EACB response to the Commission consultation on Reforming the structure of EU banking sector

11 July 2013

The EACB is the voice of the co-operative banks in Europe. It represents, promotes and defends the common interests of its 28 member institutions and of co-operative banks in general. Co-operative banks form decentralised networks which are subject to banking as well as co-operative legislation. Democracy, transparency and proximity are the three key characteristics of the co-operative banks" business model. With 4.200 locally operating banks and 63.000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 160 million customers, mainly consumers, retailers and communities. The co-operative banks in Europe represent 50 million members and 750.000 employees and have a total average market share of about 20%.
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Key messages:

- ➔ The co-operative banks subscribe to the intentions to foster prudent banking and take a stand against any and all forms of irresponsible, high risk banking. Well designed reforms can in our view contribute to more stability of the financial sector, including a better protection of tax payers' interests, and act in the interests of economic growth, innovation and competition in the financial sector. Those goals fall under the shared responsibility of policy makers and the industry, and the EACB and its member banks are committed to achieving them.

- ➔ This being said, it should be acknowledged that with the implementation of the recently adopted reforms, as well as the currently ongoing initiatives, the main objective of the reforming of the structure of the EU banking sector, i.e. preventing banks from reaching out to tax-payers' money, will be practically achieved, as is demonstrated below:
  1. The recently adopted CRDIV/CRR package will increase the level and quality of regulatory capital readily available to absorb losses.
  2. The Bank Recovery and Resolution Directive (BRRD) will ensure that institutions hold a sufficient amount of own funds and bail-in able liabilities. Moreover, the resolution authority will already have the power to require an institution to separate certain activities (either at the prevention or resolution stage). It is thus questionable if a general mandatory separation for all credit institutions will bring any added value.
  3. In case of co-operative banks, Institutional Protection Schemes and other mutual solidarity schemes can and will step in and provide additional assistance at various stages of the process.

- ➔ With the above ensured, there could hardly be any possibility of a bank reaching out for the tax-payers' money, and thus the intended separation of bank risks from the sovereigns and citizens will be ensured. In our view, further structural separation of retail and trading arms will not bring any added-value and is at the moment not needed.

- ➔ On the contrary, a radical reform of the banking sector would run the risk of: (i) disrupting the market in a fragile economic context; (ii) driving costs upwards; (iii) rising uncertainty among clients and investors; and (iv) hampering efforts towards economic growth.

- ➔ Co-operative groups and networks, near to the "real economy" in particular envisage serious difficulties in continuing serving their clients as a result of the mandatory separation. In addition, the separation would undoubtedly affect the EU universal banking system, which has major advantages compared to a separated system.

- ➔ Finally, it is questionable why the policy options considered by the Commission in the consultation paper are limited to the separation scenarios, and why from the nine scenarios only two are considered in the annexed data template.

1. Can structural reform of the largest and most complex banking groups address and alleviate these problems? Please substantiate your answer.

The co-operative banks subscribe to the intentions to foster prudent banking and take a stand against any and all forms of irresponsible, high risk banking. Well designed reforms can in our view contribute to more stability of the financial sector, including a better protection of tax payers' interests, and act in the interests of economic growth, innovation and competition in the financial sector. These goals fall under the shared responsibility of policy makers and the industry, and the EACB is committed to achieving them.

This being said, it should be acknowledged that the current ongoing reforms will already impact the structure of the banking sector in a far reaching manner, and will continue to do so for foreseeable future. The problems of shortages of liquidity and supervision identified during the crisis are already being addressed by the CRDIV/CRR package, with its higher capital and liquidity requirements, more risk sensitive approach, and new stringent governance and remuneration rules; the BRRD; the upcoming DGS Directive; central clearing which will change the business models of clearing houses under the CSD Regulation; EMIR; MiFID; etc. Furthermore, within the Banking Union framework, the ECB will soon assume independent and centralized supervisory powers and will be responsible for detecting problematic macroeconomic developments, which should be possible thanks to the development of a European reporting data network.

