the possibility of being extended to 3.5%.

*Liquidity standards*

The Basel III proposal also includes two new liquidity standards: The Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR).

The LCR aims to ensure that a bank maintains an adequate level of unencumbered, high quality assets that can be converted into cash to meet its liquidity needs for a 30-day time horizon under an acute liquidity stress scenario specified by supervisors. At a minimum, the stock of liquid assets should enable the bank to survive until day 30 of the proposed stress scenario, by which time it is assumed that appropriate actions can be taken by management and/or supervisors, and/or the bank can be resolved in an orderly way.

The NSFR aims to promote more medium and long-term funding of the assets and activities of banking organizations. This metric establishes a minimum acceptable amount of stable funding based on the liquidity characteristics of an institution's assets and activities over a one year horizon.

This standard is designed to act as a minimum enforcement mechanism to complement the LCR and reinforce other supervisory efforts by encouraging structural changes in the liquidity risk profiles of institutions away from short-term funding mismatches and toward more stable, longer-term funding of assets and business activities. The NSF standard is defined as a ratio of available amount of stable funding to a required amount of stable funding. This ratio must be greater than 100%.

The main aim of the liquidity standards is to ensure better management of liquidity risk minimizing the likelihood of individual banks experiencing difficulties in funding their liquidity needs as well as avoiding a situation where the banking system comes under severe stress again – i.e. a more stable banking sector.

*Enhanced supervision (micro and macro)*

Besides the deficiencies of the existing prudential rules, the financial crisis has highlighted the structural weaknesses of the EU supervisory architecture, which failed to anticipate and to resolve the collapse of several cross-border banking institutions.
As a strong and quick response to the deficiencies pointed out by the de Larosière group, the EU lawmakers agreed on a major overhaul of the supervisory architecture and decided to create:

- At the micro-prudential level, the European System of Financial Supervisors (the ESFS), transforming the existing Level 3 Committees (CEBS, CEIOPS and CESR) into European Supervisory Authorities (the ESAs)
- At the macro-prudential level, the European Systemic Risk Board (the ESRB) in charge of identifying, examining and reporting on vulnerabilities in the Single Market.

**European Supervisory Authorities**

The ESAs, and more specifically the EBA in the area of banking supervision, have been operational since January 1st, 2011. Even if the national supervisors keep the responsibility of the day-to-day supervision, the ESAs are given binding powers over national supervisors in seven broad areas:

- Power to intervene directly in emergency situations;
- Power to settle disputes between national supervisors;
- Exclusive supervisory powers over credit rating agencies (ESMA only);
- Power to issue binding technical standards;
- Power to intervene directly against institutions breaching EU law;
- Power to issue guidelines and recommendations;
- Power to coordinate peer reviews between national supervisors

The ESAs will ensure the consistency and the convergence of supervisory rules and practices, and will boost efforts to create a level playing field in regulation and supervision through full harmonisation and peer reviews. National supervisors will have to demonstrate that they have

the resources and take the actions required by their peers, and onsite inspections by international delegations will become more frequent and more inquisitive.
Against this background, the EBA will have a leading role in ensuring the consistent and coherent functioning of the colleges of supervisors, with a view to streamlining their functioning and the exchange of information. It is also worth noting that the new CRR / CRD 4 framework further strengthens the powers of national supervisors, which will be allowed to intervene in a more intrusive way and at an early stage, i.e. when they consider that the institution is likely to breach the prudential rules.

**The European Systemic Risk Board**

The ESRB has been tasked with the objective of Identifying and prioritising systemic risks; Monitoring the regulatory perimeter to identify risks emerging outside the regulated sector; Issuing risk warnings and making recommendations to mitigate those risks; and coordinating the work of the European Supervisory Authorities and engaging with the work of the IMF and World Bank.
The ESRB has identified three principles to underpin the framework in which this work will take place:

- Flexibility: the European authorities and Member States must have the ability to, at their discretion, require additional disclosures or to temporarily tighten a number of Pillar 1 metrics, such as aggregate capital levels, liquidity requirements or leverage limits;
- Scope to act early and effectively: Macro-prudential authorities should act before the build-up of significant imbalances or unsustainable interconnections develop; and
- Efficient coordination: Member States must coordinate their actions and exchange information via the ESRB to mitigate against negative externalities or unintended consequences.

Together, the ESRB principles will support the development of a suite of macro-prudential tools which will enable supervisors firstly to identify risks to European financial stability and second to take action to mitigate those risks. This is a vital enhancement to the European supervisory regime and one which has been replicated internationally and promoted by the G20.

EBF strongly believes that the revamping of the supervisory architecture outlined above will significantly minimize the systemic and fiscal consequences of bank failures, and will reduce moral hazard, bearing in mind that enhanced supervision and prevention should be the key to avoid the use of the resolution tools. There is no doubt that the European Supervisory Authorities will evolve over time towards a more integrated framework, interacting with the European Systemic Risk Board in order to liaise the micro-prudential and the macro-prudential perspectives.

