



EUROJÄRJESTELMÄ
EUROSYSTEMET

On the structural reform

Governor Erkki Liikanen

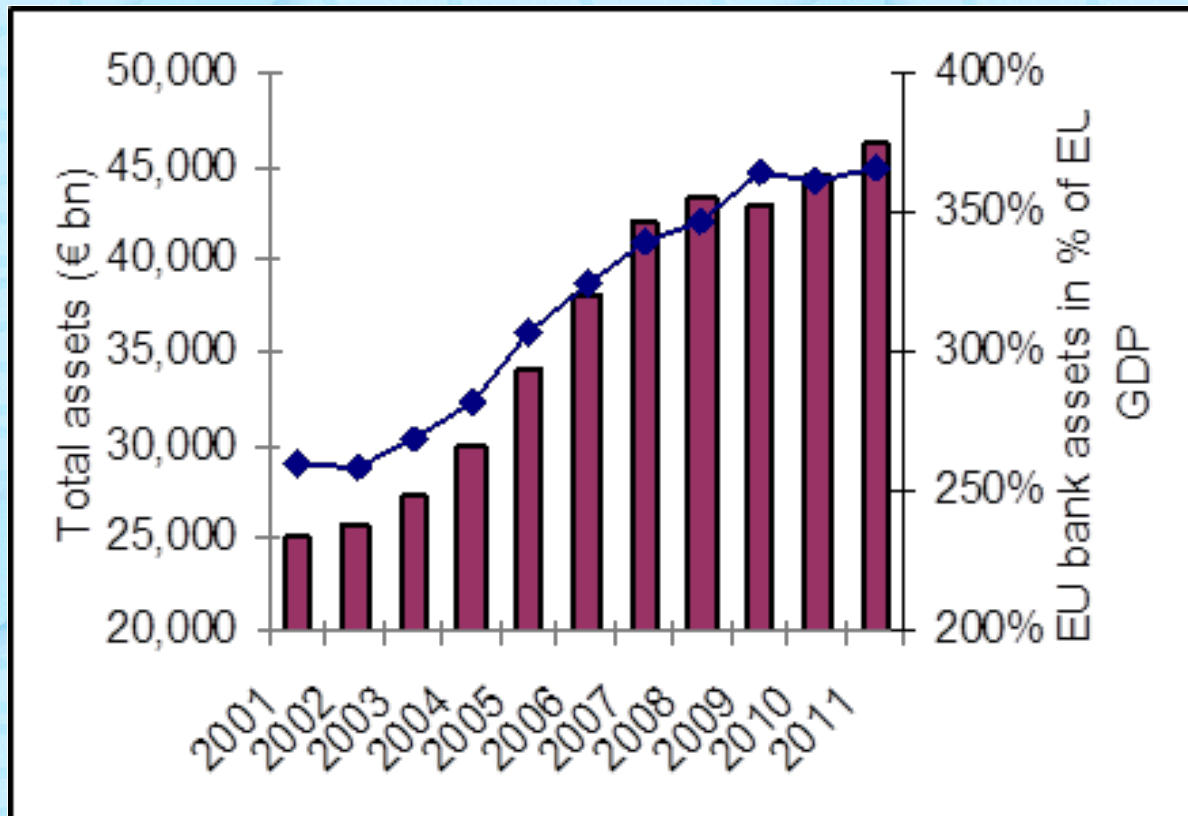
Chairman of the High-level Expert Group

ICMA Annual General Meeting and Conference

Copenhagen 23 May 2013

Rapid growth in the EU banking sector

Total assets of MFIs in EU 2001-2011

