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AFEP POSITION PAPER
ON THE REFORM OF THE STRUCTURE OF THE BANKING SECTOR IN THE EUROPEAN UNION
REPORT OF THE LIIKANEN GROUP

The group of experts chaired by Mr Liikanen released on 2 October 2012 a report of recommendations ('Liikanen report[1]') on a reform of the banking sector in the European Union (EU). This report, after being assessed and discussed, could lead to the adoption of "any legislative proposals" by the European Commission in the second half of 2013.

AFEP, which represents the largest French companies from all business sectors, welcomes the opportunity to respond to the Commission consultation and to highlight the point of view of large international groups that are bank customers[2].

1. Identifying key issues for corporate customers of banks

In continuation of measures that are already being developed to draw the consequences of the crisis in Europe, the report aims to strengthen the stability of the financial system by avoiding that, in case of a financial crisis, assets related to deposit banking activities are used without limits to offset losses from investment activities. In this regard, the report proposes in particular:

– **to legally separate, within banking groups, financial activities considered to represent the riskiest parts of trading activities and where risk positions can change most rapidly:**
    - if these activities amount to a significant share of a bank's business, proprietary trading (on securities, derivatives…) and the following trading activities should be assigned to a separate entity ('trading entity'): all assets or derivative positions incurred in the process of market-making, loans to hedge funds, Structured Investment Vehicles (SIVs) and other such entities of comparable nature, as well as private equity investments;
    - however, **deposit banks would, inter alia, be permitted to perform the following activities**: lending; trade finance; participation in loan syndications; plain-vanilla securitisation for funding purposes; **provision of hedging services to non-banking customers which fall within narrow position risk limits in relation to own funds**; securities underwriting; use of derivatives for own asset and liability management purposes, as well as sales and purchases of assets to manage the assets in the liquidity porfolio; private wealth management and asset management.

– to **reinforce certain capital requirements** (more robust risk weights and more consistent treatment of risk in internal models...), concerning in particular assets held for trading and real estate lending.

The Commission emphasizes that one of the objectives of separation of the investment activities is to prevent the coverage of risky activities, as **the financial solidarity from the retail banking would continue to apply, even if it would be restricted according to the normal large exposure rules on interbank exposures.**

[1] The Liikanen report is hereinafter referred to as 'report'.
[2] Please refer to the enclosed presentation of AFEP.

Companies note that other approaches than those used in the Liikanen report are retained elsewhere, but stress that the debate is still very much focused on the EU and the United States (Dodd-Frank Act).

2. Objectives and stakes for non-banking companies

While understanding the objectives of the Liikanen report, in particular the need to strengthen the stability of the financial system, companies consider that the possible implementation of some of its recommendations should fulfill three essential conditions:

- **preserve the banking activities and services relevant to the financing of the economy and to the activities of non-banking companies** (industrial, commercial, financing and investment / treasury activities);
- **not excessively reduce the market-making activities** of European banks relative to their international competitors, which could potentially penalise the European financial industry, reduce the supply of certain banking services and raise their costs for corporate customers (cf. below);
- if the capital requirements for European banks were reinforced for certain activities which are considered riskier, **consider lower requirements for activities relevant to non-banking companies**, including long-term financing activities.

While noting in the Liikanen report **that the list of activities permitted to deposit-taking banks is not exhaustive, companies consider that they should be closely involved in the definition of such activities**, if the recommendations would be the subject of legislative proposals. In particular, non-banking companies believe that the permitted activities as currently listed are relevant, but remain particularly attentive regarding the **conditions in which they could carry out hedging transactions** (as limits are being mentioned in the report).

3. Specific case of market-making activities

Companies wish to draw the attention of the Commission to the possible consequences of an obligation to assign market-making activities to a trading entity, for European banks and non-banking customers.

Banks argue that **the absence of guarantee from the parent company of a universal banking group to such entity would substantially alter its access to funding and its ability to act as counterparty in the interbank market**. This could have several adverse consequences:

- a **reduced ability of European banks to participate in market-making activities and in issuances of securities on the primary markets**, which are often performed in a complementary manner: this would benefit competing banks from countries that are not subject to the same obligations for market-making activities (US banks or banks from other third-countries);
- **lower liquidity** for financial instruments that are issued by corporates (bonds, shares) or commonly used by them to offset market volatility (derivatives, including foreign exchange and / or interest rate derivative instruments);
- **reduced competition and offer of banking services** and higher costs of related transactions **for corporate customers**;
- more generally, decrease in the profitability of European universal banks and increase in the cost of **bank financing**, while the latter is particularly important in the European Union (about 80% of corporate financing).

4. Need for extended impact studies

Companies have noted the intention of the Commission to assess the impact of the Liikanen report's recommendations on growth and on the security and integrity of financial services. They also call on the Commission **to study, for corporate customers of banks, the impact of the recommendations concerning market-making activities on liquidity, as well as on the availability and cost of banking activities and services (issuances of securities; bank financing; involvement as counterparties).**

About AFEP:

The purpose of AFEP (French Association of Private Companies) is to present the views of large French companies to the European Institutions and the French authorities, mainly with regard to the drafting of non-sectoral legislation (on the economy, finance, taxation, company law, financial information and markets, competition, intellectual property rights, consumer affairs, social regulations, employment legislation, environment, etc.).

AFEP represents more than 95 of the top private sector companies operating in France. The French listed companies which belong to AFEP have more than 5,8 million employees and a combined turnover of over 1500 billion euros. Their market capitalisation in 2011 amounted to 800 billion euros.

As a genuine force for generating new proposals, AFEP is also a prime forum for contacts between member firms and public authorities, which do not hesitate to consult the Association when considering plans for reforms or regulations. Senior officials in the European Union and French administrations regularly take part in meetings organised at the head office of the Association, enabling direct and constructive dialogue to take place.

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