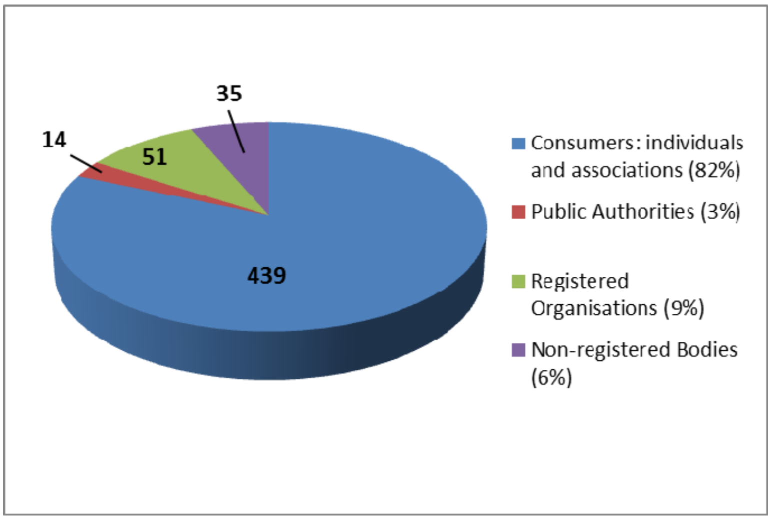
SUMMARY OF REPLIES TO THE STAKEHOLDER CONSULTATION ON STRUCTURAL REFORM OF THE BANKING SECTOR

In the context of the impact assessment accompanying a potential legislative proposal on reforming the structure of large EU banks, the Commission services have conducted a public stakeholder consultation. The consultation was open for eleven weeks (16th May 2013– 11th July 2013). It contained both qualitative and quantitative sections, with the former focusing on questions related to the need for EU action and the different options for legislative reform, and the latter containing a data template for banks to provide data on short and medium term implications of different reform scenarios on their balance sheets. This document summarises the responses to the qualitative part. This note follows the structure of the consultation document and provides a high-level summary of the nature of responses of different stakeholders. The following graphs accompanying each section of the consultation document indicate the proportions of each category of respondents that gave a certain answer[1].

The Commission services received 540 replies. These responses came from the expected type of respondents: banks and other financial institutions, corporate clients, investors, public authorities, and consumer associations and individuals (analysis shown in Graph i). However, while the composition is fairly traditional, the number of responses from individuals (439) and consumer associations (11) stand out. The majority of these 439 replies took either the exact, or abbreviated, form of a recently-publicised Finance Watch response to the consultation.

Graph i: Overall breakdown of consultation respondent by stakeholder type.

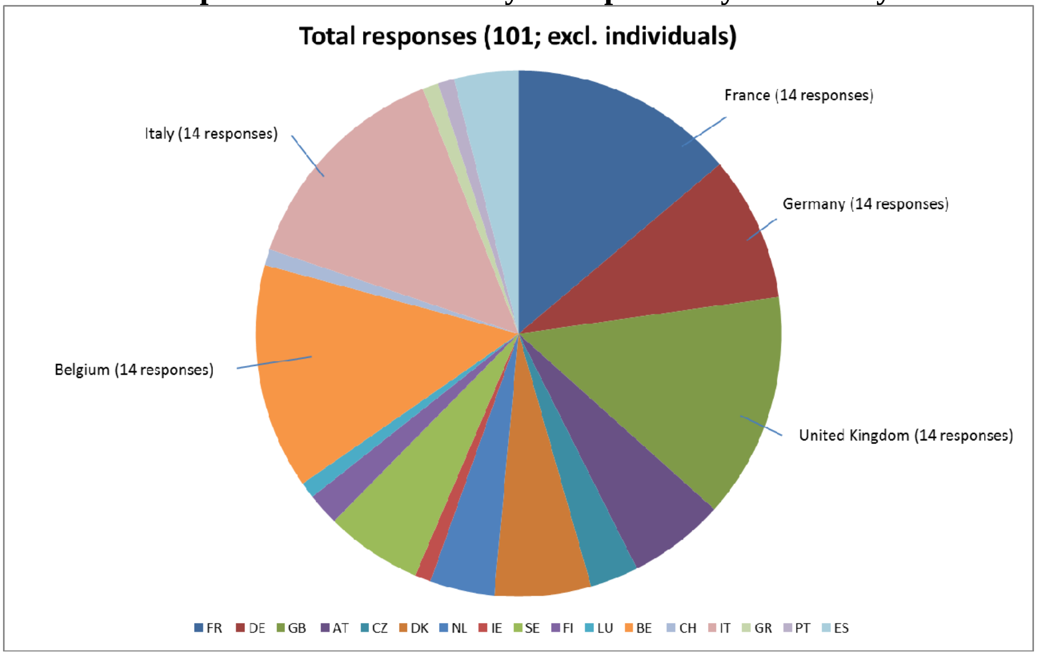


[1] Throughout, figures in parentheses following the chosen option indicate how many positive responses this option received; not necessarily the number of individual stakeholders who would choose the option. That is, respondents were not restricted to choosing a single preferred option for each question. It is for this reason that the sum of the figures in the graphs below may equate to a number greater than the total number of responses received.

The following graph shows the breakdown of all other responses by nationality. It may be worth noting that the relatively high number of responses from Belgium is composed mainly of international organisations headquartered in Belgium, but representing several European countries and member associations.

Breakdown by nationality of the 439 responses from consumer individuals is excluded, as respondents did not indicate within their response from which Member State they wrote. The majority of consumer individuals responded in English (270), followed by French (131), German (22), Italian (15), and 1 response was written in Danish.