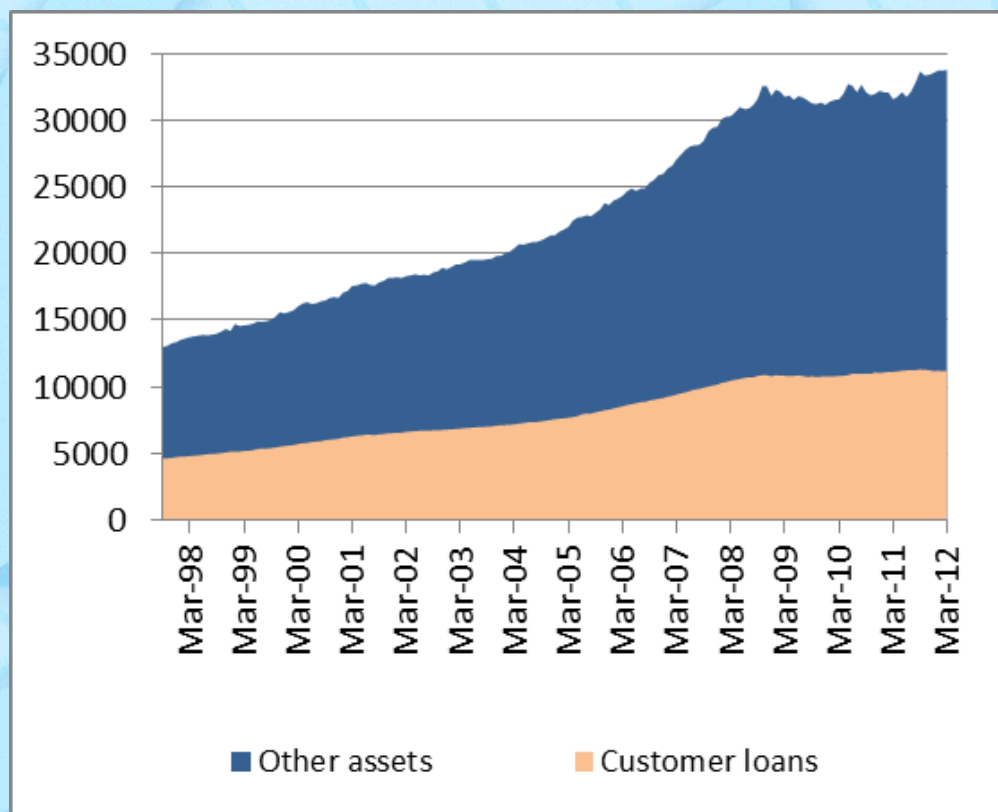


Note: Bar charts show total assets, dotted line shows assets as % of GDP

Source: ECB data as presented in High-level Expert Group Final Report

Shifts in focus of operations as illustrated by shifts in assets structures

Evolution of assets of MFIs in EU the euro area 1998-2012 (€billion)

