



## OPINION OF THE EUROPEAN CENTRAL BANK

of 12 December 2012

on banking and financial stability

(CON/2012/106)

### Introduction and legal basis

On 15 November 2012, the European Central Bank (ECB) received a request from the Minister for Economic Affairs and Finance for an opinion on a draft law on banking and financial stability (hereinafter the 'draft law').

The ECB's competence to deliver an opinion is based on Articles 127(4) and 282(5) of the Treaty on the Functioning of the European Union and the third and sixth indents of Article 2(1) of Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions<sup>1</sup>, as the draft law relates to the Banque de France and to rules applicable to financial institutions insofar as they materially influence the stability of financial institutions and markets. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

### **1. Purpose of the draft law**

#### 1.1 *Structure of banking groups*<sup>2</sup>

The draft law separates activities that finance the economy from speculative operations. Above an exposure threshold defined by order of the Minister for Economic Affairs, speculative operations will have to be ring-fenced in dedicated subsidiaries in the form of investment firms or exceptionally credit institutions. The banking groups will be authorised to keep all trading activities relating to the provision of investment services to clients, financial instruments clearing, hedging investment risks of the credit institutions or group, market-making, the sound management of group treasury and financial operations between credit institutions and assimilated entities, as well as group investment operations. By contrast, proprietary trading relating to financial instruments without these objectives will have to be conducted in dedicated subsidiaries, as well as any operation involving unguaranteed counterparty risks towards money market funds with a gearing effect or similar investment vehicles, under criteria laid down by order of the Minister for Economic Affairs. The subsidiaries will not be able to accept guaranteed deposits or provide payment services to clients whose deposits qualify for the guarantee. The Prudential Control

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<sup>1</sup> OJ L 189, 3.7.1998, p. 42.

<sup>2</sup> See draft law, Title I.

Authority (*Autorité de contrôle prudentiel*, ACP) and, if relevant, the Financial Markets Authority (*Autorité des marchés financiers*, AMF), should be provided with an organisational chart of the units in charge of the operations relating to financial instruments, their objectives, the rules of good conduct and other applicable rules. The ACP may refuse authorisation if the structure of the organisation or the internal control system is not satisfactory. The transfer of activities will take place *ipso jure*, without the need for any formality. The deadline for identifying the activities to be transferred is 1 July 2014 and the deadline for transferring activities is 1 July 2015.

## 1.2 *Implementation of a bank resolution scheme*<sup>3</sup>

First, the ACP becomes the Prudential Control and Resolution Authority (*Autorité de contrôle prudentiel et de résolution*), with a new resolution college and the Deposit Guarantee Fund (*Fonds de garantie des dépôts*) becomes the Deposit Guarantee and Resolution Fund (*Fonds de garantie des dépôts et de résolution*) (hereinafter the 'Fund'). The Prudential Control and Resolution Authority may ask the Fund to intervene in a credit institution or an assimilated entity which is failing and subject to resolution measures. The Fund would intervene according to the procedure determined by the Prudential Control and Resolution Authority in accordance with the draft law. In particular, the Fund may acquire some or all of the shares in the entity, subscribe to an increase in capital of the entity or the bridge institution set up by the Prudential Control and Resolution Authority, grant any form of funding to the entity or the bridge institution and assume part of the costs required to guarantee the solvency of the entity. The sums paid by the Fund benefit from the more favourable status granted to any creditor providing new financing to a bank or other undertaking subject to safeguard, receivership or winding-up proceedings. The Fund will only be liable in defined cases for losses resulting from the assistance granted.

Second, rules are laid down for the preventive recovery and resolution plans of banks and a bank resolution scheme is introduced. In this framework, credit institutions and assimilated entities have to submit a preventive recovery plan to the Prudential Control and Resolution Authority for possible modification and adoption. The preventive recovery plan may not involve the possibility to receive financial support from the State or the Fund. The resolution college's powers include appointing a temporary administrator, removing any manager, deciding that some or all activities should automatically be transferred or taken over, writing down or cancelling shares according to the entity's losses, and setting up a bridge institution. The resolution college ensures that the measures taken guarantee financial stability and help to maintain the continuity of activities while limiting exceptional public financial support to the strict minimum. At the same time, the resolution college will ensure that no shareholder, member or creditor is worse off than they would have been had the institution been liquidated.

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<sup>3</sup> See draft law, Title II.