All of the above mentioned reforms will contribute to limiting risk-taking behavior in the banking sector, change the landscape, and reset the financial institution's priorities. As demonstrated in the key messages on page 3, with all those reforms, the objective of separating bank risks from tax-payers' money will be practically ensured.

Especially regarding the BRRD, under certain conditions the resolution authority will already have the power to require an institution to separate certain activities (either at the stage of preventative powers or at the resolution stage). Therefore it is questionable if a general mandatory separation for all credit institutions will bring any added value. We are of the opinion that a mandatory separation should only be instructed on case by case basis, when an institution fails.

In fact, the on-going regulatory measures have already led to behavioural adaptations in banks. Financial institutions are changing their business models also on their own account, because their clients and shareholders demand it. They increasingly focus on core activities, deleverage assets that are not considered to be core business, sell off activities, concentrate on their market area, cut incentives and other factors that influence risk taking behavior, simplify products, invest in better governance, reduce non-client related trading business, etc.

The question is therefore whether structural reforms must further include the structural separation of bank's activities. In the view of the EACB, the safety, efficiency and added value of structural separation are in fact not evident. We see no need for a more radical reform of the banking sector.

Instead, the EACB would recommend proceeding with the regulatory agenda of Banking Union and the aforementioned regulatory packages,. The cumulative effect of those ongoing regulatory reforms must be subjected to an overall ex-post impact assessment. Any further options considered should be weighted carefully and would require a broader macroeconomic analysis of the consequences of structural separation for deposit banking activities and the financing of the European economy as a whole. The impact on market structure and the end users should also be carefully assessed since the ring-fencing of trading activities is likely to have important implications in terms of market consolidation (with just a few non-EU investment banks leading the market) and cost and diversity of financial services. This analysis should be based on risk sensitive data rather than exclusively on accounting data.

In this context, we note that the Commission's analysis of the "problem drivers" focuses a lot on banking institution's size, complexity and interconnectedness, but makes no in-depth assessment of the key benefits that universal banks bring to the European economy. We believe that structural separation would result in diminishing diversification advantages, increasing concentration risk and raising costs. At the same time it would not target the real risks but complete categories of activities instead, and may as a result lead to a shift of activities to the shadow banking sector, or to other jurisdictions. Another consequence is that the incurred costs would be (at least in part) shifted to the end users/customers.

2. Do you consider that an EU proposal in the field of structural reform is needed? What are the possible advantages or drawbacks associated with such reforms? Please substantiate your answer.

<u>The need for an EU proposal</u>

As mentioned above, the current EU reforms already impact the structure of the banking sector, and will continue to do so for the foreseeable future. The changes introduced by CRDIV/CRR e.g. have already resulted in alterations in balance sheet structure and the reshaping of business activities. Extra solvency requirements for trading positions will result in lower net end-of-day positions. The same applies to the proposed changes in supervision (SSM) in which independent supervision at ECB level will harmonize and should improve the quality of supervision at the national level. In addition, banks are under pressure to implement new stringent provisions provided by BRRD, MiFID II, UCITS V, EMIR, AML, Basic Payment Account Package, and more. The EACB would recommend assessing the coherence and the cumulative effect of all those measures before considering new ones.

Policy makers should avoid introducing new initiatives that may jeopardize banks' efforts to stabilize the financial system and restore confidence. They should also refrain from taking measures that would reduce diversity of the European banking sector and challenge the very existence of banking models that have proven resilient during the crisis.

Finally, we note that the current structural regulation and coordination proposals are primarily directed at the EU business of internationally active EU banks, while the business outside of the EU is only taken into account to a lesser extent. Any approach which does not equally address financial institutions at the level of (at least) G20 countries would create a further competitive disadvantage for European financial institutions with severely adverse implications for the European economy.

Drawbacks associated with separation

Concerning the drawbacks associated with such reforms, we believe that structural separation carries the following risks:

(i) disrupting the market in a fragile economic context;
(ii) diminishing diversification advantages;
(iii) increasing concentration risk;
(iv) rising costs resulting from the separation as such, including funding costs, hedging costs, operational costs;
(v) rising costs of services for the real economy as a result of shifting those costs (at least in part) onto end users / consumers);
(vi) rising uncertainty among clients and investors;
(vii) hampering efforts towards economic growth; .
(viii) it would target complete categories of activities instead of the real risks. which could lead to a shift of such activities to the shadow banking sector or to other jurisdictions.

