



EUROJÄRJESTELMÄ
EUROSYSTEMET

Is a Reform of Banking Structures Necessary?

Speech by

Governor Erkki Liikanen

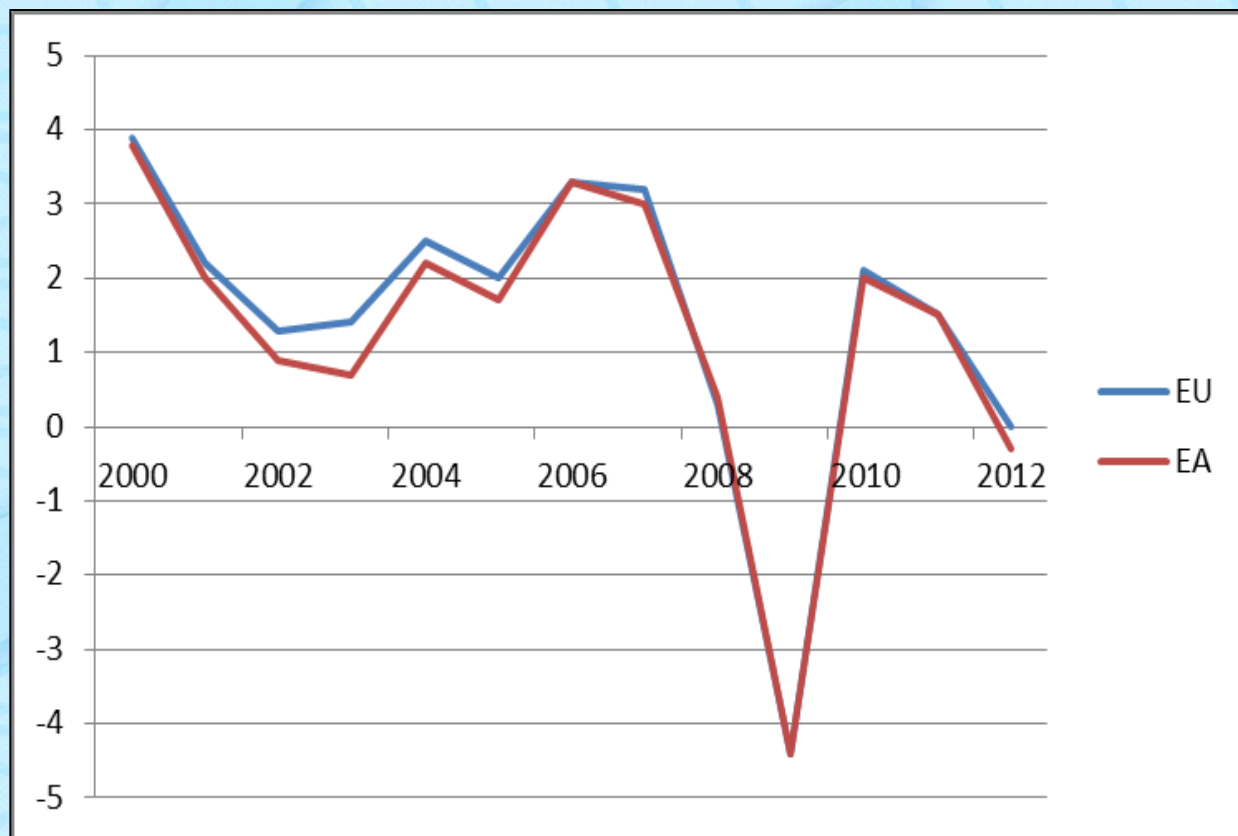
Chairman of the High Level Expert Group