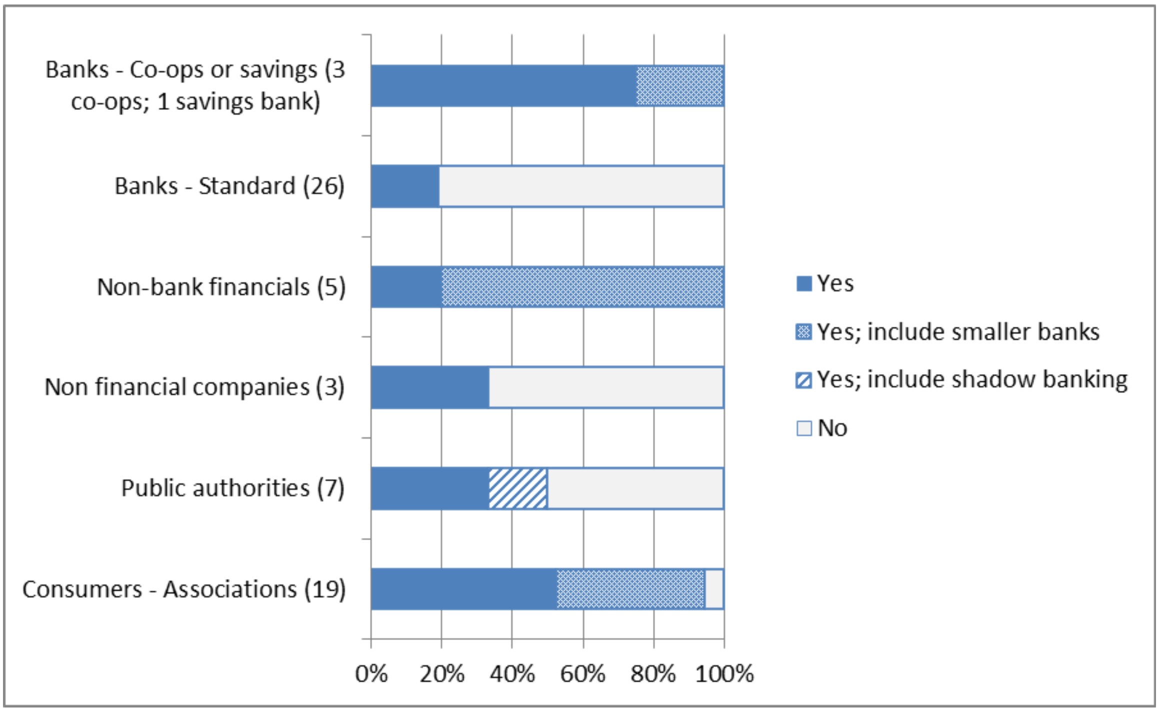
Graph ii: Overall summary of responses by nationality



1. PROBLEM DRIVERS

The consultation document outlined the problems that continue to affect the EU banking sector and outlined the potential contribution structural reform could make in addressing those problems. Stakeholders were then asked whether structural reform of the largest and most complex banking groups could address and alleviate these problems. The answers are summarised in Graph 1.

Graph 1: Are banking structure reforms relevant?



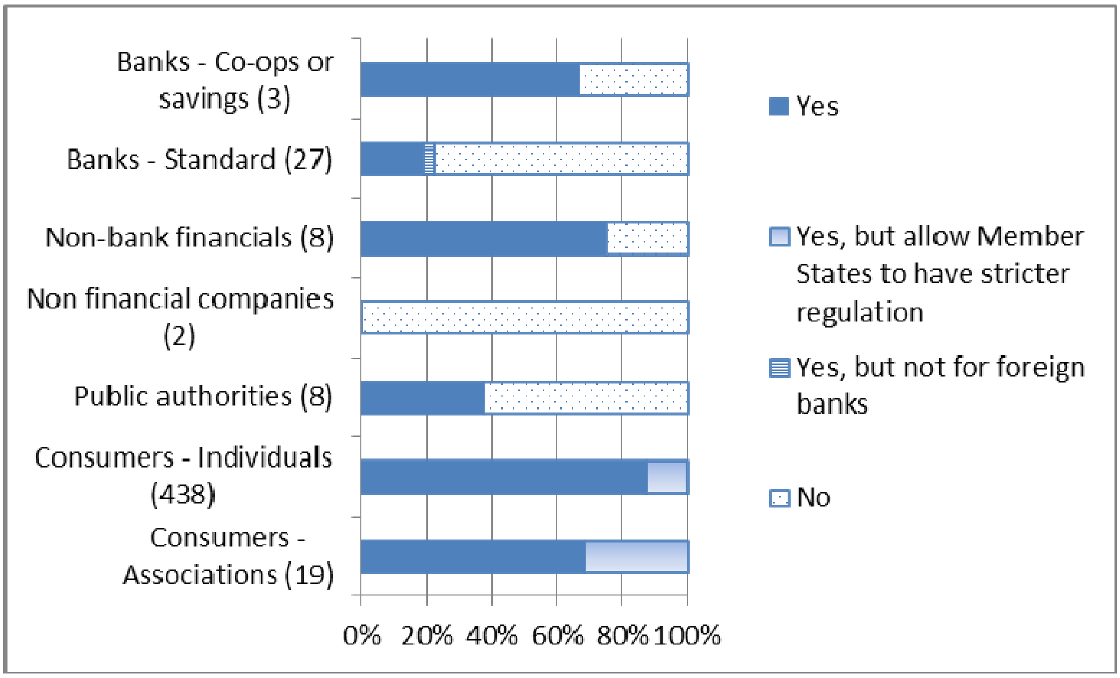
The above graph, showing the type of response as a percentage of overall responses from each group of stakeholder, excludes the responses of individual consumers. This large group's inclusion skews the graphic representation. Individuals responded in large numbers in favour of the reform proposal (433 out of 439 in favour, but with 4 disagreeing with the proposal). Along with the above graph, it is clear that there is a distinct fault line between the responses of banks, on the one hand, and consumers and non-bank financials on the other hand. The former are to an overwhelming extent against structural separation (with the exception of some cooperative banks). The latter are largely in favour. The views of other categories are more balanced. Corporate customers, while acknowledging the need to address TBTF, express opposition, based on the potential impact of such reforms on the cost of financing.

As shown in the graph, some cooperative banks, consumer associations, non-bank financial companies, and public authorities added the comment that they agreed with the proposal, but that it should target smaller banks and should consider the detriment of a shadow banking sector in the proposal process.

2. SUBSIDIARITY

The consultation document then highlighted the on-going reforms within Member States and outlined the potential benefits of action at the EU level, that is, to preserve the integrity of the internal market. It then asked for stakeholders' views on whether they considered an EU proposal in the field of structural reform necessary.

Graph 2: Is EU action needed?



Views on the need for EU action mirror the views on the merits of such reforms in the first place. There is accordingly a large opposition from most banks (excluding cooperatives) and non-financial corporates. Consumer associations and individuals are again unanimously in favour. It may also be interesting to note the relatively high number of consumer responses that supported allowing Member State legislation to "go further," than supranational reform, if possible.

3. POLICY OPTIONS

The remainder of the consultation document asked for views of stakeholders on the three different elements of bank structural reform: the scope of banks to be subject to potential separation, the activities to be separated, and the strength of separation. It also asked for stakeholders' views on the best combination of activities and strength.

3.1. Scope of banks

As regards the scope of banks, the consultation document asked questions related to, first, the threshold for banks to becomes subject to separation, and second, the extent of supervisory judgement in applying the threshold.

