

## **EU Commission's Consultation Paper on Reforming the Structure of the EU Banking Sector**

### **Comment**

Frankfurt a.M./Berlin, 9 July 2013

Bundesverband der Deutschen Industrie (BDI)<sup>1</sup> and Deutsches Aktieninstitut (DAI)<sup>2</sup> appreciate the opportunity to comment on the Commission's consultative document on reforming the structure of the EU banking sector. We restrict our following remarks on aspects that are particularly important from an industrial point of view.

#### **1. General remarks**

- Safeguarding financial stability is crucial for companies. BDI and DAI support smart regulation for financial services in response to the regulatory failures that led to the financial crisis and to address the risk of similar events occurring in the future. But reforms must strike the right balance and be mindful for companies' access to finance and risk management.
- The real economy does not pose a systemic risk. But it has to bear a large part of the regulatory burden imposed on the financial sector. As a consequence financing operations and risk management of firms have already become more costly and more difficult to obtain. Any additional burden has to be avoided when reforming the structure of the EU banking sector.
- The proposed structural separation of bank's trading activities is a serious interference with the business policy and freedom of contract of banks, which is hardly justifiable and for what high demands are placed. It is essential that the proposals are suitable to support the overall objective and that the ratio of costs to income is properly balanced. Structural separation of certain business activities of banks must not deprive firm's access to finance and risk management.

---

1 Bundesverband der Deutschen Industrie e.V. (BDI, [www.bdi.eu](http://www.bdi.eu)) is the umbrella organisation of German industry and industry-related service providers. It represents 38 industrial sector federations and has 15 regional offices in the German Länder. BDI speaks for more than 100,000 private enterprises – 98 % small and medium sized – employing around 8 million people. Membership is voluntary.

2 Deutsches Aktieninstitut e.V. (DAI, [www.dai.de](http://www.dai.de)) is the association of German exchange-listed stock corporations and other companies and institutions which are engaged in the capital markets development.

## **2. Specific aspects**

### **Effectiveness of structural reforms**

We have serious doubts whether the planned interventions in the banking structure really make a positive contribution to the system stability.

- The emphasis on short-term trading activities of banks is mainly based on the assumption that they entail particularly high systemic risks. However, a clear-cut distinction between "good" and "bad" activities is hardly possible to conduct on this basis an effective structural separation.
- Recent and historic experience has shown that financial problems may also result from traditional lending business (see problems in the Spanish and Irish, but also the U.S. banking sector). Also, the diversification of a bank's business model regularly makes a bank less risky and thus less prone to bank failure. Structural separation will counter diversification advantages which are in particular a central institutional element of the banking systems of continental Europe. It will also reduce the diversity of business models in the banking sector which will generally bear the risk of amplifying adjustments to exogenous events.
- Irrespective the separation of business units indirect transmission channels will continue to exist through which bank customers may be hit. It is questionable whether separation facilitates the resolution of banks as it will continue to depend on the individual case whether a market dominant trading entity is resolved in a crisis. Hopes that the implicit state guarantee is off the table, could be deceptive. Separating proprietary trading could even indicate investors to rely on implicit state guarantees in the "good" deposit and loan bank.
- At last, we strongly believe that the huge number of regulatory initiatives already been implemented or proposed make the financial system more resilient and force banks to cut down riskier activities thus making it significantly easier to manage an individual bank crisis. It is far from clear whether the separation of banking activities will have any additional positive effect on financial stability that will be justified given the potentially huge costs resulting from such a separation. Against this background a cost-benefit analysis that also takes into account the interdependencies among the various regulations is needed as a minimum condition before any decision is taken on the separation of banking activities.

### **Consequences on companies' access to finance and risk management**

The Bundesverband der Deutschen Industrie and the Deutsches Aktieninstitut have repeatedly advocated for the maintenance of the universal banking system in its current form. The expected burdens of adjustment and obvious risks of structural separation for a well functioning universal banking model cannot be justified with questionable stability gains.

- The universal banking system practiced in Germany and other EU countries has proven as comparatively less crisis-prone: risks from imbalances in certain business lines can be matched from others. Actually, universal banks were not af-

ected above average during the financial crisis. On the contrary, they have proved as a stabilizing factor.