Meeting with Finance Watch, Brussels

20.11.2012

Crisis impact on the real economy substantial

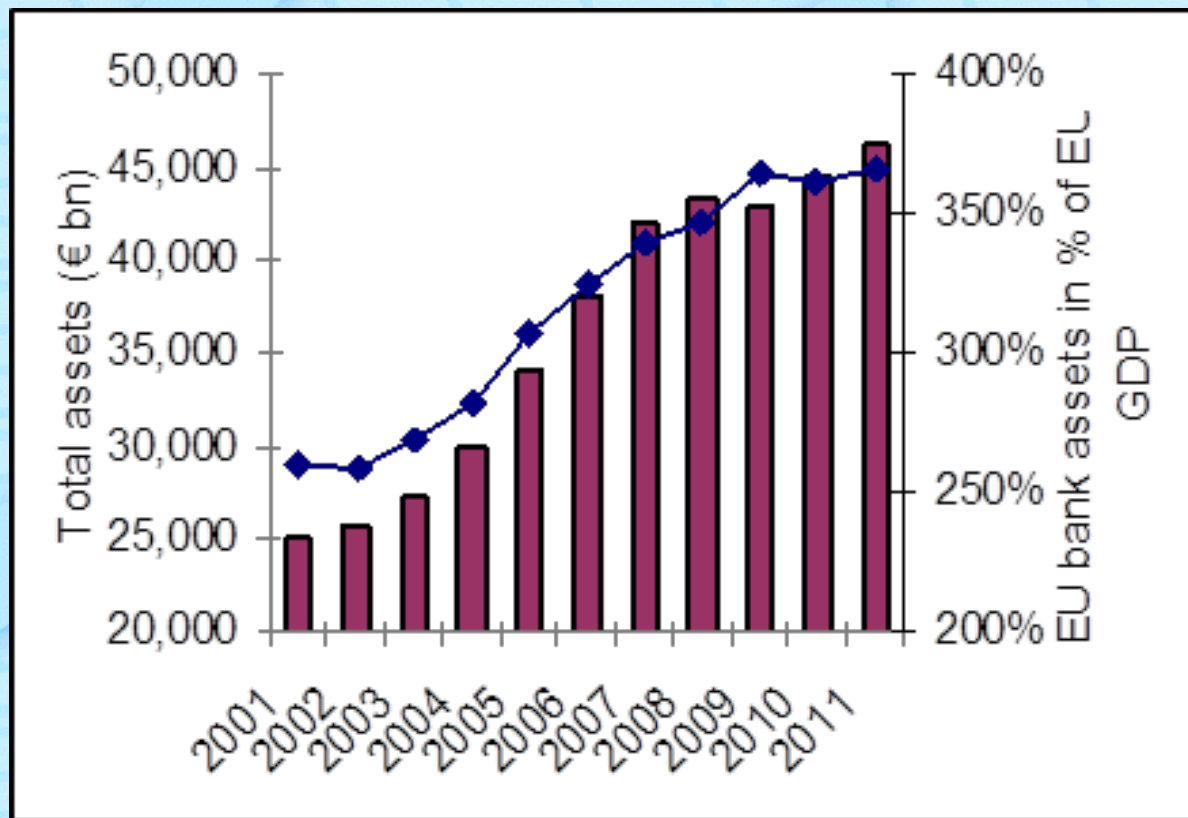
GDP growth rate (% p.a.)



