Erkki Liikanen: The proposed regulation on structural measures for banks

Comments by Mr Erkki Liikanen, Governor of the Bank of Finland and Chairman of the High-level Expert Group on reforming the structure of the EU banking sector, on the European Commission's proposal of 29 January 2014 for a regulation on the separation of certain trading activities from credit institutions.

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The European Commission has today presented a regulatory proposal based on the report of the High-level Expert Group on reforming the structure of the EU banking sector.

In October 2012 our Group proposed that proprietary trading and certain risky trading activities including market-making as well as exposures to shadow banking entities such as hedge funds ought to be separated from deposit-taking and lending activities.

The Commission proposal has the same objectives as the recommendations in our final report. The set of activities which the proposal would affect are also similar.

In some respects, the proposed Regulation does, however, differ from our recommendations. The Commission's proposal includes an outright ban on organised proprietary trading instead of requiring it to be assigned to a separate and separately capitalised legal entity. In this respect the Commission proposal resembles the structural reform implemented in the United States. This would allow for regulatory convergence at the international level.

As for market-making, risky securitisation and complex derivatives, the proposal empowers the competent authority to require separation when specific conditions prevail and also empowers the competent authority to require separation of other trading activities.

The High-level Expert Group asked the Commission to work on the calibration of the thresholds for application of the new rules. The Commission has accordingly included the thresholds in its proposal. The proposal would cover the largest and most trading-intense banks in Europe.

While striving for the same objectives as the High-level Expert Group, the Commission proposal leaves an important role for the future judgment of the competent authorities, the EBA and the Commission itself.

In implementation of the Regulation, the Commission could grant individual credit institutions derogations from application of the Regulation if national primary law in their home country is already adopted and considered at least as stringent as the Regulation itself.

Moreover, competent authorities or Member States may decide to impose similar measures also on some smaller banks, or exempt some qualifying banks from the requirement if these banks can demonstrate that they do not compromise the objectives of the Regulation or threaten financial stability.

These elements of discretion entrust the competent authorities, the EBA and the Commission with a significant responsibility for ensuring that the objectives of the Regulation are achieved without compromising the level playing field in banking and the integrity of the internal market. It is important that the Regulation is implemented in a coherent manner throughout the EU.

I welcome the Commission's proposal for the Regulation on the separation of certain trading activities from credit institutions. Depending on how it is applied, this Regulation could bring about needed structural changes in the largest and most systemically important European banks, as envisaged by our Group.

The proposed Regulation would give the authorities powers to implement a structural reform that would prevent depositor protection from becoming an incentive for banks to engage in excessive risk-taking. Together with the forthcoming EU framework for bank recovery and resolution, the proposed Regulation would also reduce the pervasive too-big-to-fail and too-complex-to-fail problems in Europe.

The proposal could also curtail interconnectedness within the financial system and hence reduce the likelihood of contagion. If consistently implemented, it would improve market discipline and redirect the European banking sector towards better serving the real economy and sustainable growth.