Coupled with the overhaul of the prudential rules, this new architecture constitutes the right way forward and makes any reform of the structure of the EU banking sector unnecessary and redundant.

*Crisis Management*

The European Commission has indicated that rules are needed to enable the effective crisis management and re-organisation or well-organised liquidation of a failing cross-border bank. The objective is to ensure that all national supervisory authorities have the tools required to identify problems in the banks at a sufficiently early stage and intervene in order to restore a bank or group of companies or prevent further decline. A further objective is to enable banks that operate across borders to go bankrupt/be phased out without the interruption of vital bank services or problems spreading to the financial system as a whole.
The awaited proposal for a crisis management directive establishes preventative, recovery and crisis resolution measures and procedures applicable to banks. This includes the creation of national resolution authorities, more risk-based supervision, Recovery and Resolution Plans, early intervention powers, resolution tools and powers, cross-border resolution procedures, bail-in tools and resolution funding.

- It is proposed that a crisis management regime be put into use if a bank is failing or likely to fail and it is unlikely to be able to meet the supervisory authorities' requirements within a reasonable time. The crisis management authorities should be conferred with a number of crisis resolution powers, including the possibility of selling the company, using a bridge bank model, separating activities as well as the possibility of writing off/converting debt (bail-in).

- It is proposed that requirements concerning a national "resolution fund" be introduced to provide coverage in the event of losses and expenses beyond the capital and the unsecured creditors. All institutions must contribute to the fund. The resolution fund can be part of the DGS Fund.

According to the principle that "Prevention is better than cure", the EBF is supportive of the creation of a crisis management framework as the one described. An effective crisis management framework in which all banks are required to comply with tight preventative measures and all creditors suffer losses before taxpayers is a superior tool for curbing systemic risk compared to structural reform.

*Recovery and resolution plans (RRPs)*

As mentioned the Recovery and resolution plans (RRPs) are an essential part of an all-encompassing crisis management framework (i.e., covering preventative, coordination, recovery and resolution measures) and a strong emphasis should be given to preventative and early intervention tools, the proper exercise and deployment of which are likely to have less detrimental impact than the deployment of resolution tools. However, a reasonable balance must be struck between effective, robust supervision and supervisory approaches which are overly intrusive into the normal, day-to-day running of a healthy business.
RRPs are vital components of the solution to addressing risk associated with SIFIs, in the following way:

- A recovery plan setting out how a bank would respond to a severe stress including a capital recovery plan and a liquidity recovery plan. Plans will need to demonstrate the extent to which recovery could be supported by management actions to reduce the risk to which the business is exposed. The plan should also cover how the firm would cope with the failure of its largest counterparties – a 'contagion control plan'. Recovery plans are clearly the domain of the bank itself, but should be subject to robust challenge by its supervisor.

- A resolution plan aimed at putting the authorities in a position to be able to use any of the options open to them under the SRR and insolvency arrangements. The authorities want to be assured that firms are able to provide in potentially very short timescales data needed to assess the resolution options and to execute the chosen strategy.

*Bail-in*

Further to RRPs the bail-in tool can be potentially useful to combat the too big to fail syndrome and therefore reduce moral hazard. As a result, the price at which banks can access funding will increase and incentives for over-leveraging will be significantly reduced. At the same time, the bail-in could potentially help to smooth the process of resolution by creating an additional buffer that could be deployed to cover losses without the need for public support or a systemically disruptive bankruptcy process.

However, the timing and the implementation of any bail-in mechanism must be carefully thought through to avoid imposing an excessive funding cost that could impair the provision of credit to the real economy and result in an excessive deleveraging, particularly at this time of financial and economic fragility. Any attempt to rapidly introduce a bail-in process could jeopardise the economic recovery. Nonetheless other parts of the framework such as the various preventative measures and empowerment of resolution authorities with resolution tools (e.g. bridge bank, asset separation) could be implemented at an earlier stage without causing market disruption and could potentially significantly enhance the framework in the short term.

Key parts of the discussion on bail-in include the scope of the liabilities eligible for bail-in. A narrow definition of bail-in-able debt could lead to incentives for arbitrage. In this case to avoid this risk, and to ensure there is a sufficient quantity of bail-in-able debt, authorities may regard it as necessary to establish a minimum quantity. Such a minimum quantity would effectively translate into the creation of a new layer of capital with subsequent funding costs.

An alternative option would be a wider scope, in which the majority of liabilities could be affected by bail-in. This could also reduce the possibilities of arbitrage and therefore the need for a minimum, thus preserving the concept of a pure debt instrument and mitigating the potential impact on funding structures and costs.

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