In addition, the separation would undoubtedly affect the EU universal banking system, which has major advantages compared to a separated system. In Europe, the universal banking system has historically grown and is targeting the economy with its special structure. Private and commercial customers have the opportunity to get a multitude of financial services from one hand (one stop shopping). This saves time and costs. It means a broader knowledge of investment opportunities in the real economy and better investment opportunities for deposits in financial markets. Universal banks have better opportunities for diversification which leads to more stable earnings and less operational costs.

All in all, proposals for reforming the structure of the EU banking sector offer a solution to a problem which does not actually exist. In particular, as earlier indicated, the BRRD already addresses the focused aims.

Given the massive number of the various other regulatory and tax measures, introducing in addition a separation concept exposes the baking industry (and likewise the national economies) to a complexity which will lead to implications which can by no means be assessed at the outset and, as a consequence, may trigger unwanted effects which will be difficult or impossible to resolve afterwards.

Co-operative specific challenges of separation

For co-operative banks specifically, mandatory separation would result in serious difficulties in continuing serving their clients. Namely, it is questionable how the separation could be applied to the inverted pyramid structure of co-operative networks, with local co-operative banks owning the central bank institutions:

- One of the main functions of a cooperative central bank is (i) to secure the liquidity and (ii) the refinancing of the regional cooperative banks and its subsidiaries and specialized companies. For the purpose of this function up to 2/3 of the assets of the central bank (e.g. repos, bonds, derivatives) held in the categories "held for trading" and "available for sale" may be needed for example, for refinancing and liquidity purpose.
- The central institution of a cooperative network, in its function, provides services which would not only be too costly if needed to be performed by each single cooperative bank, but which would also be simply to "big" and/or complex to be managed by a small local bank. Some of these services may be provided by commonly owned specialized companies of the cooperative sector (e.g. building society, insurance company, asset manager, and leasing company). Business between co-operative banks and their central bank thus includes cash clearing, liquidity and market risk management as well as other bank services for own as well as customer business. Furthermore, in some countries cooperative central banks hold minimum reserves for their associated members.
- Moreover, the cooperative central bank is also doing some business with its own customers which are usually large/international corporates and financial institutions.
- The cooperative central banks need positions in liquidity reserve, cover pools, cash collateral for derivatives, repos etc. as the cooperative central banks are providing the access to capital markets for the whole cooperative sector/their customers.

Thus, a separation of trading activities will limit the nationwide supply of adequate credits and financial products to SMEs and private clients. In addition, it will weaken the co-operative sector and the central bank function, and will even lead to a rise in funding and liquidity cost for the regional cooperative bank. In fact, the small co-operative banks will be cut-off from their common treasury function. In turn, this will lead to higher cost of financial products, which will increase hedging costs for customers and finally reduce the stability of the network itself.

Finally, in the context of the Commission's Green Paper on long-term financing, the EACB members would like to stress that prohibiting deposit banks to provide risk management to clients or separating small cooperative banks from their common treasury in the central institution would not make the financial system safer as a whole, but rather foster shadow banking as mentioned above.

3. Which of the four definitions is the best indicator to identify systemically risky trading activities? If none of the above, please propose an alternative indicator.

The EACB does not consider it appropriate to take as a starting point an assumption that trading activities in general are more risky than any other activities. For example, one of the leading causes of the latest financial crisis has been a political commitment in the USA to offer property to clients with poor repayment capacities.

In this context, the EACB believes that none of the four definitions proposed by the Commission is appropriate to identify "systemically risky trading activities". Since the objective of the Commission is primarily to identify (and reduce) high-risk trading activities, it would make more sense in our view to use risk-based indicators.