Source: Eurostat data as presented in High-level Expert Group Final Report

Rapid growth in the EU banking sector

Total assets of MFIs in EU 2001-2011

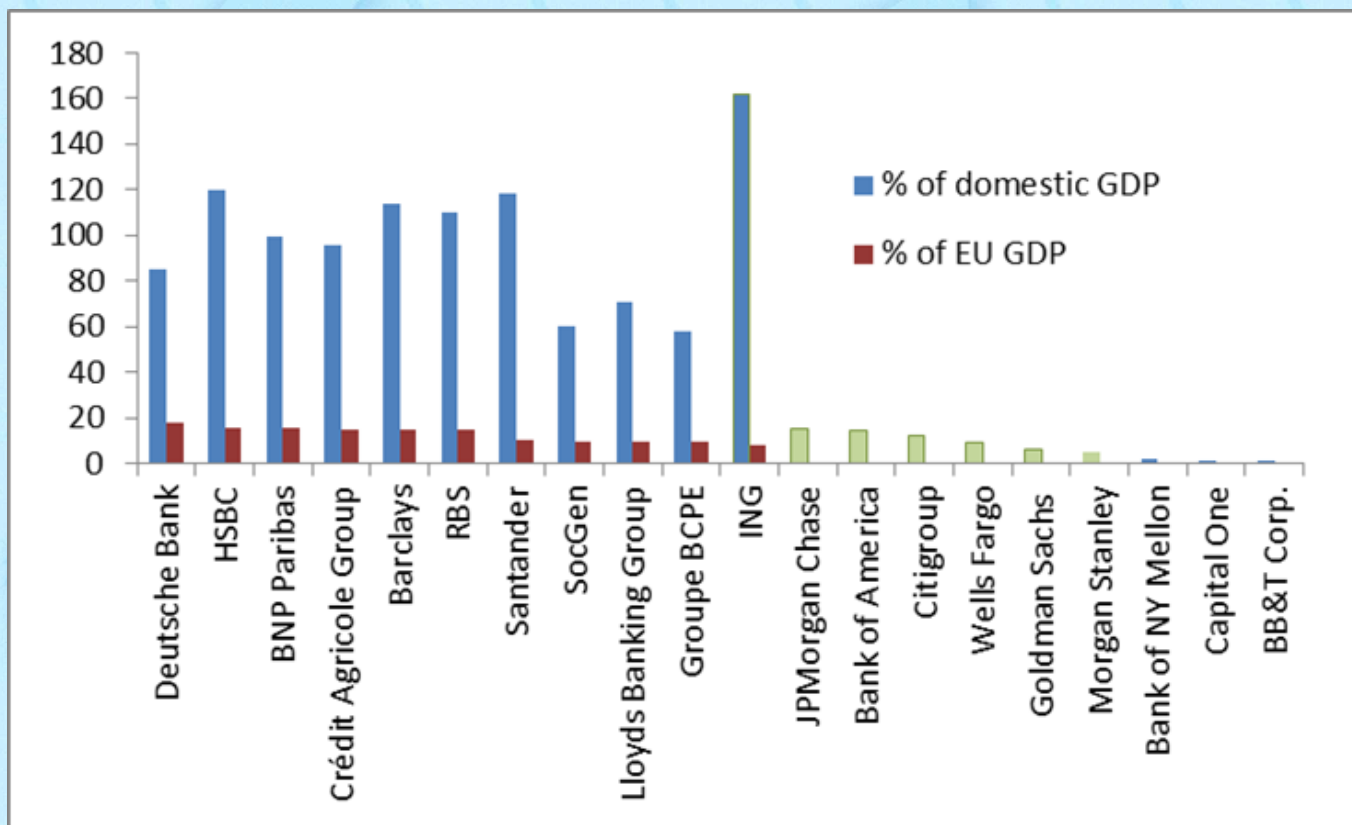


Note: Bar charts show total assets, dotted line shows assets as % of GDP

Source: ECB data as presented in High-level Expert Group Final Report

EU bank assets are sizable compared to home country GDP

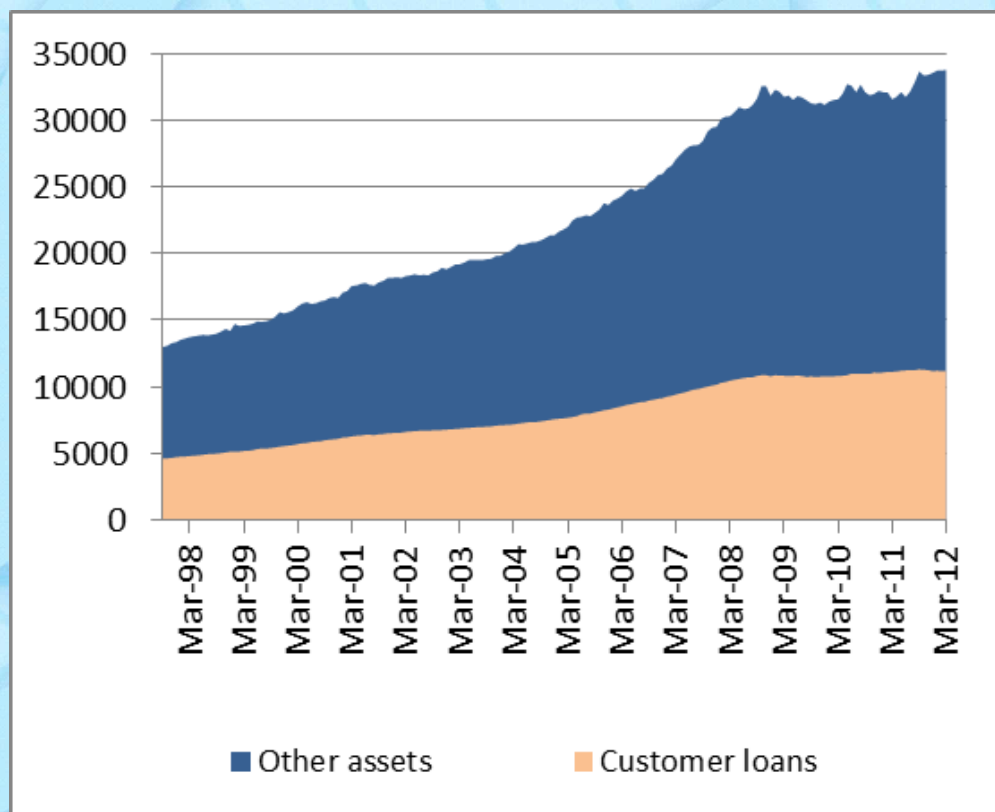
Total assets of EU and US banking groups (2011, in % of GDP)



