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## REPORT

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From: Presidency  
To: Delegations

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Subject: Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND  
OF THE COUNCIL on structural measures improving the resilience of EU  
credit institutions  
*- Progress report*

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### I. INTRODUCTION

1. The Commission Proposal for a Regulation of the European Parliament and of the Council on structural measures improving the resilience of EU credit institutions was transmitted to the Council on 29 January 2014<sup>1</sup>.
2. Under the Italian Presidency, the Proposal (“Banking Structural Reform”, BSR) was examined by the Working Party on Financial Services at six meetings (2 July, 17 July, 24 September, 10 October, 28 October and 5 December 2014).
3. The European Economic and Social Committee and the European Central Bank delivered their opinions on 9 July 2014<sup>2</sup> and 21 November 2014<sup>3</sup> respectively.

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<sup>1</sup> Doc. 6022/14 + ADD1 to 4.

<sup>2</sup> Doc. 11828/14.

<sup>3</sup> Doc. 15924/14.

4. This progress report has been drawn up under the responsibility of the Presidency, on the basis of positions expressed by delegations at the aforementioned meetings of the Working Party on Financial Services, as well as in reply to several calls for written comments on the proposed provisions.
5. The examination carried out by the Working Party on Financial Services covered the whole text of the Commission proposal and focused particularly on the following topics:
  - the objectives and the scope of application of bank structural measures;
  - the definition of proprietary trading (PT) and the prohibition of PT;
  - the rules on the possible separation of some of the other trading activities;
  - the economic, legal and operational requirements in case of separation of the other trading activities in another legal entity;
  - the interaction between competent and resolution authorities;
  - the balance of powers between home and host competent authorities;
  - the derogation from the requirements on separation of certain trading activities.
6. In the meetings, in-depth discussions took place on the above-mentioned topics on the basis of non-papers presented by the Commission, presentations by Member States that have already structural reforms in place (BE, DE, FR, UK), a presentation by the ECB of its Opinion on the draft Regulation. Finally, the Presidency presented 3 non-papers: the first one summarized the main comments provided by Member States on the main policy issues raised by the Regulation, the other two presented some options on the possible way forward on some of the policy issues discussed. This report cannot be considered as binding on the delegations, but it does represent the Presidency's best assessment of the main outcomes of the discussions held on the bank structural reform, with a view to providing concrete and pragmatic orientation for the work ahead.

## **II. STATE OF PLAY AND POSSIBLE WAY FORWARD ON THE KEY POLICY ISSUES**

7. After a thorough discussion of the text of the proposal (started already under the Greek Presidency), on the basis of the comments received from the delegations, the Italian Presidency submitted to the Working Party on Financial Services some concrete options on some key policy issues with the aim of addressing the main concerns emerged and narrowing down the most important policy choices ahead. At the last meeting of the working party, on 5<sup>th</sup> December, the Italian Presidency also submitted to the delegations a first re-draft of some parts of the Regulation, building on the comments received. The aim was to test whether the direction proposed is the right one, rather than being a precise redrafting of the provisions. The Commission put a general scrutiny reservation on the re-drafting proposals. The state of play of the discussion on the key policy issues is presented below.

### **7.1 The treatment of proprietary trading (Articles 5-6)**

Several Member States deem the definition of proprietary trading adopted by the Commission easy to circumvent. As for the ban of proprietary trading, strong concerns were raised in the course of the negotiations; several countries prefer or are open to consider the separation of proprietary trading – appropriately defined - instead of its ban, because the costs of the latter could be higher than the benefits (for instance, prohibition of proprietary trading could be detrimental to the diversification of revenue sources, in particular geographically, which may be more relevant in downturns). These countries believe that it is always better to regulate in a stricter way than prohibiting certain activities, which would then be performed by less or non-regulated entities (shadow banking sector). Only very few countries are explicitly in favor of the PT ban. The ECB Opinion expressed instead support for the ban of PT defined in a narrow way as in the Commission’s proposal.

As to the prohibition to acquire or hold units or shares of AIFs, many MSs deem the provision unclear and too restrictive; for example, they are afraid it could end up hindering the financing of growth companies. Some Member States proposed to limit the provision only to highly leveraged AIFs.