As regards the threshold for separation, the document outlined four options:

(1) Using the HLEG definition (Assets held for trading and available for sale);

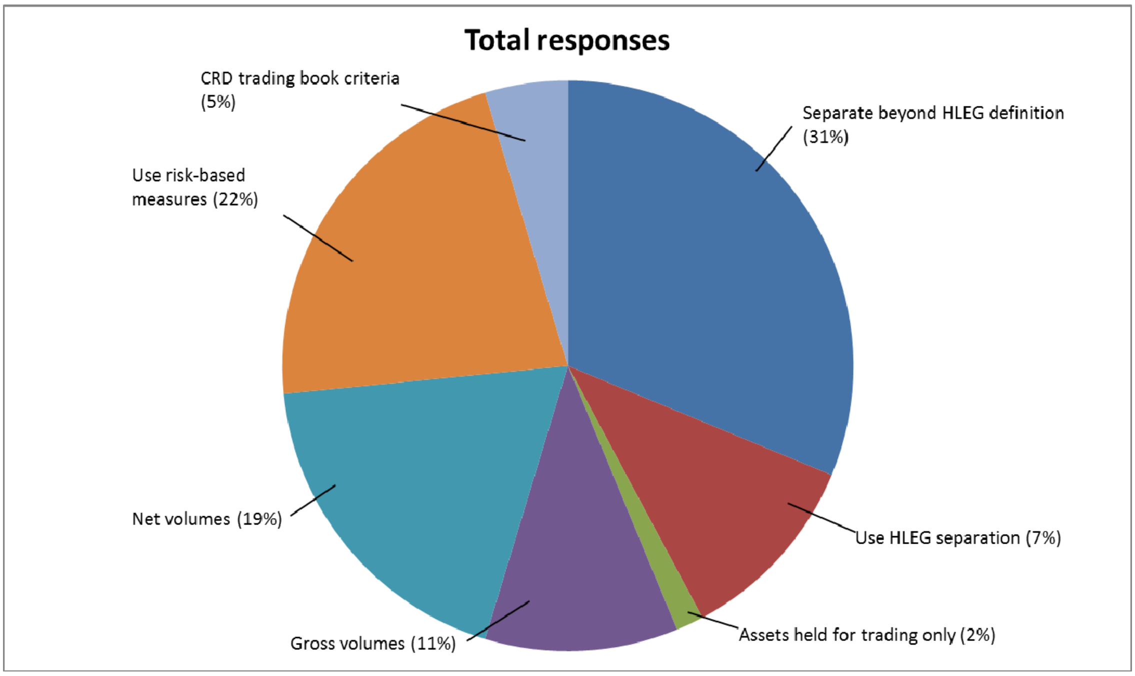
(2) A more narrow definition for separation, which excludes available-for-sale assets, as they are mostly composed of securities held for liquidity purposes;

(3) A definition focused on the gross volume of trading activity, which is likely to focus on proprietary traders and market-makers;

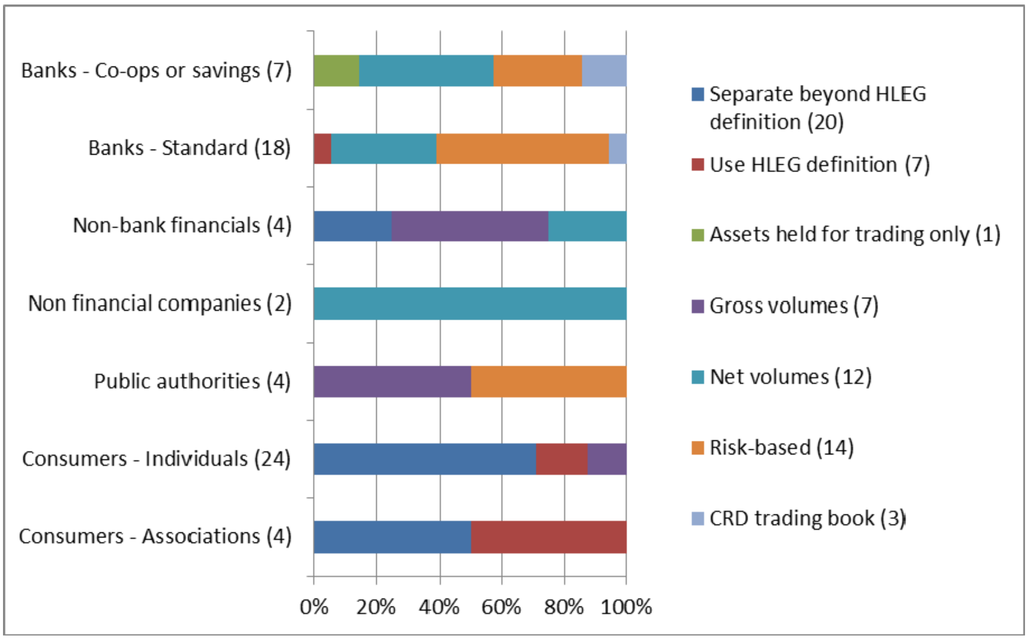
(4) A definition focused on net volumes, which is likely to only capture those institutions that have a higher share of unbalanced risk trading (proprietary traders).

It then asked stakeholders which of the four definitions would be the best indicator to identify systemically risky trading activities. If none of the above, it asked stakeholders to propose an alternative indicator. The views of stakeholders are summarised in Graph 3a. Many stakeholders, particularly consumers, did not respond to this rather technical question. Of those who did, many rejected the HLEG recommendation (option 1). Most banks, as well as public authorities, argue in favour of a risk-based approach. For those banks that expressed an opinion on the four options given (standard and cooperatives and savings), the majority favours option 4 (net volumes). Among other stakeholders, the debate lays between gross and net volumes, with the latter having the most widespread constituency.

Graph 3a: Threshold options by total consultation response.



Graph 3b: Threshold options by respondent



As regards the degree of supervisory judgement, the consultation document outlined three options:

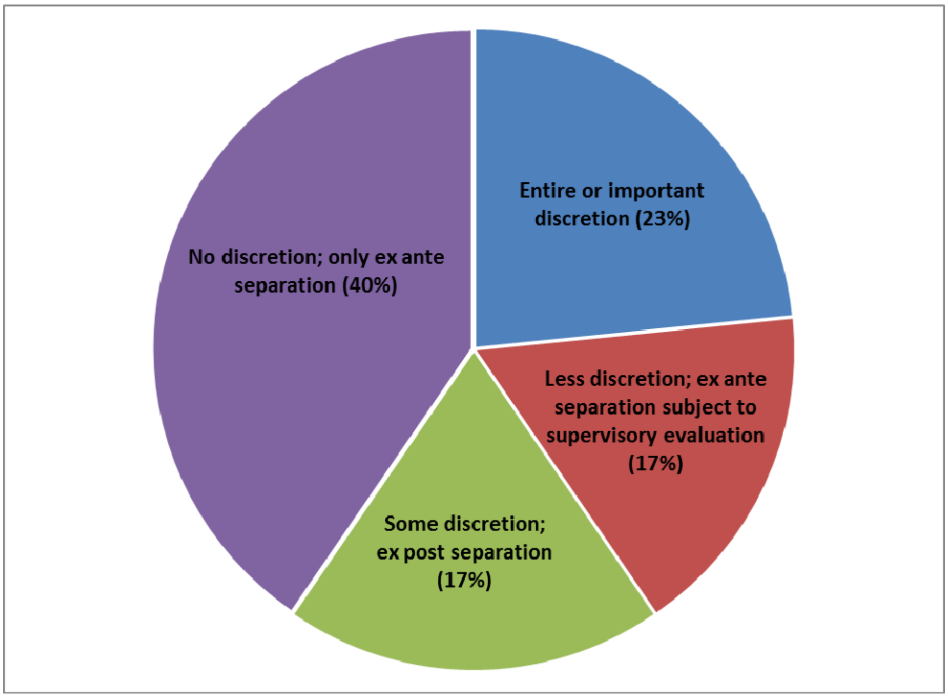
(1) *Ex post* separation subject to constrained discretion by the supervisor;

