



Financial Services User Group's (FSUG)

reply to the
consultation
on

Reforming the structure of the EU banking sector

11 July 2013



FSUG c/o European Commission
Internal Market and Services DG
SPA2 4/69, BE-1049 Brussels
markt-fsug@ec.europa.eu

FSUG was set up by the European Commission to:

- advise the Commission in the preparation of legislation or policy initiatives which affect the users of financial services
- provide insight, opinion and advice concerning the practical implementation of such policies
- proactively seek to identify key financial services issues which affect users of financial services
- liaise with and provide information to financial services user representatives and representative bodies at the European Union and national level.

FSUG has 20 members, who are individuals appointed to represent the interests of consumers, retail investors or micro-enterprises, and individual experts with expertise in financial services from the perspective of the financial services user.

GENERAL REMARKS

FSUG welcomes the consultation document on “Reforming the structure of the EU banking sector”. We see this matter as one of great importance that will determine the future state of play of the banking sector and will therefore directly affect users’ level of risk-taking.

We regret to see that the European Commission has ultimately adopted the no-complete-separation scenario for the future financial institutions. In our Response to the HLEG Final Report¹ we stressed that users did not seem to be at the core of the objectives that the Expert Group was asked to pay particular attention to, and in this consultation document we verify this conclusion of ours. The reform of the EU banking sector should aim for the elimination of taxpayers’ liability, excessive risk-taking, and the stake that taxpayers have in the trading parts of banking groups and these concerns do not seem to be taken under consideration. Also, EU Public authorities should ensure that central bank funding (which is public money) should only be provided to commercial banking (i.e. the transformation of deposits into loans to the real economy), and not to any other business such as securities and forex trading, investment banking, asset management, insurance, etc.

In the context described above, the FSUG presents its comments and suggestions in the paragraphs that follow.

Questions

1. Can structural reform of the largest and most complex banking groups address and alleviate these problems? Please substantiate your answer.

There is no doubt that structural reform is necessary in addressing and alleviating these problems. FSUG has already highlighted that too-big-to-fail and too-interconnected-to-fail universal banks caused most of the detriment that taxpayers were asked and are still being asked to endure. We see structural reform as the only way to ensure that such situations will be avoided in the future and thus to safeguard users from similar future detriment. Specifically, structural reform is expected to define the new state of play of future financial institutions, reshape the regulatory and supervisory mechanisms which proved inadequate prior to crisis, increase the level of transparency in the financial sector by separating consumer-based from investment banking activities and ultimately create a sustainable and less risky, in terms of systemic risk, financial sector.

2. Do you consider that an EU proposal in the field of structural reform is needed? What are the possible advantages or drawbacks associated with such reforms? Please substantiate your answer.

We believe that structural reform should take place at EU level. There is no point in designing other reforms at EU level (solvency and resolvability, deposit guarantee schemes etc.) and leaving structural reform in MS level. In any case, this does not seem to be a matter of advantages and drawbacks; it is a necessity driven by the efficient

¹ For our Response on the HLEG Final Report please see: http://ec.europa.eu/internal_market/finservices-retail/docs/fsug/opinions/bank_structure_reform-2012_11_13_en.pdf

operation of the Single Market per se. For the reasons already explained in the consultation document, the reform must be implemented at EU level.

3. Which of the four definitions is the best indicator to identify systemically risky trading activities? If none of the above, please propose an alternative indicator.

As mentioned in the introduction of our response, we regret to see that the European Commission has ultimately adopted the no-complete-separation scenario for the future financial institutions. There is thus no point in debating once again with facts and references to studies and scientific journals why this is not the optimal solution for the users of financial services and for the banking sector itself; we have already provided our position in our Response to the HLEG Final Report.

Also, the Commission does not seem to fully take into account the recent developments of the UK reform of banking structures, and, in particular the First Report of the UK Parliamentary Commission on Banking Standards (19 December 2012) which emphasizes the need to go further into the separation of banking businesses and to “electrify” the ring-fencing of commercial banking activities in the UK. FSUG by the way fully supports the analysis of the UK Parliamentary Commission and finds that it applies not only to the UK but to the whole EU².

What is however even more worrying is the fact that the new three definitions are even more conservative towards lower levels of thresholds than the one proposed from HLEG.

What contributes even more to our concerns is the “*absence of publicly available data for banks’ specific business lines*” which leads to an analysis done “*on the basis of publicly available accounting data from commercial providers*”, as admitted in the consultation document. This is worrying because decisions to separate universal banks will be made upon thresholds that will make use of or rely on a limited set of accounting data provided by banks...

Our comment in this question is that we are still wondering on what basis deposit-taking, commercial financial institutions will be allowed to carry out trading activities and other non-commercial banking activities, even if these comprise only a small share of their business. FSUG believes that there must be a complete separation between commercial/retail and investment banking.