Thus, the EACB does not support any of the given options in their entirety. We have doubts that any of the suggested separation approaches would contribute to a safer and better functioning of financial market. Instead, we believe that any identification of risky trading activities should rather focus on an **alternative approach** along the following steps:

Step I

The EACB considers that the use of the IAS/IFRS categories "held for trading" and "available for sale" is not appropriate for the following reasons:

- Assets 'held for trading' and 'available for sale' according to IFRS do not contain only speculative trading assets, but include also:
  - liquidity buffers (i.e. state bonds)
  - ECB eligible bonds (i.e. state and corporate bonds)
  - securities required for market making
  - assets and derivatives for asset/liability management
  - derivatives for market risk management
  - assets for repos to secure overnight balances from money transfer

  The categories therefore do not deliver any precise indicators for a suitable level of the threshold and would be misleading to the public.

- It would be too simplistic, taking into account the heterogeneity of the 27 national markets within the EU. This could be illustrated by the following example:
  - Using the IFRS definitions, the two largest banks in Denmark, Danske Bank and Nordea, to give an example, rank high in terms of trading volumes (Liikanen report, charts 3.4.6 and 3.4.7). One key reason why this is the case relates to the structure of the Danish mortgage market with specialized mortgage banks and regular banks.
  - In Denmark, for example, funding of mortgage loans is based on issuance of covered bonds. Specialized mortgage banks (including subsidiaries of e.g. Danske Bank and Nordea) transform illiquid mortgage loans to liquid assets. A large part of these liquid assets show up in the regular banks' trading books instead of illiquid loans in the banking book. This means that from an accounting perspective, trading books will seem larger for banking groups operating in countries with structural characteristics like Denmark, than for banking groups

operating in countries where simple deposits are channelled directly to fund mortgages.
    - Further, a system where deposits are stored as liquid assets in the trading books rather than illiquid mortgage loans, should be preferable from the view point of simple depositors. A mandatory separation of e.g. market making activities of Danish mortgage bonds, into a new legal entity might imply unintended consequences for the liquidity of the system and eventually financial stability.

- Furthermore not all banks using IAS/IFRS.

- In addition, the IAS/IFRS categories may lead to difficulties since IFRS are not developed for supervisory purposes. In the opinion of the IASB, supervisors are not even considered to be a primary user group. Moreover, considering that IFRS are under the exclusive auspices of the IASB as a fully independent entity and undergo changes that lie beyond the control of the European legislator, it seems inappropriate to take them as a basis for a regulatory rule.

Step II

A better alternative to using the 'held for trading' and 'available for sale' categories could be the net volume of trading activities, although the whole exercise still remains very difficult:

- The netted amount of derivatives will be more meaningful than the gross trading positions, because it includes hedging activities. When the bank sells to its customer a derivative product, a counter-transaction to hedge the bank's risk will appear on the other side of its balance sheet. Adding the two for the purpose of benchmarking the systematically risky trading activities would not be appropriate.
- The use of the outright market value of derivative positions on the asset side (held for trading) is misleading. For example, the major part of cooperative central banks' derivative positions are interest rate linked. Therefore, any movement of interest rates would lead to a different market value and hence a different ratio of derivatives to assets. As banks, like co-operative central banks, use those derivatives mainly for customer purpose and overall bank management, a similar sensitivity of derivatives will appear on the liability side. Thus, the variation of the market value of these derivatives on the asset and liabilities side is nearly the same, attesting that the vast majority of derivatives are fully hedged.
- The open positions of a bank could possibly be calculated where the bank has a non-hedged risk.
- To assess the "trading" character of the residual derivatives, the calculation method could include the asset and liability side of the derivative position, ideally just the open net position (asset minus liability) of these. This calculation shows a bank's non-economic based assets in risk and gives a transparent view of the scope of a bank's investment banking activities.