(2) *Ex ante* separation subject to evaluation by the supervisor; or

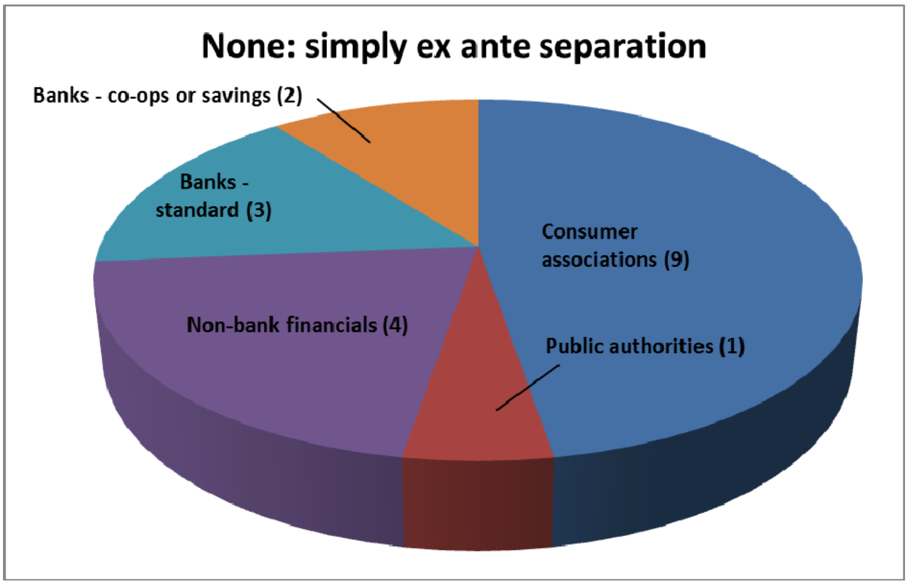
(3) *Ex ante* separation.

It then asked for stakeholders' views on which would be the most appropriate approach, including suggestions for alternatives. The pattern of responses is similar to views of the fundamental merits of structural separation. Bank respondents however are more divided, already showing some acceptance of separation with limited supervisory discretion, mostly to ensure a level playing field in the market and ensure legal certainty. The graph below does not reflect the responses of individual consumers, as the volume of these respondents again will skew the graphic illustration. The consumers who did answer this question (216) expressed complete support for no supervisory discretion.

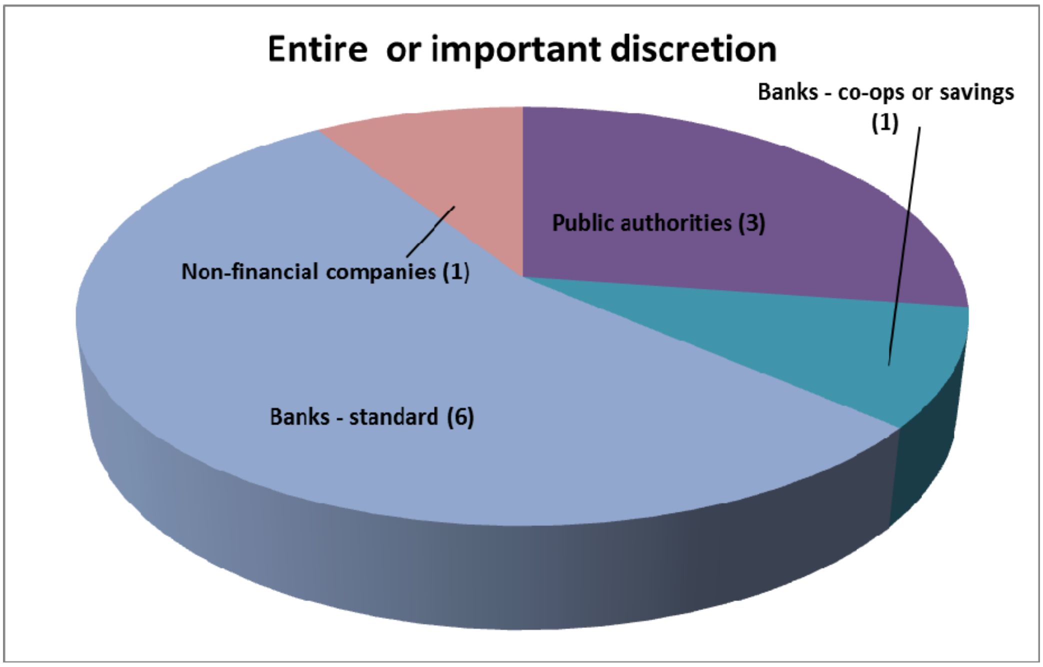
Graph 4: The degree of supervisory judgement (excluding individual consumers)



Of those non-individuals who responded to this question, 3 of the 18 total standard banks responded favourably to leaving no supervisory discretion, with ex ante separation. The graph below depicts the composition of respondents (excluding the 216 individual consumers) who responded in the same way.



Contrastingly, a third of all standard banks who responded to the consultation replied in favour of either entire or important discretion:



3.2. Activities

The consultation document highlighted the broad range of activities banks may engage in and provided three scenarios for separation, ranging from only some activities (e.g. proprietary trading, PT) being separated and the trading entity thus remaining 'narrow' and the deposit-taking entity 'broad'; to a scenario where many activities (e.g. all wholesale and investment bank activities, WIB, would be separated and the trading entity accordingly becoming 'broad' and the deposit entity correspondingly 'narrow'. More specifically:

(1) "Narrow" trading entity and "broad" deposit bank;

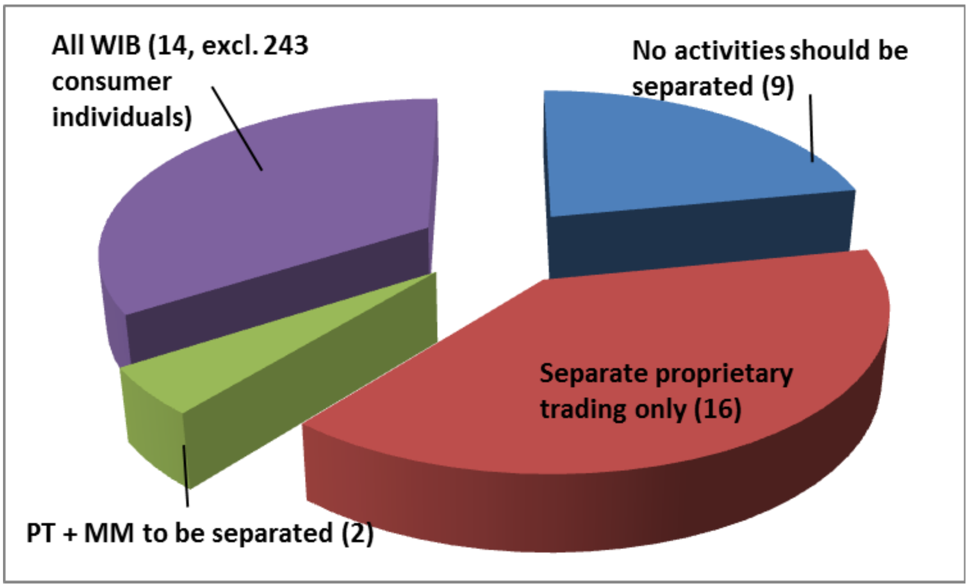
(2) "Medium" trading entity and "medium" deposit bank; or

(3) "Broad" trading entity and "narrow" deposit bank.

