AmCham EU's position on Bank Structural Reform

Executive summary

AmCham EU believes that the practical operation of recently adopted legislation (notably the BRRD, SRM and CRD IV/CRR I) needs to be properly assessed before further initiatives in the area of bank structural reform are pursued. In addition, we would question the benefit in terms of safeguarding financial stability of further legislation on bank structural reform, particularly in light of the implications for the real economy that may arise from a curtailment of liquidity that could develop if traditional providers of large-scale liquidity are no longer permitted to continue such activity or it is no longer viable. It is also essential that serious consideration is given to the potential implications of the draft Regulation on EU operations of non-EU headquartered firms. There remains significant uncertainty over how the draft Regulation will interact with other structural reform initiatives both within the EU and in other jurisdictions. Finally, the impact of the proposal on the functioning of the internal market needs to be taken into account.

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AmCham EU speaks for American companies committed to Europe on trade, investment and competitiveness issues. It aims to ensure a growth-orientated business and investment climate in Europe. AmCham EU facilitates the resolution of transatlantic issues that impact business and plays a role in creating better understanding of EU and US positions on business matters. Aggregate US investment in Europe totalled €2 trillion in 2013 and directly supports more than 4.3 million jobs in Europe.

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POSITION PAPER

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Introduction

The American Chamber of Commerce to the European Union ("AmCham EU") welcomes the opportunity to outline its position on the European Commission's draft "*Proposal for a Regulation…on structural measures improving the resilience of EU credit institutions"* ("the draft Regulation") of 29 January 2014. In general, the industry will need to carefully consider the European Commission's impact assessment, "*A reformed financial sector for Europe*" ("the comprehensive impact assessment") of 15 May 2014 before making detailed comments on the draft Regulation. This position paper (1) places the draft Regulation in the current regulatory context, (2) highlights some of the third country implications of the draft Regulation, (3) draws attention to the impact of the proposed measure on the internal market and (4) outlines areas where further clarity is required.

1. *Current regulatory framework*

It should be noted that a significant amount of work has already been undertaken to address the challenges posed by financial institutions that are considered to be "too big to fail". The Bank Recovery and Resolution Directive ("BRRD"), which is required to be implemented (save for the bail-in provisions) by EU Member States by 1 January 2015, is intended to ensure that all banks, regardless of their size or complexity, can be allowed to fail without imposing losses on taxpayers and in a way that does not threaten wider financial stability. Importantly, the BRRD already gives national supervisors the power to address impediments to the resolvability of financial institutions *ex ante*, including the power to remove structural impediments to their resolvability. The Single Resolution Mechanism ("SRM") further builds upon the BRRD for the Eurozone Member States. The further – and key – issue of principle here is that the Union's resolution frameworks make clear that ***all*** firms should be equally resolvable, while the draft Regulation implies that some must be kept safer than others. This will invite market speculation and undermine the credibility of the BRRD/SRM framework. Additional legislation on bank structural reform might be regarded as redundant against this background.

Additionally, the transposition of Basel III in the EU through the Capital Requirements Regulation ("CRR I") and the fourth revision to the Capital Requirements Directive ("CRD IV") has increased the quality and the quantity of capital that banks are required to hold. CRD IV/CRR I have also introduced an EU-wide liquidity regime in banking regulation for the first time. These reforms are expected to lead to significant changes in bank structure going forward and are intended to make banks safer. Increased capital standards contribute to addressing the "too big to fail" challenge and the perceived implicit funding subsidy. As a result, some of the issues that the draft Regulation is designed to address have arguably already been addressed.

AmCham EU queries the benefit in terms of safeguarding financial stability of further legislation on bank structural reform, particularly in light of the implications for the real economy that may arise from a curtailment of liquidity that could develop if traditional providers of large scale liquidity are either no longer permitted to continue such activity or it is no longer viable. The initial impact assessment of the European Commission concluded that there would not be any benefits to public finances. Moreover, given that legislative measures such as the BRRD, the SRM and the CRD IV/CRR I are still in the early stages of implementation, we would suggest that more time will be required to assess their operation in practice before pursuing additional structural legislative initiatives. In general, there is little evidence from the financial crisis that one bank model is superior to another – as the Liikanen group and the International Monetary Fund concluded.

2. *Third country implications*

AmCham EU is aware of the challenges caused by extra-territoriality and the need to limit the scope for duplicative or conflicting requirements. It is important that serious consideration be given to the way in which the draft Regulation will impact the EU operations of non-EU headquartered firms. In particular, there needs to be clarity around the treatment of branches and subsidiaries of non-EU firms and of how separation would work in practice. This is particularly important in light of the fact that (by Art. 9 1. (c)) EU branches of non-EU firms fall within the scope of the draft Regulation even where no 'core credit' business is undertaken; if intentional, this is a grave level-playing field risk.