Following the above-mentioned comments, the Presidency presented to the delegations some options on the definition and treatment of proprietary trading: it emerged from the discussion that the majority of countries are in favor of a broader definition of proprietary trading and of its separation.

The Presidency proposed some drafting suggestions along these lines at the last meeting of the working party. In doing so, the Presidency drew inspiration from the work already done at national level by some Member States which have already passed structural measures in their legislation and defined proprietary trading by difference with respect to a list of “allowed trading activities” (i.e. provision of services to clients, market making, treasury management, hedging, clearing of financial instruments, buying/selling financial instruments acquired with the intention of holding them durably). All that is not allowed is proprietary trading, and can only thus be performed by a separate legal entity within the group. A large number of delegations showed support for the direction of the proposed changes, that is, the preference for separation of PT defined along the lines illustrated above. However, the Presidency also underlined that many details remain to be defined in this framework, in order to avoid an unintended weakening of the requirements and for it to be enforceable. In particular, should in the end Member States go down this route, it is clear that, differently from the Commission’s proposal, where PT is prohibited - the drafting of Chapter II – where PT activities are separated - is very much linked to Chapter III (Separation). The concerned institutions will in fact have to demonstrate to the competent authority that their ‘allowed’ activities fall into the above-mentioned categories; to this end, the Regulation should specify a reporting framework and robust internal control mechanisms with the appropriate metrics to ensure that those activities do not involve proprietary trading. In turn, the set of mechanisms and controls to be developed are deeply linked with the provisions concerning the possible additional separation of (some or all of) these same trading activities, in the light of the metrics and criteria in the end decided.

As for AIFs, in view of the comments received, the Presidency proposed to work around a) the activities to be separated (e.g. only investments in units/shares of AIFs or also loans and other exposures to AIFs) and b) the type of AIFs to be considered (e.g. only those which use leverage on a substantial basis, as suggested by some Member States, or also others).

The Presidency proposed some drafting suggestions aiming at: including in the separation only highly-leveraged AIFs; capturing not only investments in units or shares of these AIFs, but also unsecured credit exposures and guarantees to these AIFs; capturing also investments in funds which in turn are invested above a certain percentage in leveraged AIFs. In the last working party, several Member States showed appreciation for the direction of the work, although several details will have to be specified also in this case, in order to avoid unwarranted loosening of the provisions.

## **7.2 The separation of the other trading activities and the exercise of supervisory discretion (Articles 8-10)**

Various countries strongly highlighted the need for relying on a greater degree of supervisory discretion when it comes to the separation decision; it is also to be considered that clear criteria and principles should be chosen to frame the supervisors' discretion in the European context, in order to ensure a level playing field. In addition, many countries believe that the metrics proposed by the Commission are too much based on size, while due attention should be paid to risk indicators to adequately capture the riskiness of banks' trading activities. More in general, many delegations have pointed out that any framework for separation should not be detrimental to the role played by market making activities in providing liquidity to the markets and to the universal banking model.

Finally, a few Member States underline that, after the separation, the trading entity might still be or become 'too big to fail' as a result of concentration of trading activities in order to reach the desired scale; this concern is also mentioned in the ECB opinion, which underlines therefore that the separation process has to be carefully monitored, in order to avoid unintended effects.

The Presidency started reflecting on how a greater degree of framed discretion could be introduced within the Regulation and proposed some ideas to the delegations for their consideration: in particular, the Presidency proposed to introduce a greater degree of framed discretion by changing the role played by the metrics in the Commission proposal.

The metrics, however defined, would not serve to trigger an immediate separation decision, but as criteria for the supervisors to assess the trading activities, leading for example to the application of stricter prudential measures in order to dissuade banks from engaging in excessively risky trading activities. Once a further financial stability assessment has been made by the competent authority, a separation could possibly be decided, if the bank still remains too risky. It has to be underlined that the ECB Opinion seems to indicate a similar line of reasoning: the assessment of the metrics should be complemented by the exercise of the consolidated supervisor's discretion, who should assess whether there is a threat to the financial stability of the core credit institution or of the whole or part of the Union financial system. In the design of such a framework, it would be very important to decide what trading activities – different from proprietary trading - should be subject to the specific internal controls and risk limitations.