Source: Data from SNL Financial. Eurostat for GDP data as presented in High-level Expert Group Final Report

Shifts in focus of operations as illustrated by shifts in assets structures

Evolution of assets of MFIs in EU the euro area 1998-2012 (€billion)

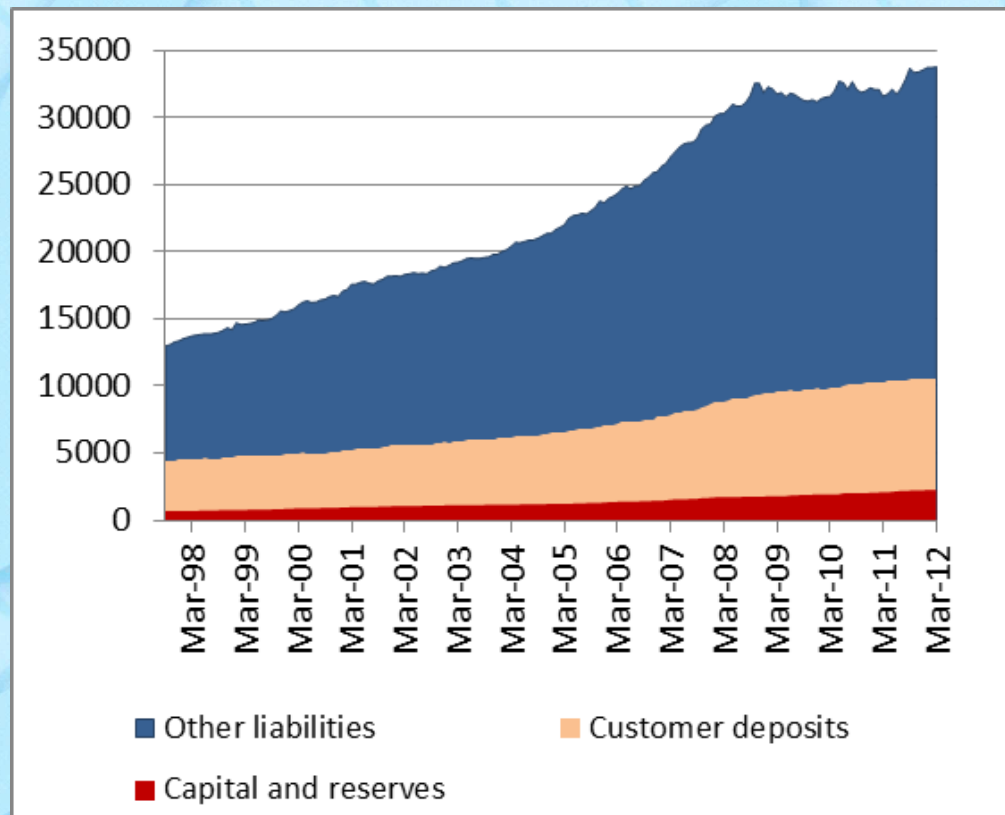


Notes: Customer loans are loans to non-monetary financial institutions excluding general government

Source: ECB data as presented in High-level Expert Group Final Report

Increased leverage as illustrated by shifts in funding structures

Evolution of liabilities of MFIs in the euro area 1998-2012 (€billion)