Step III

At least the following categories would have to be assigned to the deposit bank without any limit:

- for market making and other activities associated with the fulfilment of client's needs

- as liquidity buffers: In this respect it has to be highlighted that the highly liquid assets that banks will have to hold to meet the requirements of the future Liquidity Coverage Ratio (LCR) should in any event be excluded from the definition of ring-fenced activities.
- for asset/liability management: Balance sheet management activities are focused on managing interest and term risks in the cause of the transformation process a bank performs. It is at the heart of banking and has the objective to keep risk profiles within earlier determined limits. Therefore these balance sheet management actions are to be allocated to the deposit bank as being fundamental for management purposes and not being of high risk.
- for market risk management: (e.g. FX, interest) of the bank as a whole (i.e. derivatives).
- other exposures to counterparties according to general principles and terms of business: we are of the opinion that exposures corresponding to ordinary terms of business (e.g. assessment of the counterparties, collateralization, etc. should be out of trading/investment banking scope and should be eligible for the deposit bank. In our opinion, the character of the counterparty is irrelevant, when the transaction, along classical terms or risk assessment, is low risk.

Step IV

Finally, in this context of defining risky trading activities, the EACB would like to invite the Commission to closely consider the key principles underlying the French and German banking reform proposals as a basis for its work, to the extent that the French and German authorities have already outlined banking reform proposals which positively take into consideration the need to support the global economy whilst at the same time preserving the main benefits of the universal banking model. In particular, where market-making operations contribute to market liquidity and / or to the supply of useful risk management services for clients, they should not be subject to any ring-fencing rules.

4. Which of the approaches outlines above is the most appropriate? Are there any alternative approaches? Please substantiate your answer.

- ➔ **Approach 1: Ex post with constrained discretion of supervisor**
- ➔ **Approach 2: Ex ante subject to evaluation by supervisor**
- ➔ **Approach 3: Ex ante**

From the analysis of the consultation paper, the difference between ex-ante and ex-post is not evident, making it difficult to fully assess the appropriateness of different options and directly respond to this question.

The EACB's understanding of the approaches proposed is as follows:

(i) In the first option, EU legislation would prescribe the 'how' of the separation (which activities to be separated, and in what form), and the 'who' (by setting the threshold; however, it would be left entirely to the supervisor to decide whether the separation would actually need to be carried out (i.e. the 'if')

(ii) In the second option, EU legislation would prescribe both the 'how', and the 'if'; however, the supervisor would be given some degree of discretion on the 'who'

(iii) In the third option, EU legislation would prescribe the 'how', the 'if', and the 'who', and the supervisor would not be given any discretion.

In general, the EACB would support an approach which would ensure legal certainty, but at the same time flexibility allowing for tailor-made solutions/decisions by the supervisors. Thus, and assuming that the above interpretation of the above options is correct, an approach could be some form of a mix between options 1 and 2:

- On the basis of the steps described in question 3, it would always be the supervisor to finally decide to accept the explanation of the bank and to determine any repercussions on the separation.
- In addition, a transition period should be added. A separation cannot be anticipated because the relevant assets are only to a limited extent controllable. Besides, it would take some time to transfer the assets into the trading entity after the supervisor's decision is made.

This type of approach, which the EACB would support, is already taken in some Member States. For example, the draft French and the German banking law reform also foresees a mixed approach:

- The French Supervision and Resolution Authority will be able to ring fence "ex-ante" speculative trading activities that are not considered as « useful » for the financing of the economy and its actors. It will also be able to separate activities "ex-post" if the volume of trading activities – including market-making activities – has reached a level that may threaten the financial stability of one or more financial institutions. Finally, the French banking law also takes into consideration the principle of the RRD, i.e.: if, after the review of a bank's resolution plan, the competent authority considers that the institution would not meet the criteria of an orderly resolution in case of a crisis, it may impose structural adjustments.

- The German reform will , not allow proprietary trading if certain thresholds are exceeded or the trading business is not transferred to a separated trading entity. If a bank exceeds the thresholds, the German approach asks the bank for a detailed risk assessment within six month, to identify the business which has to be separated. There is a transition period of twelve month after exceeding the thresholds. In addition to that, the Banking Supervisory Authority (BaFin) can also ban e.g. market making activities or other activities with a comparable risk profile, if these activities threaten the solvency of a bank, regardless of whether the thresholds are exceeded.

5. What are the costs and benefits of separating market-making and/or underwriting activities? Could some of these activities be included in, or exempt from, a separation requirement? If so, which and on what basis?

