European Commission

Consultation on the recommendations of the High-level Expert Group on 'Reforming the structure of the EU banking sector'

Ring fencing banks' trading activities from other activities could increase overall costs, limit the availability of products to 'end users' (consumers, SMEs and larger corporates), and damage the competitiveness of larger European banks compared to other international banks.

KPMG welcomes the opportunity to respond to the European Commission consultation on the recommendations of the High-level Expert Group on reforming the structure of the EU banking sector.

We acknowledge the importance of the remit of the Group and the contribution its comprehensive analysis provides to the global financial reform debate.

For most other areas of post-crisis reform there is a G20 agreement in place. For structural reform there is no such commitment, which means Europe should be cautious of acting alone and damaging its international competitiveness.

However the Commission also has an important role to maintain some consistency within the EU as several countries are either developing or discussing their own proposals for ring fencing or separation. We base our comments on experience gained through our strong European practice.

Overall points

Major operational considerations - banks will have to commit considerable resources and effort into change programmes to create separate legal entities – this could be in excess of 3 years work based on our experience of major separation projects.

In addition to the direct costs and challenges of restructuring, there is the knock on economic impact of multiple banks focusing on restructuring rather than lending and supporting economic activity. This is at a time when de-leveraging is already reducing the flow of credit to the real economy. Careful consideration of any timetabling should be undertaken to minimise the risk of wider economic dislocation.

Increased capital and cost of funding – there is no clear evidence that the funding costs of the deposit bank will go down, while it is probable that the cost of funding the trading bank will increase as it will no longer have access to retail deposits. This increased cost will be compounded if different parts of the group receive different external credit ratings.

Changes to business models - banks will need to decide what happens to impacted activities, in particular services for business customers, which could fit into either entity. This will inevitably lead to some choosing to exit business lines or bring their size below the threshold, which overall could mean less choice for end users. While the reduction in activity may reduce the level of risk in the overall system, large corporates who need

wide ranging services are likely to be disadvantaged and possibly seek banking services from outside of Europe.

Dealing with multiple requirements – the recommendations have the focus of the US Volcker rule but follow an approach more akin to the UK ICB by allowing a separate legal entity within the same group. With some countries already considering their own structural reforms there is a real risk of a patchwork of structural requirements which overall could damage the competitiveness of European banks. There is also potential for less choice if the barriers to entry are high and international banks are discouraged from entering Europe.

Specific concerns

Ring-fencing

- Need to take an end-user view – large European corporates need a choice from a full spectrum of commercial banking services including OTC / traded derivatives and hedging products. Business end users want access to the well developed and competitive debt capital markets, which are facilitated by a deep and liquid secondary market. By forcing end-users to deal with separate entities there is a risk that this will increase costs and create inefficiency.

- Clarity needed on whether suggested restrictions between trading entities and retail deposits is intended to reshape the operation of the interbank money markets. If there is a restriction, and assuming the trading activity remains at similar levels, there will be concentration risk between the deposit banks which may not be desirable.

- Much of the cross-border international financial system which supports the deposit system is supplied by the trading infrastructure. It is not clear whether deposit banks will continue to have access to this infrastructure in the future and what the consequences of that would be on business end-users.

Recovery and resolution planning

- Current EU legislative proposals already set out how the Resolution authorities may intervene in advance to change a bank's structure if this is necessary to enhance resolvability. The Review acknowledges that this is the subject of existing proposals. Any plan to implement the recommendations of the Review should be carefully calibrated with the existing proposals.

- There needs to be consideration given as to how the recommendations will be reconciled with the proposals for enhanced supervisory scrutiny under the banking union proposals. These will address some concerns around interconnectedness and transparency, at least within euro zone banks and should not be repeated under these proposals.

- The discussions around recovery and resolution plans are already underway in some countries. The proposals should not necessarily result in more ex-ante requirements to restructure banking groups being put in place unless there is some form of cost/benefit analysis undertaken.

Bail-in capital

- While calling for clarity the Group does not offer a suggestion of which instruments should be bailed-in – and in which order.

- In recommending that bail-in instruments cannot be held by other banks, the possibility of wholesale deposits raised from other banks being bailed-in is precluded.

- Still uncertain who the investor for 'bail-in' instruments are and what price they would be willing to pay.

Capital requirements

- If the RWA recommendation regarding property assets is to be accepted there would need to be a wider recalibration of other assets. This would probably need to be carried out by the Basel Committee to make sure that it was adopted on a consistent global basis.

- There is a question of whether the Basel 3 minimum leverage ratio of 3% is sufficiently tough, although no specific alternative figure is suggested. A change in this policy at this stage would create considerable uncertainty in the market and should be referred back to the Basle Committee as above.

Corporate governance

- Unclear how the separate entities would interact with the Group board and what the implications are on company law and the ability of the ring fenced banks to 'veto' its ultimate owner.

- Numerous proposals currently contain add-on requirements which risk not producing an overall successful result.

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