It then asked a question specifically related to the separation of market-making (MM) and underwriting activities. This question has served as a foundation for classifying responses into the three options highlighted above.

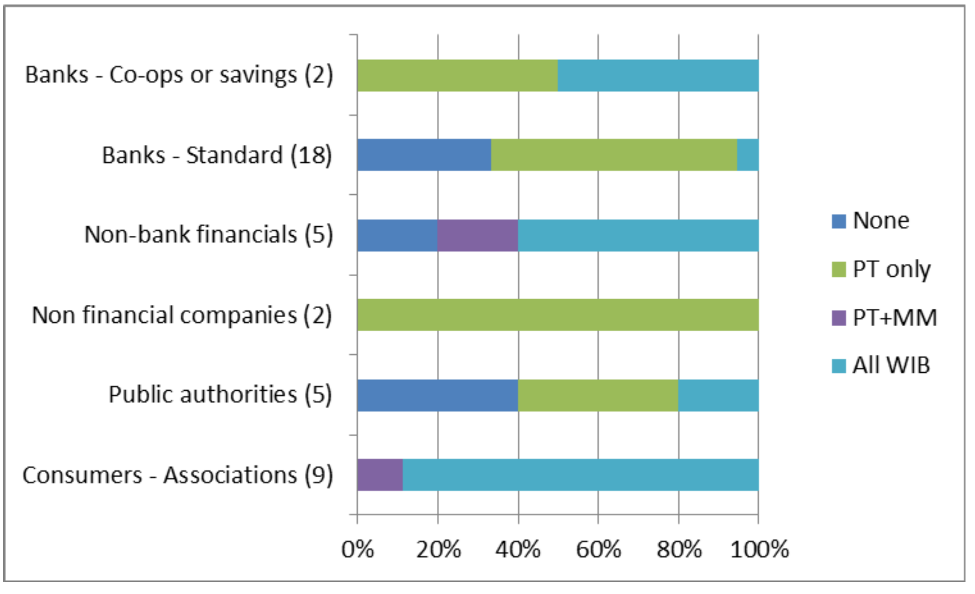
Responses here again reflect the general pattern of replies. Bank responses are divided between those who argue against separation, and those who argue that if there is to be separation, then it should only focus on proprietary trading. This sentiment is echoed by corporates, who argue in favour of an as narrow separation as possible in order not to affect their access to (low cost) financial services. Individuals and consumer associations on the other hand favour option 3, i.e. separation of all investment bank activities.

Graph 5: Which activities should be separated?



Consumer individuals are excluded from the above graph, as 243 extra favourable respondents skewed the scale of the chart. The individuals who were in favour of the reform and who responded to the question, however, were all in favour of separating all wholesale and investment activities. As shown in the graphs, standard banks who accept a certain degree of separation favour separating proprietary trading only from the deposit-taking entity, much like non-financial companies and some public authorities.

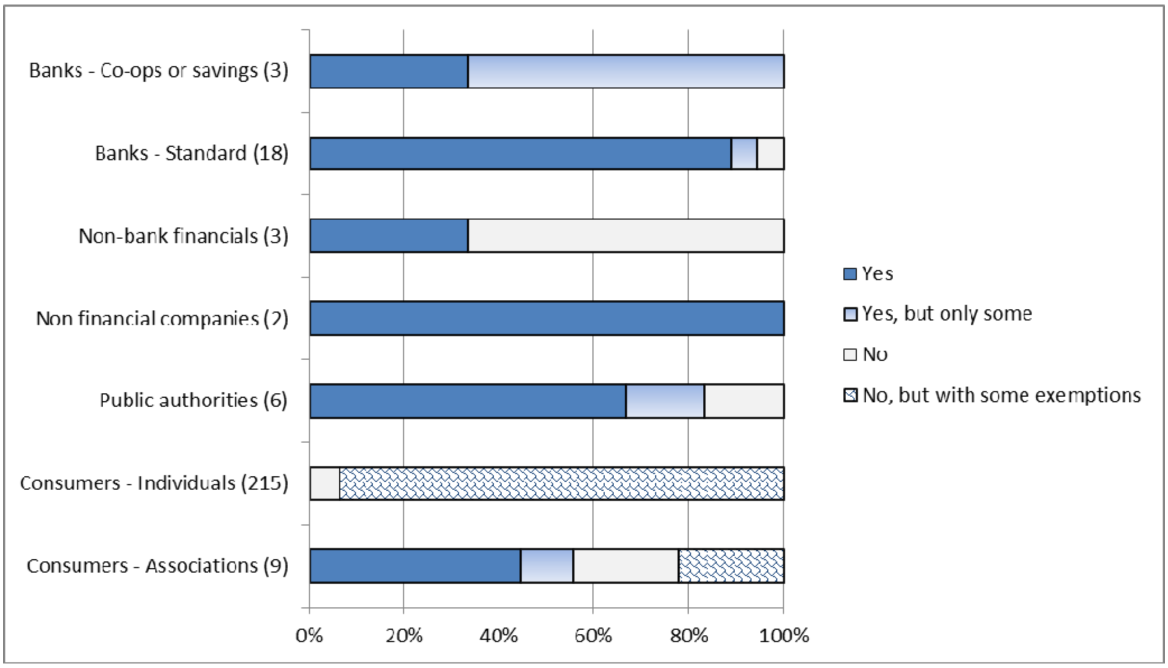
Graph 6: Activities to be separated, by respondent



The consultation document also highlighted the particular case of risk management products, where the banking group and its constituent entities not only need to be able to engage in prudent risk management practices for treasury purposes, but where the deposit entity may provide risk management products to its clients. The consultation document therefore asked if deposit-taking entities should be allowed to directly provide risk management services to clients, and if so, whether any additional safeguards should be considered.

Many stakeholders did not respond to this rather technical question. Of those who did, many (most banks) responded in favour of the deposit-taking entity being able to provide such services. Some argued in favour of safeguards (e.g. simple derivatives, caps). Consumers, some non-bank financials (investors) and public authorities were against such provisions.

Graph 7: Should the deposit entity be able to provide risk management products?