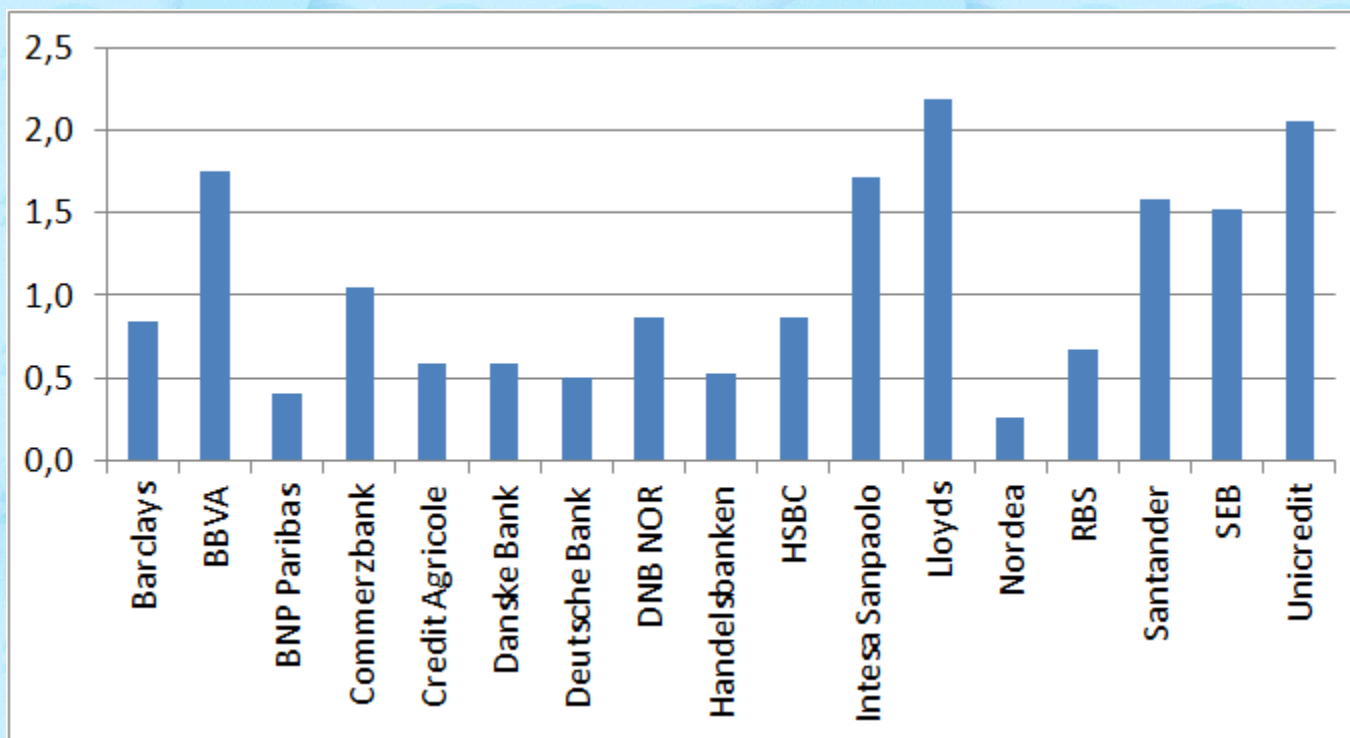


Notes: Customer deposits are deposits of non-monetary financial institutions excluding general government.

Source: ECB data as presented in High-level Expert Group Final Report

Insufficiencies in capital requirements on trading book positions

Capital requirements for market risk for large EU banks (2011, as % of trading assets)

