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Commission proposes further revision of banking regulation to strengthen rules on bank capital and on remuneration in the banking sector

(see MEMO/09/335)

The European Commission has put forward a further revision of EU rules on capital requirements for banks that is designed to tighten up the way in which banks assess the risks connected with their trading book; impose higher capital requirements for re-securitisations; increase market confidence through stronger disclosure requirements for securitisation exposures; and require banks to have sound remuneration practices that do not encourage or reward excessive risk-taking. Under the new rules, banks will be restricted in their investments in highly complex re-securitisations if they cannot demonstrate that they have fully understood the risks involved, while national supervisory authorities will review banks' remuneration policies and have the power to impose sanctions if the policies do not meet the new requirements. The proposal, which amends the existing Capital Requirements Directives, represents part of the EU's response to the financial crisis, and reflects consultation with Member States, banking supervisors and industry. It now passes to the European Parliament and the Council of Ministers for consideration.

Commission President José Manuel Barroso declared : *These proposals address risks linked to two major causes of the current crisis, securitisation and remuneration. We are acting ambitiously to prevent lightning striking twice. The proposals aim to ensure that banks hold enough capital to reflect the true risks they are taking. In particular, banks will have to offset risks associated with highly complex resecuritisation products and deal with perverse incentives created by pay and bonus schemes. We will legally oblige banks and investment firms to have remuneration policies consistent with effective risk management. Supervisors will be given the powers to take measures, including increased capital requirements, to address any failures. I am calling on Member States and the European Parliament to back these proposals and on other jurisdictions to act on similar lines, in line with the common commitments made at the G20.*

Internal Market and Services Commissioner Charlie McCreevy said: *"These new rules target some of the investments and practices that lie at the root of the financial crisis. New rules on re-securitisations – the highly complex financial products that caused huge losses for banks – will require banks to hold significantly more capital to cover their risks when investing in these products, while the additional disclosure rules will help to create a climate of market confidence. The requirements on pay and bonuses are designed to put an end to the culture of excessive risk-taking for short-term success at the expense of long-term profitability and sound risk management. This package of amendments will strengthen the risk management, transparency and sound investment practices that are key to a healthy and stable banking system."*

Proposed amendments to the Capital Requirements Directives

The purpose of the Capital Requirements Directives (2006/48/EC and 2006/49/EC) is to ensure the financial soundness of banks and investment firms. Together they stipulate how much of their own financial resources banks and investment firms must have in order to cover their risks and protect their depositors. This legal framework needs to be regularly updated and refined to respond to the needs of the financial system as a whole. The main changes proposed are as follows:

- **Capital requirements for re-securitisations**

Re-securitisations are complex financial products that have played a role in the development of the financial crisis. In certain circumstances, banks that hold them can be exposed to considerable losses. The proposal will impose higher capital requirements for re-securitisations, to make sure that banks take proper account of the risks of investing in such complex financial products.

- **Disclosure of securitisation exposures**

Proper disclosure of the level of risks to which banks are exposed is necessary for market confidence. The new rules will tighten up disclosure requirements to increase the market confidence that is necessary to encourage banks to start lending to each other again.

- **Capital requirements for the trading book**

The trading book consists of all the financial instruments that a bank holds with the intention of re-selling them in the short term, or in order to hedge other instruments in the trading book. The proposal will change the way that banks assess the risks connected with their trading books to ensure that they fully reflect the potential losses from adverse market movements in the kind of stressed conditions that have been experienced recently.

- **Remuneration policies and practices within banks**

The proposal will tackle perverse pay incentives by requiring banks and investment firms to have sound remuneration policies that do not encourage or reward excessive risk-taking. Banking supervisors will be given the power to sanction banks with remuneration policies that do not comply with the new requirements.

The proposal is available at:

http://ec.europa.eu/internal_market/bank/regcapital/index_en.htm