3.3. Strength of separation

The consultation document subsequently highlighted different forms of separation and indicated that the Commission services were considering three degrees of strength:

(1) Functional separation with economic and governance links restricted according to current rules;

(2) Functional separation with tighter restrictions on economic and governance links; or

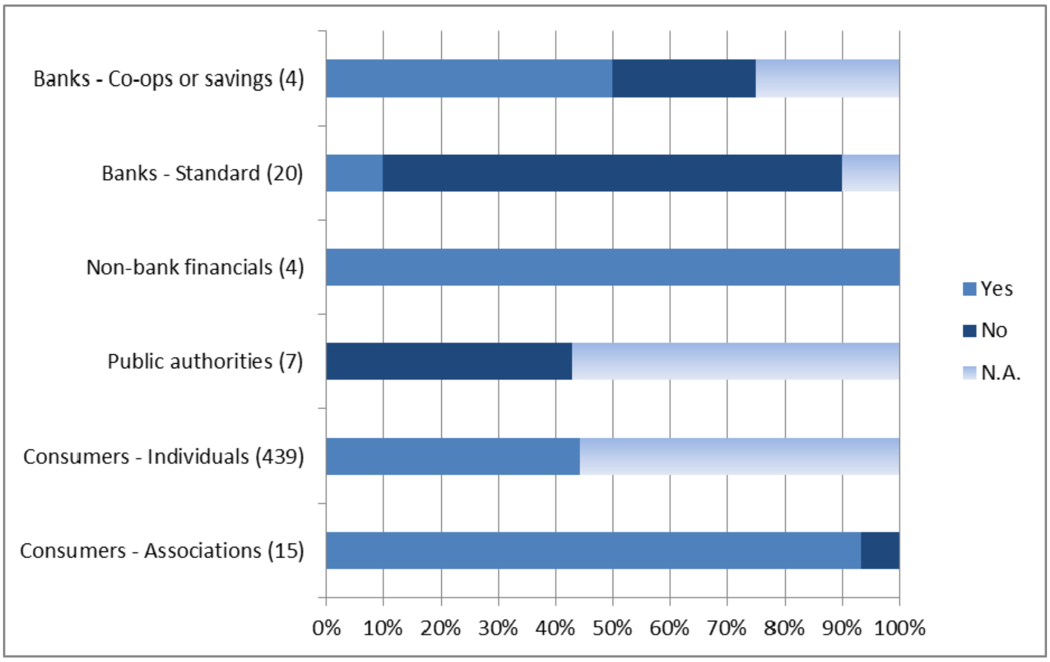
(3) Ownership separation (full prohibition).

It then asked stakeholders for their views on the pros and cons of stricter legal and economic separation, as well as views on full ownership separation.

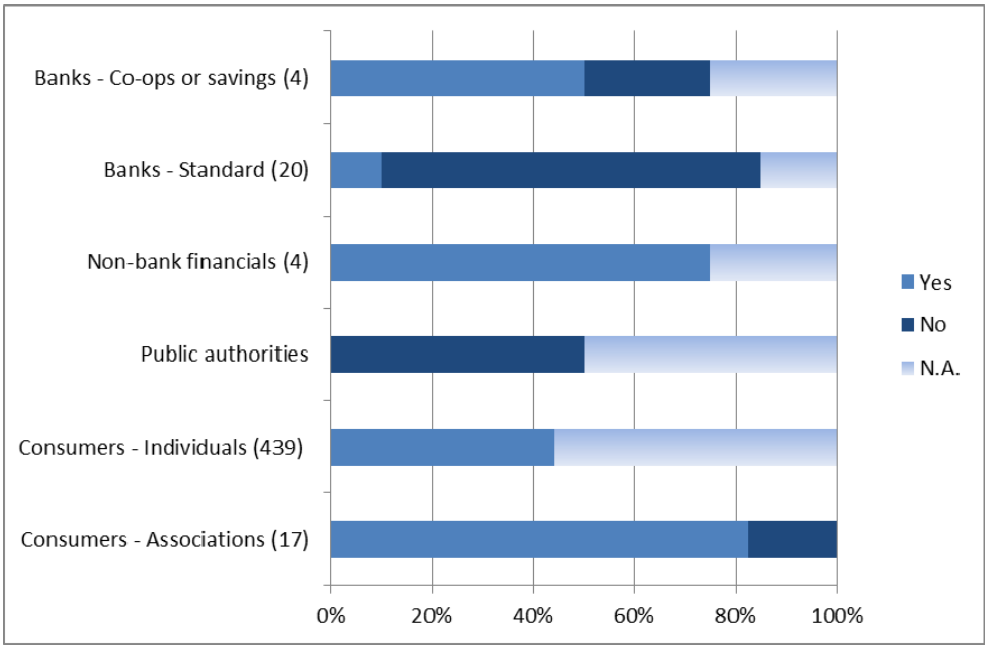
- As regards legal and economic separation, the classical pattern can be observed, with some cooperatives being concerned about the potential implication of structural reform on their reverse-ownership structure;

- As regards ownership separation, this has polarised opinion, with most banks highlighting the costs, and consumer associations and individuals and some non-bank financials highlighting it as the simplest and most effective option in the longer term.

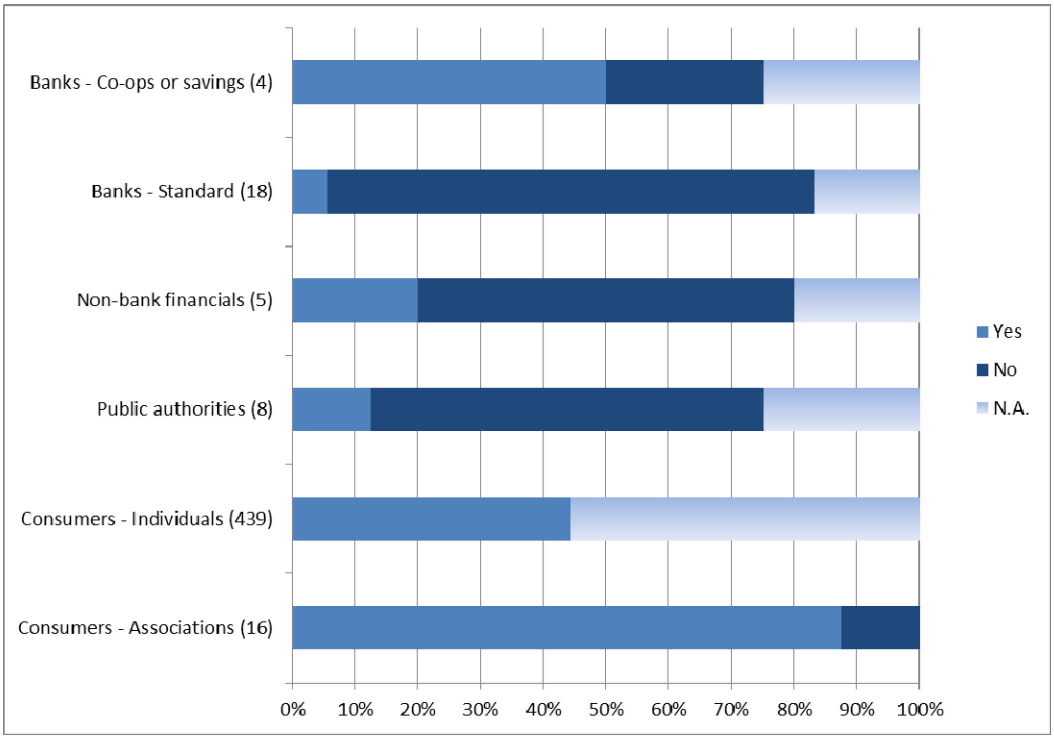
Graph 7: Is there a case for stricter legal separation?