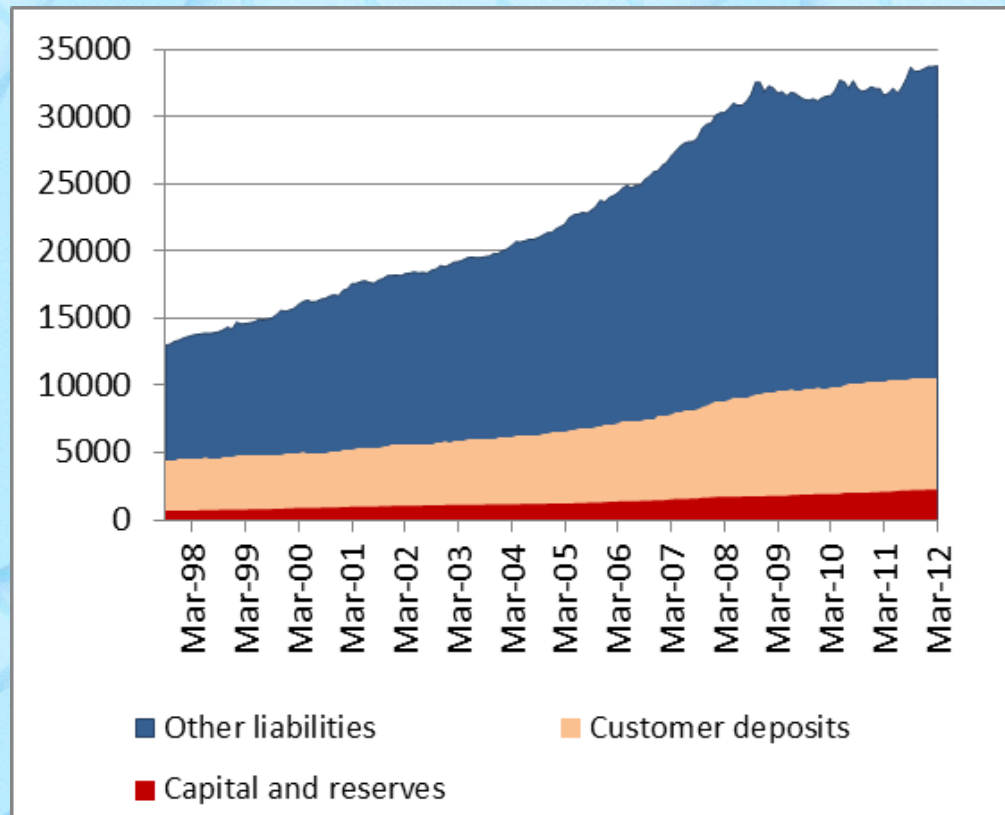


Notes: Customer loans are loans to non-monetary financial institutions excluding general government

Source: ECB data as presented in High-level Expert Group Final Report

Increased leverage as illustrated by shifts in funding structures

Evolution of liabilities of MFIs in the euro area 1998-2012 (€billion)



Notes: Customer deposits are deposits of non-monetary financial institutions excluding general government.

Source: ECB data as presented in High-level Expert Group Final Report

Summary of the problems in the EU banking sector identified by HLEG

Identified problem by HLEG

- Excessive risk-taking in trading, lending, funding
- Complexity (making bank management, monitoring, supervision and resolution challenging)
- Limited loss absorbency
- Intra-group subsidies
- Ineffective governance and control

- Interconnectedness
- Limited resolvability
- Bank-sovereign feedback loop

- Inadequate EU institutional framework
- Excessive focus on intra-financial business, as opposed to real economy
- Competitive distortions and implicit subsidies
- Inadequate consumer protection

Result

Increased probability of failure

Increased impact of failure

Reduced internal market efficiency and level playing field

Two avenues as a possible way forward were considered

◆ **Avenue 1**

- A non-risk weighted capital requirement is imposed on trading activities.
- Conditional separation of activities is imposed, if the bank cannot prove that the required recovery and resolution plan is credible.

◆ Cf. Darrell Duffie

◆ **Avenue 2**

- Mandatory separation of retail banking and investment banking is imposed on banks.