² In particular, the UK Parliamentary Commission’s analysis of the background for the Reform: “*Public confidence in bankers and banking has been shaken to its roots. Certain conduct in wholesale markets, for example in relation to the London Interbank Offered Rate (LIBOR), has exposed a culture of culpable greed far removed from the interests of bank customers, at least among some market participants. The systematic mis-selling of a range of retail products, over a number of years, on a scale which is only now becoming apparent, has reinforced the impression of a culture across the banking sector which viewed the customer as a short-term source of revenue rather than a long-term client. The bank failures and weaknesses in 2007 and 2008 required a massive injection of taxpayers’ money, yet the bankers and bank creditors who had benefited the most in the years leading up to that crisis were seen to have suffered little, if at all, from the consequences.*”

4. Which of the approaches outlines above is the most appropriate? Are there any alternative approaches? Please substantiate your answer.

A key concept that should be considered here is moral hazard situations. We believe that there is considerable space for the development of moral hazard situations in option 1, less, but existent space for option 2 and no space for option 3. Therefore, we opt for ex ante separation.

5. What are the costs and benefits of separating market-making and/or underwriting activities? Could some of these activities be included in, or exempt from, a separation requirement? If so, which and on what basis?

6. Should deposit banks be allowed to directly provide risk management services to clients? If so, should any (which) additional safeguards/limits be considered?

In line with our answer to question 3, we believe that deposit-taking institutions should not be allowed to carry any trading activities or risk management services. It is important to understand that commercial banks are less likely to fail, are more transparent and enjoy the unique privilege to access funds from central banks.

The main benefits of separating market-making and underwriting activities are the clear differentiation of the level of risk of each separate institution, increased transparency in the operations of each institution, easier to supervise each institution with estimated lower cost.

7. As regards the legal dimension of functional separation, what are the costs and benefits of regulating intra-group ownership structures?

8. What are the relevant economic links and associated risks between intra-group entities?

9. As regards full ownership separation, what are the associated costs and benefits?

We have already expressed our concerns regarding the issues raised in this section in our Response to the HLEG Final Report and we refer to them in this text as well. Our main concern is *“the level of immunization of the distinct financial organizations within the same banking group; any future failure of the non-depository risk-taking organization, as part of a banking group, should not by any means affect the viability of the group as a whole, and thus threaten the safer and most probably healthier deposit-taking institutions of the group. We are very concerned about the risk of contamination between the trading entity and the more socially important deposit taking entity in the event of the trading entity collapsing”*.

Regarding costs and benefits, as already noted in our Response *“we would dispute that a full separation would be significantly more costly than the ring fencing option”* and that *“any additional short-term costs would be offset in the medium to long-term as the costs of monitoring, regulating and reporting costs with regards to a ring-fenced operation would be significantly greater than with a clear legal separation”*.

Therefore, we believe that the best option from the users' perspective would be an ownership separation.

10. Does the above matrix capture a sufficiently broad range of structural reform options?
11. Which option best addresses the problems identified? Please substantiate your answer.

The matrix does capture a sufficiently broad range of structural reform options.

Following the rationale of our answers provided in this consultation and on our Response to the HLEG Final Report we believe that the best option is Option I: Ownership Separation and Broad Trading Entity/Narrow Deposit Bank. We believe that this is the optimal option for users for the following reasons:

- Regarding activities, according to the consultation document, a “broad” deposit bank “*remains relatively unrestricted and allowed to perform a broad set of retail and investment banking activities*”. We believe that deposit-taking entities should not be in a position to perform a broad set of investment banking activities.
- Regarding separation, a complete separation of commercial and investment banks would reduce the levels of risk for commercial banking and would focus commercial banks back on funding the real economy.
- A proper separation would remove any potential conflicts of interest which would arise within an internal separation structure. Today, these “potential” conflicts of interest are massive. As an example, full separation is the only way to prevent commercial banks to “advise” and promote their own retail investment products at the point of sale: this is a limit of the ban on commissions in the UK: it is very difficult to apply it in actuality to integrate financial undertakings, especially banks which own asset management businesses (directly or indirectly through some holding entities).
- The cost of monitoring, regulating and reporting are expected to be lower if the full separation option is chosen
- Public support is necessary in protecting consumers’ life-long savings. Furthermore, the banking system should facilitate the monetary policy, being the main channel of cash flows to the real economy. This relationship between the banking sector and the state should be limited to the commercial banking sector. Actually, central bank funding has never been meant to help any other business than commercial banking. “internal” separation does not prevent central bank funding to indirectly benefit other businesses of the same banking group . Currently the one trillion euros “LTRO” programme of the ECB is a huge public subsidy to banks (nearly unconditional loan at 1% over 3 years), but none of it benefits the real economy (non-financial enterprises and households) as the only constraint required by the ECB is to provide collateral solely in the form of Euro Government bonds.