### 1.3 *Macro-prudential supervision*<sup>4</sup>

The Financial Regulation and Systemic Risk Council (*Conseil de régulation financière et du risque systémique*) becomes the Financial Stability Council (*Conseil de stabilité financière*). It will supervise the financial system as a whole and will define macro-prudential policy, with the aim of maintaining the stability of the financial system. It will evaluate systemic risks, taking into account the opinions and recommendations of the competent European institutions, adopt opinions or recommendations it deems necessary to prevent any systemic risk and any threat to financial stability and decide to define additional capital requirements at the proposal of the Governor of the Banque de France. The Banque de France, in cooperation with the Financial Stability Council, will help to maintain the stability of the financial system, identify and monitor risks to it and contribute to the implementation of the measures taken by the Financial Stability Council.

### 1.4 *Enhanced powers of the AMF and of the ACP*<sup>5</sup>

In particular, the powers of the ACP are strengthened in relation to, *inter alia*, the nomination of managers and other persons on the Board of Directors or Supervisory Board of *inter alia* credit institutions. The ACP may object to a nomination if the criteria of good repute, competence and experience required are not met. It may also suspend persons who no longer fulfil the criteria.

## 2. **Measures relating to the structure of banking groups**

This draft law arises in conjunction with the Report of the European Commission's High-level Expert Group of 2 October 2012 on reforming the structure of the EU banking sector (hereinafter the 'Liikanen report')<sup>6</sup>. The European Commission will prepare a comprehensive impact assessment of its recommendations and will make corresponding legislative proposals as appropriate, to ensure a consistent Union framework. Given that these measures primarily address internationally active banks, the ECB considers coordination and consistency to be important at European and international levels to avoid regulatory arbitrage.

More specifically, the draft law provides for a mandatory separation of proprietary and other high-risk non-client related activities from the deposit-taking institution. Such a separation would further protect depositors from being exposed to losses from these high risk activities, reduce complexity and enhance resolvability. The ECB also notes that, unlike the Liikanen report, the draft law does not provide for ring-fencing of market making activities.

## 3. **Prohibition on certain activities**

The draft law prohibits the dedicated subsidiaries, in the form of investment firms or, exceptionally, of credit institutions, from carrying out high frequency trading (HFT), dealing with financial instruments

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<sup>4</sup> See draft law, Title III.

<sup>5</sup> See draft law, Title IV.

<sup>6</sup> Available on the European Commission's website at: [http://ec.europa.eu/internal\\_market/bank/docs/high-level\\_expert\\_group/report\\_en.pdf](http://ec.europa.eu/internal_market/bank/docs/high-level_expert_group/report_en.pdf).

where the underlying asset is a raw food material, and the sale and purchase of derivative instruments for a credit event affecting a State without connection to the holding of securities issued by this State. In this respect, the ECB is of the view that less intrusive approaches, in line with international recommendations<sup>7</sup>, might be preferable. In addition, consistency should be ensured at Union level.

First, as regards HFT, as highlighted in Opinion CON/2012/21<sup>8</sup>, the ECB supports the Commission's proposal to introduce organisational safeguards for trading venues, such as circuit breakers, minimum tick sizes and maximum ratios of unexecuted orders, in line with international recommendations. Further, the ECB considered that all entities engaged in algorithmic trading on a professional basis should be considered as falling within the definition of investment firms and be subject to supervision and monitoring of their activities by competent authorities. Finally, the ECB supports the empowerment of competent authorities to temporarily prohibit or restrict certain types of financial activity or practices with a view to addressing a threat to the orderly functioning of financial markets or the stability of whole or part of the financial system.

Second, as regards the proposed prohibition on operations relating to financial instruments where the underlying asset is a raw food material, Opinion CON/2012/21 supports the empowerment of competent authorities to set ex ante position limits for commodity derivatives over a specified period of time, while the European Securities and Market Authority will be granted a coordination role of such measures as well as specific direct powers in this area<sup>9</sup>.

#### **4. Financial Stability Council**

The ECB welcomes the extension to the powers of the Financial Regulation and Systemic Risk Council, now renamed as a Financial Stability Council. This will enhance its role as a national macro-prudential authority in France<sup>10</sup>.

The tasks of the Financial Stability Council include: (a) ensuring that the institutions represented on its panel cooperate and exchange information, and examine the situation in the financial sector and markets, and (b) cooperating with equivalent authorities in the other Member States and the competent European authorities. Moreover, actions of national macro-prudential authorities should take account of the responsibility of the European Systemic Risk Board (ESRB) for macro-prudential oversight of the

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<sup>7</sup> See IOSCO Report 'Regulatory Issues Raised by the Impact of Technological Changes on Market Integrity and Efficiency', October 2011, and 'Principles for the Regulation and Supervision of Commodity Derivatives Markets', September 2011.

