



**EUROPEAN COMMISSION**  
Internal Market and Services DG

Deputy Director-General

**Subject: Public consultation on banking reform in the United Kingdom -  
Response from the European Commission's DG Internal Market**

### **General**

DG Internal Market is replying to this consultation on an informal basis. Many of the questions raised in the consultation document concern issues surrounding the organisation of banking supervision which fall outside the competence of the EU. In accordance with the principle of subsidiarity, we do not believe it would be appropriate to comment on issues such as the organisation of the relationship between responsible authorities at national level.

That being said, the consultation document does contain a number of suggestions for changing legislation in areas covered by Community legislation – and where that is the case we address specific points below.

While we fully understand and share the objectives behind this consultation, we would wish to sound a general note of caution. There is intense and urgent work being carried out at both EU and international level in response to the current crisis – which will in all probability result in changes to the regulatory framework. It would be unfortunate if any changes in the national framework resulted in additional complications to achieve agreement at EU or international level. Care will therefore need to be taken to monitor very carefully the ongoing discussions in the appropriate fora, so as to ensure that any solutions developed fully reflect the need to address problems arising from the international nature of financial services and the need to develop the international financial stability framework capable of handling the cross-border effects of a crisis. It will be important to ensure that whatever solutions are developed at national level, the national framework should remain sufficiently flexible and adaptable to the possible changes resulting from the need to

strengthen the international financial stability framework.

### **Comments on specific chapters**

It is not our intention to comment in detail on all the issues raised in the consultation paper. We would however like to make the following comments on specific aspects:

In **Chapter 4**, DG Internal Market agrees with the main thrust of the UK proposal to reduce the impact of a failing bank by establishing a special resolution regime. This is in line with the recommendations of the EFC report on "Developing EU Financial Stability Arrangements". In that respect, the 9th October 2007 ECOFIN requested the Commission services to consider by mid-2009 proposals on how to further improve EU banking groups' crisis resolution arrangements. The Commission is expected to *"assess the possible extension of the scope of the present EU Directive on winding-up and reorganisation to include insolvent subsidiaries with the objective to increase the efficiency, the optimal reorganisation and winding-up of cross-border banking groups taking due consideration of the interests of all stakeholders concerned"*.

Of particular importance is the need to appropriately define a *trigger* for banks entering a special resolution regime. DG Internal Market is of the opinion, for a variety of reasons, that the 'leverage ratio' under the US Prompt Correction Action system is ill-suited for this purpose. We would suggest that this issue should be discussed in depth in European fora, given its implications for branches or subsidiaries of UK banks established in other EU countries.

We fully subscribe to the policy statement that authorities have limited tools available to maximise the chance of a successful resolution of a failing bank. This issue is particularly acute in a cross-border context, where discrepancies between supervisory authorities' powers could undermine a smooth crisis management process. We suggest that any reflection about the availability of supervisory tools should also be addressed in a cross-border context. Furthermore, the Ecofin has requested the Commission to produce this analysis by October 2008, while CEBS has been asked to contribute to this survey as part of the Lamfalussy review on supervisory powers.

The UK consultation paper points out that any resolution tool involving public money would require approval by HM Treasury. This is in line with the MoU recently agreed by Ministers of Finance, whereby ministries will be involved when a bank runs into insolvency problems. More importantly and in a cross-border context, this means that clear burden sharing arrangements across EU Member States will be a key component of any special resolution regime.

We fully concur with the views expressed in the consultation document that the emphasis should be on private sector solutions. Nevertheless, as pointed out by Commissions' public consultation on the review of the EU Directive on Winding-Up and Reorganisation of Credit Institutions, there are important obstacles in national laws (company law, banking law and insolvency law) to an unfettered transferability of assets. This may jeopardise any attempt to implement a special resolution regime where its implementation may be detrimental to stakeholders in other EU jurisdiction.

In **Chapter 5** on Deposit Guarantee Schemes, we believe that your proposals would enhance depositor confidence and further improve the capacity of the FSCS to deal with a crisis. In general, the proposals are consistent with the Directive on Deposit Guarantee

Schemes, which only stipulates a very limited degree of harmonisation. Many of the issues you raise are also being dealt with by the European Forum of Deposit Insurers (EFDI), further to the Commission's own Communication of November 2006<sup>1</sup>. We would prefer to await preliminary results of this work most of which is scheduled for spring/summer of this year before taking a position.