◆ Cf. Alan Blinder

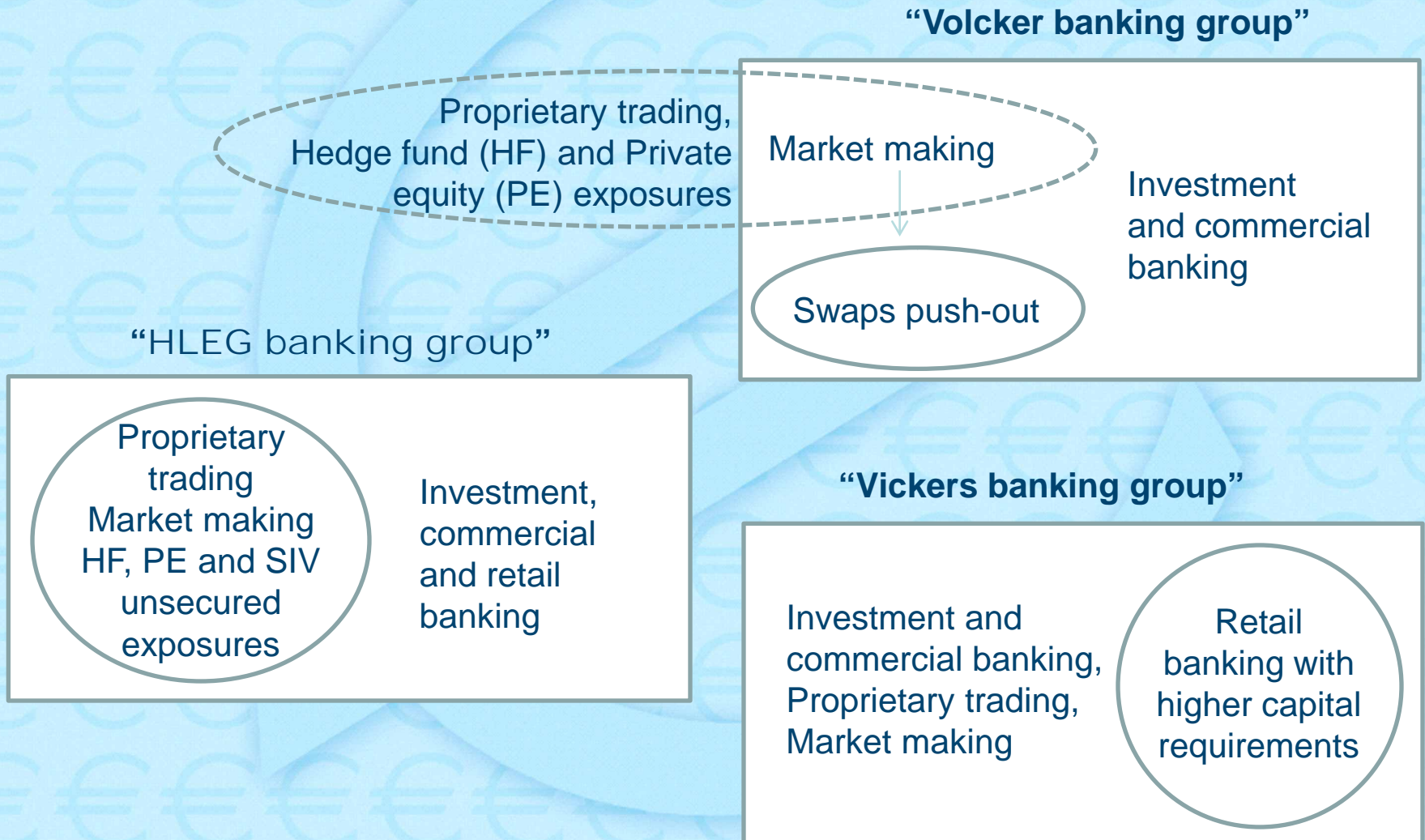
The High-level Expert Group's proposal for mandatory separation

- ◆ ***Activities separated to the “trading entity”:***
 - Proprietary trading and market-making
 - Loans, loan commitments and unsecured credit exposure to hedge funds, SIVs, and private equity investments
- ◆ ***Activities which are permitted to “deposit banks”:***
 - Hedged, client-driven transactions that fall within narrow risk position limits
 - Securities underwriting
- ◆ ***Activities permitted only to “deposit banks”***
 - Insured deposits and supply of retail payment services
- ◆ ***Restrictions on transfers and exposures between the separated entities***
- ◆ ***The entities can be operated within a banking group***

Rationale for mandatory separation

- ◆ ***Limit the spill-over of the effects of the deposit guarantee system and any implicit government guarantees, to the trading activities of banks***
 - Makes the pricing of funding of the separated entities more efficient and risk-based
- ◆ ***Reduce complexity and interconnectedness***
 - Enhances bank management
 - Facilitates supervision and monitoring thus reinforcing market discipline
 - Facilitates recovery and resolution and thus helps make it credible
- ◆ ***Reduce mixing of management cultures***

Comparison of suggested structural reforms



The five proposals of the High-level Expert Group

- 1. *Mandatory separation to deposit bank and trading entity***
- 2. *Additional separation requirement***
 - If the recovery and resolution plan otherwise not credible
- 3. *Bail-in instruments***
 - Pre-defined scope and terms to facilitate pricing and liquidity
- 4. *A review of capital requirements on trading assets and real estate related loans***
- 5. *Strengthening the governance and control of banks***
 - Including the use of bail-in instruments in compensation



Thank you!