The separation would undoubtedly affect the EU universal banking system, which has major advantages compared to a separated system. In Europe, the universal banking system has historically grown and is targeting the economy with its special structure. Private and commercial customers have the opportunity to get a multitude of financial services from one stop shop. A universal banking model means a broader knowledge of investment opportunities in the real economy and better investment opportunities for deposits in financial markets. Universal banks have better opportunities for diversification which leads to more stable earnings and less operational costs. Consequently, separating wholesale and investment banking by distinguishing market-making and underwriting activities would create higher risk costs for inter-company transactions (as opposed to intra-company transactions, e.g. risk add-ons, liquidity add-ons, etc.), administration, IT, refinancing and supervision.

There is a close connection between the client coverage units (e.g. Key Accounting, corporate client business, capital markets sales and advisory) and the client focused investment activities of a universal bank. Activities such as market making, stocking securities and bonds (on clients' demand) and underwriting are not separated from client business. Service packages are developed solely in close interaction of client business and investment banking activities, which are able to satisfy the broad range of clients needs. Therefore, a separation of those investment banking activities mentioned above must be looked at also from a client's perspective.

Furthermore, the contribution of some trading activities to the real economy has to be recognised. Certain products such as derivatives, interest rate swaps, foreign currency swaps, etc. are used also by retail customers including in particular SMEs to hedge their risks, and retail banks should be able to provide those services.

Thus, **as a minimum, market making activities and certain underwriting activities for which banks can explain by evidence that they are directly related to retail-oriented business should be exempted from separation requirement**. This should be possible as this kind of business is protected by an appropriate risk and control structure.

In addition, the special relation and reliance of local co-operative banks on their central institutions to provide certain type of services should be properly taken into account (see answer to Question 2).

6. Should deposit banks be allowed to directly provide risk management services to clients? If so, should any (which) additional safeguards/limits be considered?

Yes, if such activities serve the non-financial clients and the real economy. Products such as derivatives, FX deals, interest rate swaps or foreign currency swaps are primarily used by retail and corporate customers to hedge their own lending and foreign currency receivables. Even local co-operative banks should be able to continue providing those banking services, but under the strict governance of an appropriate risk and control framework, limiting the maximum loss for the bank. In this context appropriate risk measures (e.g. Value At Risk) are already well established and should be further used.. The structure and procedures should be (and are in fact) supervised.

7. As regards the legal dimension of functional separation, what are the costs and benefits of regulating intra-group ownership structures?

There are certain services that the central institutions provide to the local co-operative banks, which would be too small to carry them out individually on their own (see answer to question 2). Thus, a functional separation, which would include legal separation with rules on ownership structure (e.g. separate funding), or economic separation where intra-group transactions would be on third party/commercial terms, would affect the very fundaments of a co-operative network business model.

Separate legal entities which comply, each individually, with the CRD requirements would result in loss of diversification benefits and a less efficient governance structure. This would be caused by the need for more capital on individual business levels/subsidiaries as each business would have to approach the capital market individually on their own merit. Thus, more capital would be needed in total for the whole group, causing additional cost.

8. What are the relevant economic links and associated risks between intra-group entities?

In case of co-operative networks, one of the main economic links to be taken into account is the one deriving from the roles of the co-operative central banks. Those roles include securing the liquidity, as well as refinancing of the regional cooperative banks and its subsidiaries and specialized companies. The central bank also provides services which would not only be too costly if needed to be performed by each single cooperative bank, but which would also be simply too "big" and/or complex to be managed by a "small" local bank. Some of these services may be provided by commonly owned specialized companies of the cooperative sector (e.g. building society, insurance company, asset manager, and leasing company). The described structure and division of work is a compulsory element of the co-operative central bank on the one hand, and the local and/or regional co-operative banks on the other hand, and guarantees the liquidity supply respectively to the investment of surplus funds. Against the background that the regional co-operative banks have no own and direct access to capital markets it is the task of the co-operative central bank on behalf of the regional banks to trade in securities, derivatives, etc. Only this integrated model guarantees a nationwide supply of adequate credits and financial products to SMEs and private clients, as well as provision of cheaper services because of cross selling, diversification advantages, etc. If the bank's clients continue to require the services for which the 'assistance' of the central bank is required, the bank has to buy the services on the market, which will increase costs and expose the bank to additional counterparty risks