- Universal banking one-stop services allow considerable cost savings and an efficient use of bank capital and liquidity, from which the real economy significantly benefited. A legally prescribed separation of bank trading will lead to efficiency losses and further concentrations in the banking market. State-mandated funding structures and costs could cause traditional universal banks to intensify their focus on the deposit and lending business and no longer continue to operate certain lines of business. Thus financing options of firms will be reduced, dependencies (also from foreign banks having not the same affection for the German market) will increase. Expected changes would force companies to adjust proven business relationships. Adverse effects on the financial structure of the company cannot be excluded.
- Particularly high adjustment costs for the financial and real economy are expected in financial systems with distinct universal banking tradition. Undue interference would particularly hit the German banks and financial system in a highly competitive environment. This inevitably leads to distortions of competition in the German real economy. While the U.S. financial system can be primarily characterized as a capital market-oriented approach, German companies finance their business to more than 70% through bank loans. Companies have a clear need of strong banks that help them entering world markets and have also a strong presence on the domestic market. They require a broad range of products and services for finance and risk management. Threatening the substance of the proven universal banking system has to be avoided at all costs.

### **Thresholds for the separation of trading categories**

The German "Trennbankengesetz" is based to a large extent on the recommendations of the Liikanen group, e.g. as regards the thresholds above which certain businesses need to be outsourced to a special financial trading institution.

- We consider the threshold values as generally appropriate to detect systemically risky trading activities. However, it must be ensured that the bases for breach of threshold values and the business lines to be separated are identical. Financial positions which are still allowed should be consistently excluded in the calculation of the threshold.
- Given the considerable structural and organizational burdens of adjustment resulting from the separation of trading activities a strict focus on the thresholds appears to be not appropriate. A singular breach of the absolute or relative threshold should not automatically initiate a termination or separation of trading business. To avoid short-term fluctuations of the respective values which might have undesirable economic consequences, an average value calculated on the basis of multiple reporting dates should be used as a basis for the separation of risky business.

## Spectrum of structural reform options

- How trading business of banks is specifically separated is crucial to the impact the regulation has on the real economy. From an economic point the negative impact on the real economy will be the bigger the more lines of business will have to be separated and separately backed by bank capital and liquidity. As bank capital and liquidity are limited any form of separation will reduce banks' role as intermediaries.
- More directly, the strength of the structural separation also determines whether and to what extent banking businesses that serve hedging activities and complex capital market operations of companies remain possible. Against this background and the general arguments provided above we have already been sceptic with regard to the German model (option A of the EU Commission's document).
- However the German model has some elements that at least limit the impact of a separation on the real economy. First, the purchase and sale of financial instruments on own account as a service to others and market making are still allowed without limitations. Second, any form of risk management activities of banks need not to be separated, which allows banks to offer integrated services for their clients. Would market making be made substantially more costly through separation this would transfer into higher costs of finance of non-financial companies. In particular, the market for shares of smaller and medium sized companies and the market for corporate bonds would suffer.
- The German law, however, also allows BaFin to prohibit market making or to demand banks to separate from other activities, if the solvency of the deposit-taking institution is threatened. We do not oppose such a supervisory authorities' discretion to demand the separation of certain activities per se, provided it would be properly defined and properly justified. Indeed, some members of the Liikanen group suggested to separate trading activity of an individual bank only if the recovery and resolution plan of the respective bank is unsatisfactory. Basically, we would prefer discretionary over a legal separation.

## Contacts

Bundesverband der Deutschen Industrie e.V.  Dr. Reinhard Kudiß Abt. Wirtschafts- und Industriepolitik Breite Straße 29 10178 Berlin T +49 30 2028-1422 F +49 30 2028-2422 r.kudiss@bdi.eu	Deutsches Aktieninstitut e.V.  Dr. Gerrit Fey Head of Capital Market Affairs Niedenau 13-19 60325 Frankfurt am Main T +49 69 92915-41 F +49 69 92915-12 fey@dai.de
---	--