We share your view that the coverage limit should be appropriate, i.e. sufficiently high to maintain depositor confidence during a crisis. As you will be aware, the Directive allows almost unlimited flexibility above the minimum €20,000 threshold. Consequently, the protection of particular kinds of deposits above the normal coverage limit discussed in the consultation paper would not raise concerns.

Nor do we believe that special rules for client accounts would be problematic. The Directive only requires clients to be identifiable in order to benefit from the full coverage limit.

Drawing on recent experience, rapid payout would seem to be a crucial element in restoring depositor confidence. The current three-month delay on payouts in the Directive may need to be revisited, taking in account information technology advances. In addition, we need to be clear that a timeframe for payouts should cover the finalization of the whole payout process, and not its initiation. Consequently, we appreciate the reflections in the consultation paper about a significant reduction of the payout delay. Indeed, the transmission of data from the bank to the scheme seems to be an important element in order to achieve a quick payout. However, there might also be other factors. Before making detailed observations, we would prefer to await the preliminary results of the work of EFDI, which is working on identifying obstacles to a quick payout and on possible solutions on how these could be removed. Down-payments may be a possible solution to strike the balance between an accurate assessment of depositors' of claims and a quick reinstatement of depositor's liquidity, thereby avoiding any loss of confidence. One key prerequisite for quick payments is of course the rapid ability of the scheme to access the necessary funds – whether this is ensured by ex-ante or ex-post contributions or if necessary by borrowing from the markets or other sources.

With regard to the depositor's eligibility, we believe that the Directive provides a sufficient degree of flexibility, subject to a few mandatory exclusions. These seem to have been taken into account in your proposal.

We support the principle of risk-based contributions by banks to ex-ante funded schemes, which provide a useful additional incentive for prudence and result in fairer treatment of banks who contribute according to the degree of risks they take. As you may be aware, we will soon publish a report of the Commission's Joint Research Centre on existing approaches in some Member States in order to allow EFDI to discuss useful models that could be used by other schemes on a voluntary basis.

In **Chapter 7** ("Effective Coordination), the approach on information sharing would appear to be fully in line with the changes we are contemplating in the Capital Requirements Directive, whereby, in emergency situations, the competent authorities would not only be responsible for alerting other authorities but also for communicating all information which is essential for the pursuance of the tasks of central banks and Ministries of Finance within the EU.

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<sup>1</sup> COM(2006)729 final

We would endorse the ideas in the consultation document about enhancing the role of the Financial Stability Forum— including a high level oversight role, serving as a forum bringing together regulators and standard setters, developing mitigating responses at global level and promoting best practice for crisis preparation and financial stability issues and supporting IMF surveillance. However, in order for this to be effective, it would be essential to ensure adequate representation of all interests – especially as the outcomes from the Financial Stability Forum may well have a strong influence on the design of standards at EU level.

We would also support in principle the idea of developing a role for the IMF and Financial Stability Forum in terms of an international early warning system. It will be critically important to clarify how precisely such a role might work in practice and what it is exactly that needs to be assessed. Also we need to ensure that the arrangements at EU level are fully "plugged in" to the international system. The conclusion of the recent Brown/Merkel/Sarkozy/Prodi/Barosso Summit are pertinent in this regard. It would be particularly important to avoid unhelpful overlapping or underlapping of functions – in particular with regard to the respective roles that the "level 3" Committee might play. In this respect we place particular importance in the harnessing of existing resources to reflect a "bottom-up" approach – based in particular on information provided to CEBS through colleges of supervisors.

We also agree that "consideration needs to be given to the global dimension rather than just a European focus". That being said, we would wish to stress that the deeper state of integration in the EU market as opposed to the international market substantiates the need to make further and urgent progress on developing the supervisory framework at EU level. We always ensure that this ongoing debate at EU level reflects closely the debate at international level – especially at the Basel Committee, where a discussion on bank resolution has been tabled.

Finally, we would fully support the holding of a crisis simulation exercise at international level, building on the experience of recent exercises which have taken place within the EU.