Graph 8: Is there a case for stricter economic separation?



Graph 9: Is there a case for full ownership separation?



Non-financial companies have been excluded from the above graphs, as they consistently did not reply to the questions on the strength of eventual activity separation.

As shown by comparing the three graphs, there is a high level of consistency across respondents. That is, a large proportion of respondents in favour of increased economic separation are also in favour of increased legal separation, for example.

3.4 Options

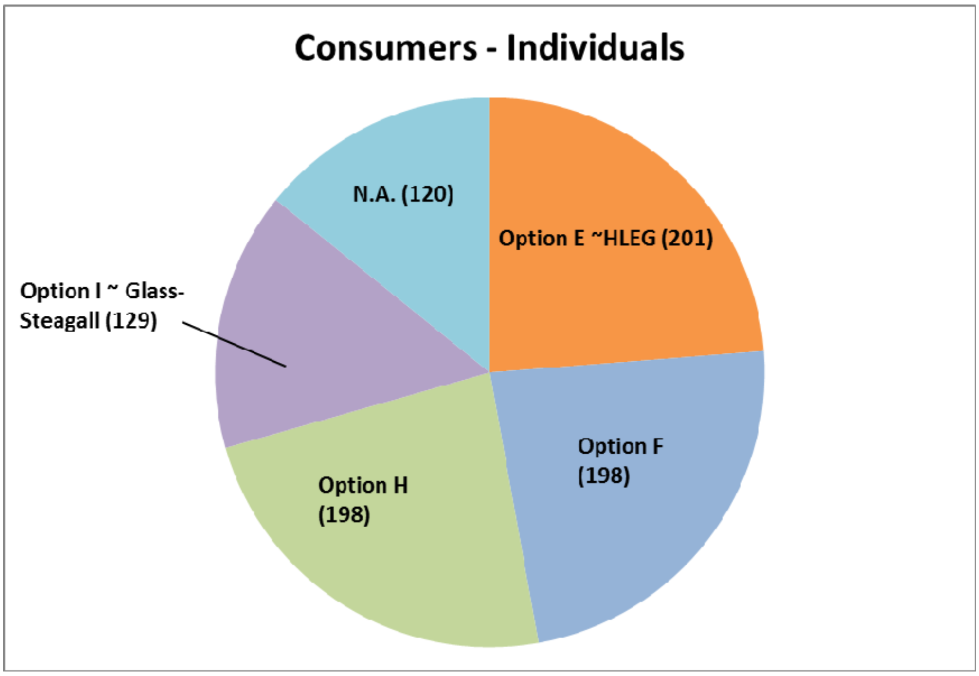
The consultation document then highlighted a number of preliminary and illustrative combinations of different degrees of activity restrictions and separation degrees that would be subject to further assessment in terms of costs and benefits (Table 1).

Table 1: Overview of policy options

Activities\ strength	**Functional separation 1 (SUB)** *Current requirements*	**Functional separation 2 (SUB+)** *Stricter requirements*	**Ownership separation** *Ownership separation*
Narrow trading entity/ broad deposit entity *E.g. Proprietary trading + exposures to HF (PT)*	Option A	Option B [≈ FR, DE baseline]	Option C [≈ US Volcker]
Medium trading entity/ medium deposit entity *E.g. PT + market-making (MM)*	Option D	Option E [≈ HLEG; ≈ FR, DE if wider separation activated]	Option F
Broad trading entity/ narrow deposit entity *E.g. all investment banking activities*	Option G	Option H [≈ US BHC; ≈ UK]	Option I [≈ Glass-Steagall]

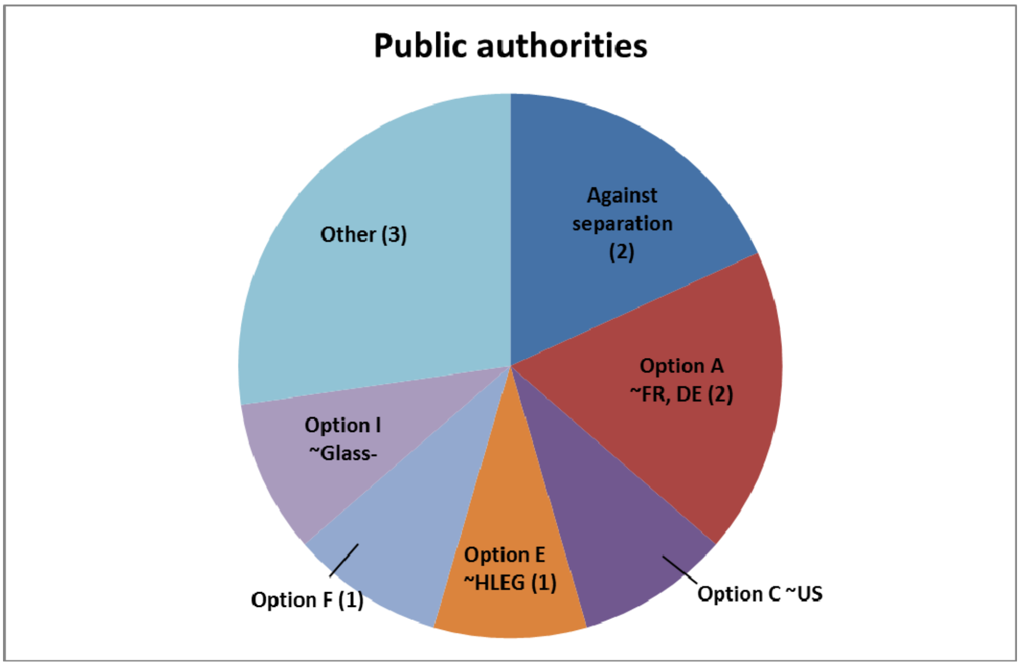
It then asked stakeholders whether (i) the above matrix captured a sufficiently broad range of structural reform options and (ii) which option would, in stakeholders' views, best address the problems identified. Fundamental views show up again, with a large portion of banks expressing a blanket opposition to structural reforms or endorsing option A (PT Only). Consumer associations and individuals, however, argue that option E (HLEG) is the minimum effective option and express a preference for either option H (UK ICB) or I (Glass-Steagall).