If the approach mentioned above is chosen (separation of PT activities and reporting and control framework of the 'allowed' activities), the trading activities to be assessed should be the allowed ones. Concerning the metrics and criteria the supervisor should resort to for the assessment, the large majority of the Member States believe that only some of the metrics proposed by the Commission should be kept, and that in general they should be complemented by quantitative indicators that are more risk-based, such as the prudential indicators used by supervisors, as well as by qualitative criteria that could guide the competent authority in the exercise of its supervisory discretion.

In this regard, the ECB Opinion suggests a set of additional qualitative criteria that could be considered. In order to avoid excessive discretion by different supervisors and problems of level playing field, in the view of some Member States the metrics and criteria should be combined in such a way to provide an 'anchor' and a guide for the potential decision on separation.

### 7.3 The legal, economic and operation links between the core credit institution and the trading entity (Articles 13 and 14-17)

The discussion in the working party focused on the intra-group ownership structure and on the Large Exposures (LE) provisions. As to the ownership structure, the Commission's proposal envisages that the Core Credit Institution (CCI) cannot hold shares/voting rights in the trading entity. Some Member States maintained that the Regulation should be neutral as to the banks' choices in terms of ownership structure, since in their view the strength of the separation should be based on the other restrictions imposed (e.g. the large exposures rules). Other Member States supported the so-called 'holding company model', whereby a holding company holds both the CCI and the Trading Entity (TE) which are 'sister companies', as they see this model more appropriate to ensure effective separation and independence between the two legal entities. Given the differences of views, the Presidency proposed an initial re-drafting whereby the two legal structures are contemplated, but the difference in the structure is linked to more or less severe limits concerning the Large Exposures provisions; in particular, should the CCI be allowed to own the TE, then the LE rules should be more severe, so as to ensure separation and avoid contagion risks as much as possible.

As to the LE provisions, the majority view pointed to the need for sticking to the CRR framework for intragroup large exposures and for the credit-risk mitigation techniques when a separation decision is made; as for the extra-group limits, the majority view was that the 200% limit proposed in the Regulation was not sufficiently justified, it was not consistent with the CRR framework and should thus be removed. On the basis of the comments received, the Presidency proposed an initial re-drafting with the aim to simplify and align the LE provisions with the CRD IV /CRR framework, where specific rules are foreseen in case of a separation decision taken on the basis of national rules; the Presidency also proposed keeping derogations envisaged in the CRR during the transitional period. The direction of the work proposed was appreciated by several delegations.

#### **7.4 The interaction between competent and resolution authorities (Article 19)**

Member States voiced concerns about the lack of clarity on the respective competences and the cooperation framework applying to competent and resolution authorities. A clearer framework for the interaction between these authorities is necessary, so that consistency of decisions is ensured. The Presidency undertook to propose a re-drafting of the cooperation between the two authorities in order to ensure that: a) the competent authority is the one in charge of making the final decision; b) the measures imposed by the competent authority do not impede resolvability; c) the actions of the resolution authority do not impede the exercise of the competent authority's powers under the proposed Regulation; d) the efficiency of the decision-making process is safeguarded, thus avoiding overly complex consultation/decision making processes. At the last working party the Presidency proposed a drafting of the article according to the principles mentioned above, which met in general the support of the delegations. However, some Member States were not entirely satisfied yet, and some others made reference to the suggestions included in the ECB Opinion, whereby it is specified that, even where the resolvability assessment has not identified any substantive impediments to resolvability, the competent authority may nevertheless identify the need for structural measures under the proposed Regulation.