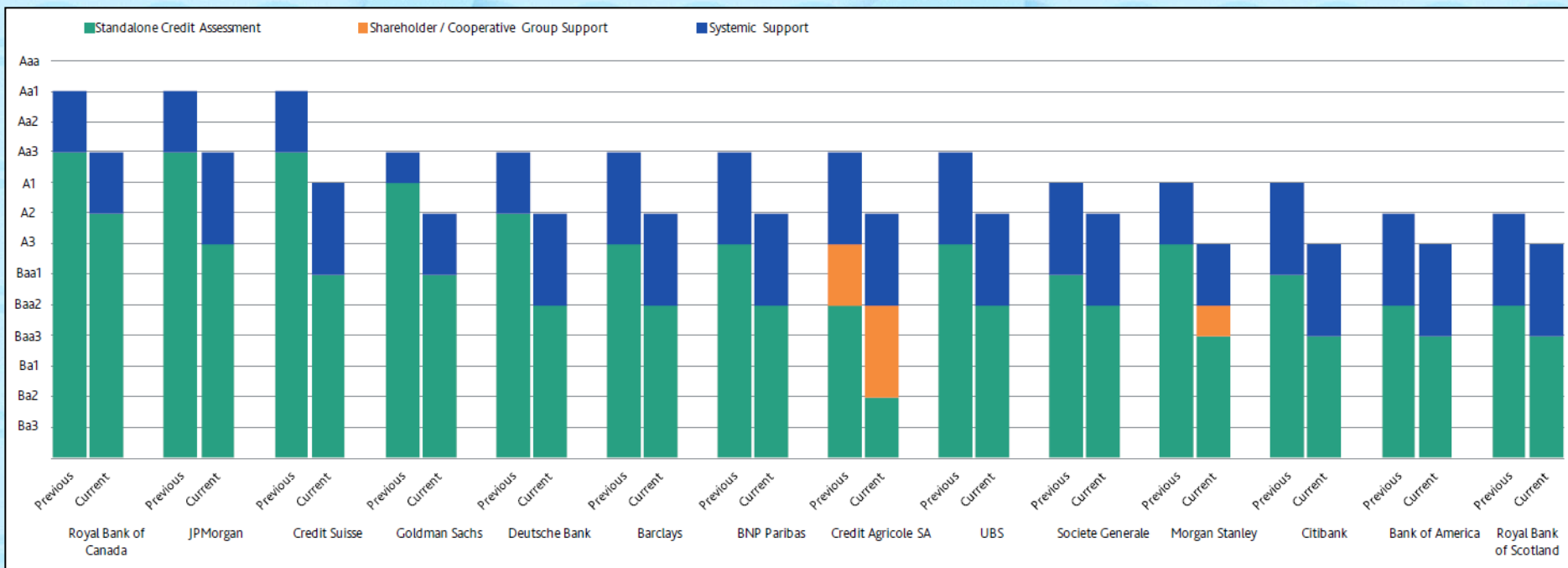


Notes: Capital requirements calculated as 8% of RWA for market risk

Source: Data from Bloomberg as presented in High-level Expert Group Final Report

Implicit subsidies remain high

Credit ratings and systemic support uplift for a sample of EU and US banks (previous and current after downgrade in 6/2012)