<sup>8</sup> Opinion CON/2012/21 of 22 March 2012 on: (i) a proposal for a directive on markets in financial instruments repealing Directive 2004/39/EC of the European Parliament and of the Council; (ii) a proposal for a regulation on markets in financial instruments and amending Regulation (EMIR) on OTC derivatives, central counterparties and trade repositories; (iii) a proposal for a directive on criminal sanctions for insider dealing and market manipulation; and (iv) a proposal for a regulation on insider dealing and market manipulation (market abuse) (OJ C 161, 7.6.2012, p. 3). Paragraphs 10.1 to 10.4.

<sup>9</sup> Paragraph 11.1.

<sup>10</sup> See for example ECB Opinion CON/2012/55. All ECB documents are available on the ECB's website at [www.ecb.europa.eu](http://www.ecb.europa.eu).

financial system within the Union<sup>11</sup>. The ECB recommends in this respect that the draft law requires the Financial Stability Council to inform the ESRB of all actions taken to address systemic risks at national level. Furthermore, it should inform the ESRB prior to the issuance or publication of its opinions and recommendations, if significant cross-border effects are to be expected.

Lastly, the Financial Stability Council's activities will have to take account of the ECB's macro-prudential supervisory powers in the context of the single supervisory mechanism.

## **5. Involvement of the Banque de France in macro-prudential supervision**

The ECB supports the enhancement of the macro-prudential functions performed by the Banque de France in cooperation with the Financial Stability Council. The ECB understands that the Banque de France will contribute to: (a) monitoring financial stability and systemic risks, (b) ensuring implementation of the Financial Stability Council's recommendations, (c) making proposals to the Financial Stability Council concerning the application of the specified macro-prudential instruments, such as capital or own funds requirements or conditions for lending practices of credit institutions.

As stated in the ECB's Convergence Reports<sup>12</sup>, the involvement of the Banque de France in the application of measures to strengthen financial stability must be compatible with the Treaty. A national central bank's functions must be performed in a manner that is fully compatible with its functional, institutional and financial independence to safeguard the proper performance of its tasks under the Treaty and the Statute of the European System of Central Banks and of the European Central Bank. To the extent the role of the Banque de France under the new legislation goes beyond advisory functions and requires it to assume additional tasks, it must be ensured that these tasks will not affect the ability of the Banque de France to carry out its ESCB-related tasks from an operational and financial point of view.

Additionally, the inclusion of Banque de France representatives in collegiate decision-making supervisory bodies or other authorities such as the Financial Stability Council or the Prudential Control and Resolution Authority would need to give due consideration to safeguards for the personal independence of the members of Banque de France's decision-making bodies<sup>13</sup>.

## **6. Framework for the recovery and resolution of credit institutions and investment firms**

The ECB welcomes the proposed amendments in the draft law. It notes that national legislation will have to be brought into line with forthcoming Union legislation, in particular the proposal for a directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms<sup>14</sup> (hereinafter the 'proposed directive') and the establishment of a

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11 Article 3(1) of Regulation EU (No) 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board (OJ L 331, 15.12.2010, p. 1).

12 See for example ECB's Convergence Report 2012, p. 22.

13 See for example ECB's Convergence Report 2012, p. 22.

14 COM(2012) 280 final, available on the European Commission's website at <http://ec.europa.eu>.

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single resolution mechanism, focused on a European Resolution Authority, which the ECB fully supports<sup>15</sup>.

The draft law provides that the Prudential Control and Resolution Authority may, *inter alia*, write down or cancel shares. The ECB welcomes the development of bail-in as a debt write down or conversion mechanism to absorb losses of institutions that are failing or likely to fail. The bail-in mechanism should be in line with internationally agreed key attributes for effective resolution<sup>16</sup>. In particular, the resolution authority should be empowered under a resolution regime to bail in a wide range of liabilities in accordance with the creditor hierarchy that would apply in liquidation. The ECB supports the introduction of such a bail-in tool by the Member States before 1 January 2018<sup>17</sup>. This would allow for further work on bail-in, which may be necessary to assess the possibility of introducing a minimum requirement for a targeted level of designated bail-in instruments while still maintaining the overall scope of bail-in and the practical implications of bail-in as a resolution tool.

This opinion will be published on the ECB's website.

Done at Frankfurt am Main, 12 December 2012.

[signed]

*The Vice-President of the ECB*

Vítor CONSTÂNCIO

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<sup>15</sup> Paragraph 1.5 of ECB Opinion CON/2012/96 of 27 November 2012 on a proposal for a Council regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions and a proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority), not yet published in the Official Journal.

<sup>16</sup> See 'Key Attributes of Effective Resolution Regimes for Financial Institutions', October 2011, available on the Financial Stability Board's website at [www.financialstabilityboard.org](http://www.financialstabilityboard.org).

<sup>17</sup> See Article 115(1), third paragraph of the proposed directive. See also paragraph 6.1 of ECB Opinion CON/2012/99.