## 7.5 The powers and duties of home and host competent authorities (Article 26)

Several MS expressed concerns as to the model proposed by the Commission for the interaction between home and host competent authorities. Given that the Commission's proposal differs from the other banking legislations in the field of home-host powers, they fear that this could set a precedent. Moreover, Member States seem concerned that, after the separation, it could be convenient for the banking group to concentrate the trading activities in a single trading entity located in the home country or just in one foreign country for reasons of economies of scale, therefore trading activities in many host countries, in particular market making ones, would lose significance. This could make the provisions of services to the real economy more difficult and costly. Therefore, an appropriate involvement of the host authorities in the decision making process should be provided. On the basis of the comments received, the Presidency proposed to adapt the framework for cooperation already in place in other banking directives to the case in question. The existing legislations (CRR/CRD and BRRD) contain a number of provisions which could be useful in this regard. In the last working party, in its initial re-drafting of art. 26 the Presidency proposed to use the CRD/CRR type of joint decision for pillar II with binding mediation, which in its view lends itself better to be used for the case in question<sup>4</sup>. It has also to be decided whether the participation of the host authorities of subsidiaries in the decision on structural measures should take place in all cases or only when the trading activity of the subsidiary is material for the individual subsidiary, or when the potential effects on the financial stability of the local market are perceived as significant. The Presidency proposal opted for an approach which allowed for participation in the joint decision when the share of trading activities in the subsidiary's balance sheet total are considered to be material; only in these cases it would seem justified to set up a framework for joint decision and binding mediation.

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<sup>4</sup> In the BRRD it is foreseen a joint decision for resolution plans where binding mediation is possible only if no authority invokes a budgetary impact, and a joint decision for resolution action with non-binding mediation. In the view of the Presidency, the BRRD model does not seem to be adequate for the BSR case, because the non-binding mediation is not justified; by contrast, a consistent solution for the organizational structure of the bank has to be pursued.

The reaction of Member States was mixed: while those Member States representing primarily host authorities strongly appreciated the change from the lead supervisor model contained in the Commission proposal to a more balanced framework, they also in part disagreed with the model chosen for the joint decision, because they are in favor of the involvement of any host authority of a subsidiary of a banking group subject to separation, independently of its significance for the group or in the local market, and they prefer a model of non-binding mediation. Other Member States were instead in favor of a proportionate approach for the involvement of host authorities, for example on the basis of the systemic relevance of the subsidiary in the local market.

Another issue concerning the balance of powers among authorities is the interaction between the competent authority and the macro-prudential authority. Some Member States have argued that empowering the competent authority to adopt structural measures should be without prejudice to the possibility to add them to the toolkit of macro-prudential authorities, which could be empowered to impose capital add-ons at subsidiary level. This should be possible even in case the banking group as a whole is not separated as a result of the review of trading activities conducted by the consolidated supervisor. In the view of the Presidency, in order to avoid a situation in which the fragmentation of competences among different authorities at European and national level (competent authorities, resolution authorities, national macro-prudential authorities) unduly increases complexity and uncertainty about the respective responsibilities, this kind of concern could be dealt with by providing for the competent consolidating authority to take into account the financial stability concerns in the local market in carrying out the assessment on separation, possibly also on request by the national macro-prudential authority of the host subsidiary.

## 7.6 The proposed derogation from the structural measures (art. 21)

Art. 21 of the Commission proposal provides for the possibility for the Commission, upon request from a MS, to grant a derogation from the requirements of Chapter III (separation) to a credit institution which is subject to a national legislation which meets some criteria having an equivalent effect to the provisions of the proposed Regulation. Several Member States have objected to the derogation provision as currently designed, as it could create a precedent in financial services legislation and would not ensure a level playing field. Many countries affirmed that any kinds of flexibility should be open to all Member States on equal footing. The ECB Opinion contained the same concerns. The Council Legal Service issued an opinion on this provision, concluding that the current wording is not compatible with the legal basis of the proposal (Art. 114), the nature of the proposed instrument as defined in the TFEU and the general principles established in the Treaties. The Opinion also included some suggestions to remedy these shortcomings. Although no specific proposal has been discussed in the working party yet, the vast majority of Member States expressed widespread support to find a solution able to accommodate this specific situation and are open to look at various options. The Italian Presidency could not deal with this issue in the allowed time frame; the Latvian Presidency could therefore address it, in parallel with the concrete way forward on the other main policy issues identified.

## III. CONCLUSIONS

8. The Italian Presidency expects delegations to take note of this Progress Report, with a view to the incoming Latvian Presidency to further progressing work on the draft Regulation with a particular focus on the policy issues identified in this Report and the possible concrete solutions, and preparing negotiations with the European Parliament.