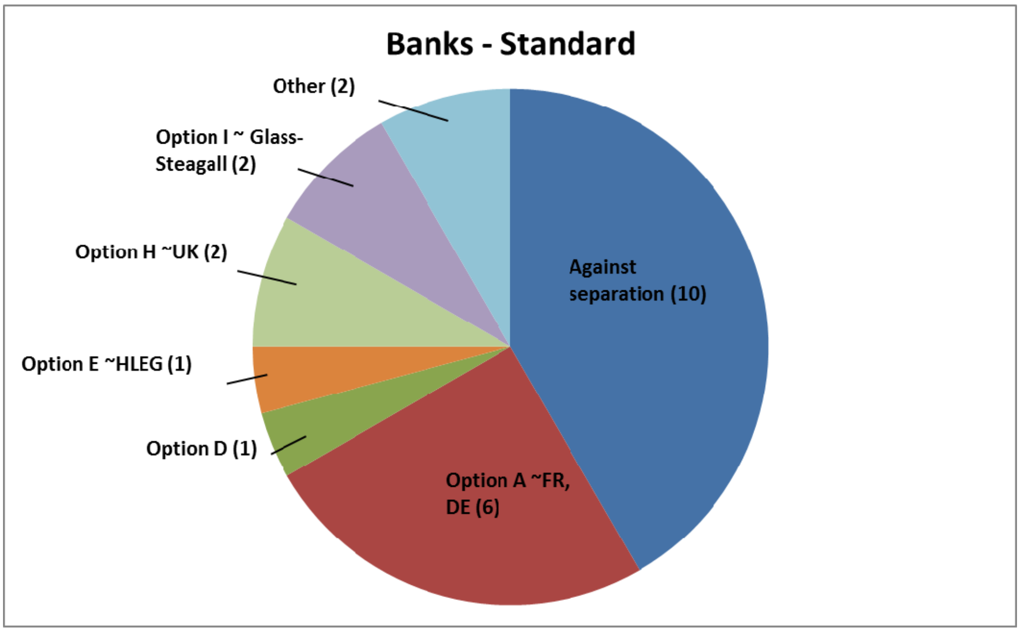
Graph 10: Preferred reform approach

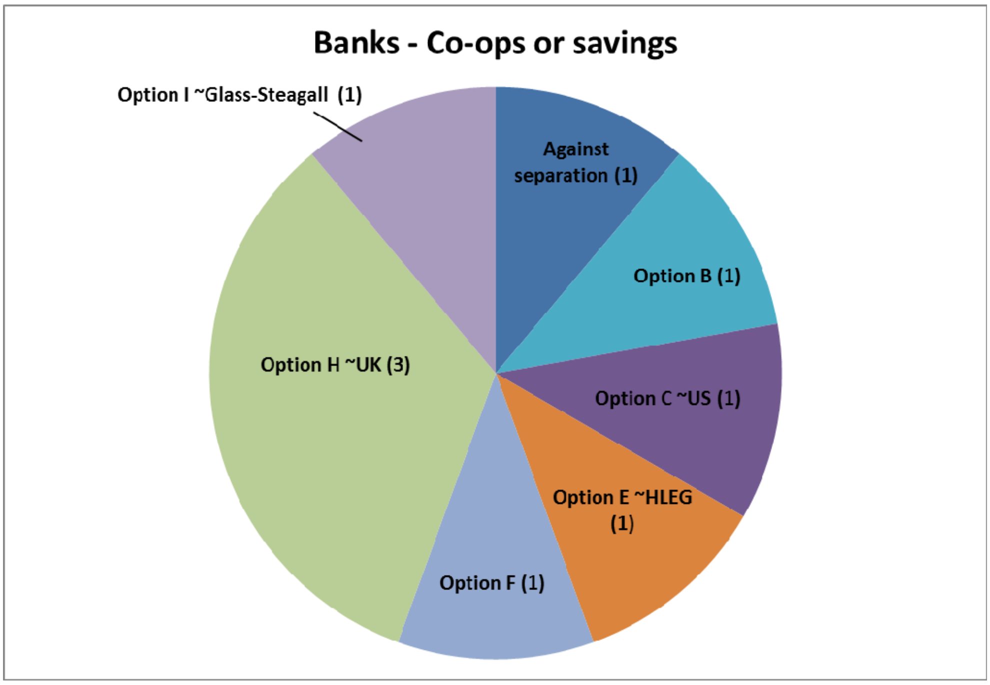


As with several of the other responses, it is worthy to note that the respondents do not necessarily add up to the total number of responses received by the Commission. For this question in particular this is especially evident, as many stakeholders expressed their preference for Option E as a minimum option, but said that combinations such as H and I or F and I would also work.

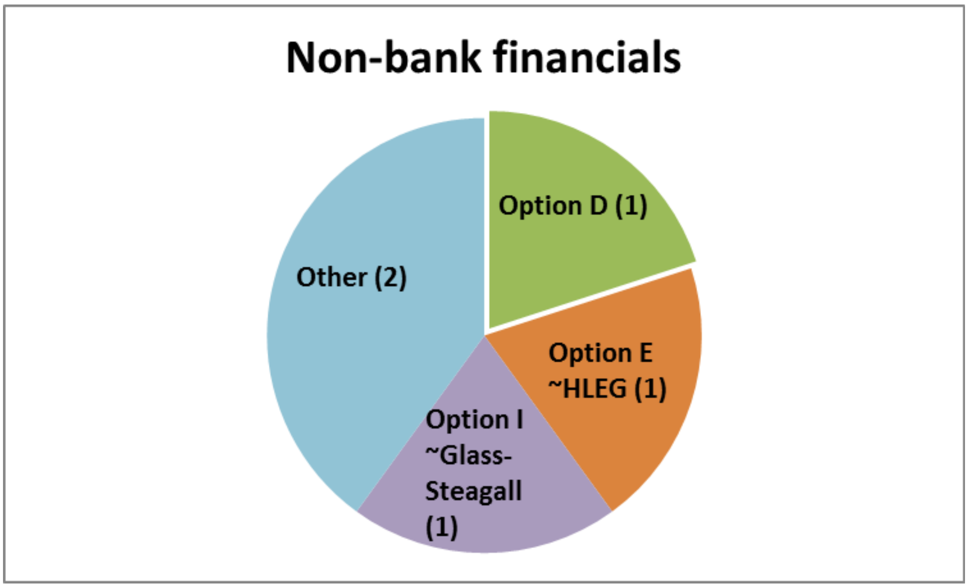
Only one public authority cited capping total assets as the preferred reform method. Others were divided fairly evenly over the range of options.







With regards to consumer associations, four respondents preferred option H (~UK), while 14 respondents preferred the Glass-Steagall type option on structure, or option I for separation. Only Option G received no support from any respondent.



4. Conclusion

While consumers are overwhelmingly in favour of the proposal for structural reform and banks are predominantly against, where respondents addressed the numerous detailed choices within the proposal, they displayed a wide range of views. Of course especially for the final policy option and the divide between banks and consumers regarding supervisory discretion, some dominant choices appear. Accompanied by several detailed, analytical responses to the consultation document, as well as the quantitative feedback from banks, the Commission has gleaned much information from the varied group of respondents.