Source: Moody's (2012) as presented in High-level Expert Group Final Report

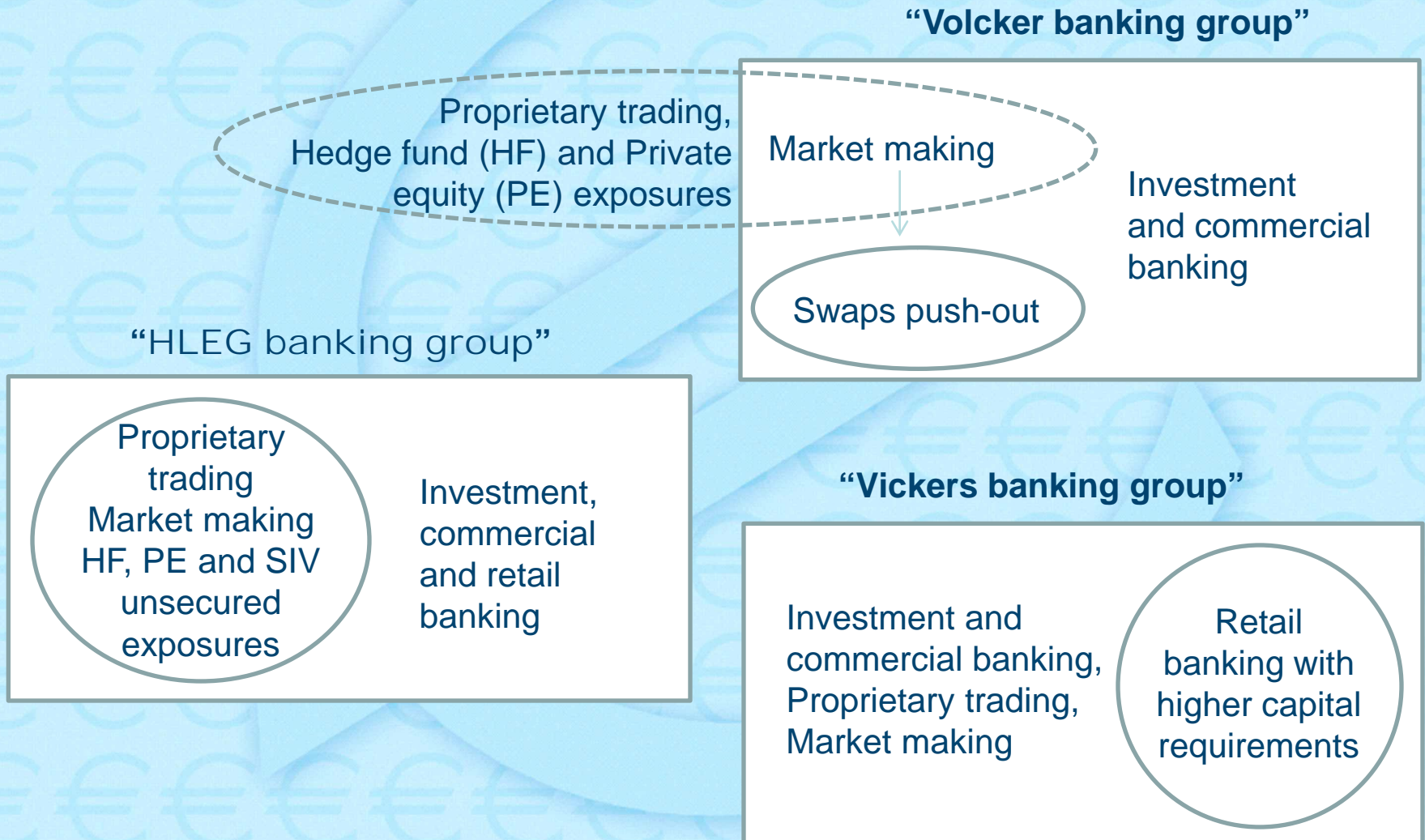
Focus of regulatory reform

- ◆ *Regulatory reforms have been focused on two crucial areas*
 - Capital adequacy and liquidity requirements as set by Basel III and implemented in EU by means of regulation and a directive
 - The Commission's recovery and resolution framework
- ◆ *The regulatory reform will, at least to some extent*
 - improve the resilience of banks,
 - reduce incentives for excessive risk taking and leverage,
 - reduce complexity and interconnectedness and
 - reduce the social costs of bank failure and the need for implicit government guarantees

The High-level Expert Group's proposal for mandatory separation

- ◆ *Activities separated to the “trading entity”:*
 - Proprietary trading and market-making
 - Loans, loan commitments and unsecured credit exposure to hedge funds, SIVs, and private equity investments
- ◆ *Activities that are permitted to “deposit banks”:*
 - Hedged, client-driven transactions that fall within narrow risk position limits
 - Securities underwriting
- ◆ *Activities which are prohibited to the “trading entity”:*
 - Insured deposits and supply of retail payment services
- ◆ *Restrictions on transfers between the separated entities*
- ◆ *The entities can be operated within a banking group*

Comparison of suggested structural reforms



Rationale for the High-level Expert Group's proposal on mandatory separation

- ◆ *Prohibit banks with insured deposits from engaging in trading activities whose risks are potentially high and difficult to measure precisely*
- ◆ *Reduce complexity and interconnectedness, especially between banks and shadow banking system*
- ◆ *Make recovery and resolution easier*
- ◆ *Make banking groups simpler and more transparent, which facilitates market discipline, supervision, and improves risk sensitivity of funding costs*
- ◆ *Reduce mixing of management cultures*

The five proposals of the High-level Expert Group

1. *Mandatory separation to deposit bank and trading entity*
2. *Additional separation requirement*
 - If the recovery and resolution plan otherwise not credible
3. *Bail-in instruments*
 - Pre-defined scope and terms to facilitate pricing and liquidity
4. *A review of capital requirements on trading assets and real estate related loans*
5. *Strengthening the governance and control of banks*
 - Including the use of bail-in instruments in compensation

On the role of banking

- ◆ *Banks play an important role in the society*
 - Provide payment services to ease trade
 - Mobilise and pool savings and allocate these to prosperous investments
 - Engage in maturity mismatching
 - Manage risk on behalf of less sophisticated stakeholders
- ◆ *Banks have a pivotal role in providing finance to the real sector particularly in Europe*
- ◆ *Strengthening the banks' ability to provide socially vital financial services efficiently and in a stable manner benefits our societies at large*



Thank you!