There is still considerable uncertainty regarding the ways in which the draft Regulation will interact with the U.S. Volcker rule, the UK ring-fencing regime and other structural reform initiatives being implemented or under consideration in other EU Member States, in particular where the application of those national regimes to banks are determined by different standards (e.g. the application of the UK regime is subject to a minimum level of deposits). The differing national implementation timeframes with respect to such measures only add to the uncertainty.

In addition, the U.S. Volcker rule applies to EU branches of U.S. banks. These branches could also be subject to the Commission proposal and to legislation introduced by individual Member States, unless the European Commission makes an equivalence determination with respect to the U.S. It is currently unclear on what basis such an equivalence decision would be made and what the outcome would be. The proposed articles on derogation and equivalence lack clarity in terms of their implementation and their requirements as to cooperation with competent authorities of non-EU jurisdictions. As a result, it is unclear at present which third country jurisdictions (if any) would likely be deemed 'equivalent' and how reciprocity would apply in practice. Moreover, the equivalence provisions should apply to subsidiaries of third country headquartered firms, as well as branches, in instances where third country laws and regulations apply to such subsidiaries (again, Volcker is an apposite example).

Finally, particular care needs to be taken to ensure that the draft Regulation does not unintentionally favour the multiple point of entry approach to the cross-border resolution of internationally active banks over the single point of entry approach. AmCham EU is strongly of the view that the draft Regulation should be genuinely 'approach-agnostic'. This is important to facilitate the individual resolution strategies of financial institutions.

3. *Internal market impact*

As discussed, the draft Regulation provides for a derogation on application to the European Commission by the relevant Member State, provided that the respective Member State has a pre-existing scheme that meets certain conditions, including that it requires the separation of retail deposit-taking functions from trading activities. Nevertheless, it is currently unclear:

- whether the derogation applies to all firms in the jurisdiction, or just to those institutions that are required by their local scheme to be separated;
- whether the derogation will be aligned with the DGSD 2014, as the definition of 'core credit institution' is intended to be;
- what the effect on the derogation will be by the above adjustment to the 'core credit institution' definition (i.e. is it coherent for a Regulation, which applies a separation scheme to all deposit taking entities, to permit a national derogation for any scheme which, such as the UK's Vickers scheme, is based on retail depositor protection and any key retail infrastructure)?

4. Further aspects requiring clarification

AmCham EU welcomes the European Commission's desire to refine certain elements of the draft Regulation, as expressed in the comprehensive impact assessment. In particular, AmCham EU agrees (1) that clearer definition of trading activities that would be subject to separation is required, (2) that a clearer distinction between different market-making activities is needed and (3) that the question of how supervisors' assessments on the need for separation to take into account resolvability assessments should be addressed.
This section lists some additional areas where AmCham EU considers that further clarification is required:

- How the proposed EU rules interact with those in other jurisdictions, such as the U.S. Volcker rule;
- How the definition of proprietary trading applies to investments made by relevant financial institutions which are not done for short-term financial profit;
- How the definition of market-making across the EU will work, especially vis-à-vis the U.S. regulatory framework. It is of utmost importance that the draft Regulation is consistent with the need to preserve the functioning of global trading markets. The importance of market-makers and underwriters to the preservation of market liquidity and the benefits they provide in terms of lower cost of capital and greater access to capital and credit markets for the real economy needs to be acknowledged and preserved in practice. A narrow market-making definition, as well as requiring the separation of market-making activities and limiting other trading activities in the core credit institution – such as derivatives where only certain cleared derivatives are out of scope for potential separation – could unintentionally reduce liquidity and impair the availability of credit. This in turn could undermine market stability and seriously damage the real economy;
- How the proposed draft Regulation will interact with existing EU legislation? For example, the European Commission has made it known that the draft Regulation, which – in its current form – essentially intends to protect insured retail depositors from 'risky' trading activities, will be revised to align with the new Deposit Guarantee Schemes Directive. This will see the 'core credit institution' scope term extended to include the taking of any eligible deposits and, hence, raises fundamental issues of the scope and purpose of the draft Regulation and the nature of the separation requirements it can impose. As such,
    - it is not clear what purpose is being served by extending 'retail' protection to, e.g., corporate treasurers of listed companies, or hedge funds; and
    - nor is it clear what systemic stability objective is being achieved by breaking all links between long-term funding and trading activities and driving institutions into monoline funding models.

Conclusion

To conclude, AmCham EU considers that the practical operation of recently adopted EU legislation, such as the BRRD, the SRM and the CRD IV/CRR I needs to be assessed before new legislative initiatives are pursued in the area of bank structural reform. Furthermore, it is of great importance to take into account the third country implications of the draft Regulation. In this context, special consideration needs to be given to the way in which the draft Regulation will impact the EU operations of non-EU headquartered firms. The impact of the draft Regulation on the functioning of the internal market also needs to be taken into account. Finally, there are a number of issues in respect

of which further clarity is required. AmCham EU looks forward to engaging with EU policy-makers on these issues during the EU legislative decision-making process.