9. As regards full ownership separation, what are the associated costs and benefits?

Depending on the timing of separation and the market / economic conditions, the net proceeds/gains will vary. Forced separation would be in general costly. The divested activity may be worth more to the group it belonged to, then to the buyer (because of cross selling, diversification advantages, etc.). If the bank's clients continue to require the divested activities, the bank has to come to an agreement with the buying party or has to buy the services on the market. This will most likely increase cost and will expose the bank to additional counterparty risk.

In addition, the EACB members are concerned about the possibility of implementing ownership separation to the co-operative networks, where members own the local co-operative banks, which in turn own their central institutions. The central institutions provide to the local co-operative banks some essential services which would be simply too "big" and/or complex to be managed by a "small" local bank. Some of these services may be provided by commonly owned specialized companies of the cooperative sector (e.g. building society, insurance company, asset manager, and leasing company). Central institutions also secure the liquidity, and refinance the regional cooperative banks and its subsidiaries and specialized companies. Furthermore, in some countries cooperative central banks hold minimum reserves for their associated members.

10. Does the above matrix capture a sufficiently broad range of structural reform options?

The matrix should not in our view be limited to separation scenarios, but consider all possible policy options. As a minimum, a baseline option of 'no separation' should be also included. Also other options, such as EU minimum harmonisation approach, or a solution through the recovery and resolution planning should have been considered. Moreover, we are concerned that the Commission's data template in Annex to the consultation only considers two out of the nine separation scenarios outlined in the matrix, namely a) the HLEG avenue and b) a broader separation of all *"wholesale and investment banking"* activities, where the definition of "wholesale and investment banking" activities is left open to interpretation by stakeholders.

By focusing only on two scenarios, the Commission tends to undermine other possible – less disruptive and more growth-oriented – approaches to the banking reform. In particular, we found no detailed reference in the consultation paper to two of the most advanced structural reforms currently under debate in the euro zone (and soon to be adopted and implemented[1]), namely the French and German banking law reforms. This is regrettable in our view since the French and German approaches have made considerable efforts to strike a balance between the need to secure financial stability and address the *"too-big-to-fail"* dilemma on the one hand, and the need to support the recovery of the European economy on the other. Furthermore, the French and German approaches have tried to capture the main benefits of the universal banking model (which has proved to be globally resilient throughout the financial crisis) whilst reducing the potential risks this model is exposed to.

[1] In France, structural separation will be compulsory as from 1st July 2015.

11. Which option best addresses the problems identified? Please substantiate your answer.

As previously stated, the EACB does not consider structural separation to of any added value, and thus none of the options is fully supported:

- Options C, F, I, as well as G ,H and E do not seem appropriate at all. The options of an ownership separation (C, F, I) have not been analyzed with a focus on their (macro-) economic effect. In our view they could bear new risk elements for the financial sector and its stability. In addition, segregation of funding of commonly owned trading institutions would most probably create major problems for co-operative networks as a whole if the trading entity is the central institution that acts as common treasury unit. In case the central institution has trading activities beyond HLEG's thresholds these would have to be separated in an own legal entity which could not be refinanced by the co-operative shareholder banks.
- If any of the options indicated in the consultation document would have to be chosen, the EACB considers option A as the most suitable one.

However, the EACB strongly believes that should the Commission decide to go ahead with developing an EU-wide approach to banking structure reform, it should be based on high-level principles, as listed below:

(i) The case for structural reform should be properly justified and be based on a thorough macroeconomic analysis;

(ii) Any reform proposal should be well-articulated with the adopted and forthcoming prudential reforms (CRR/CRD4 rules, BRR, Basel Committee Trading Book Review, Banking Union, MiFID2, etc.);

(iii) Instead of separating risky trading activities on the basis of strict quantitative thresholds, a distinction should be made between those market trading activities that directly support the financing of the real economy and/or provide useful risk management services to clients, and those which are not;

(iv) Market-making operations which contribute to the supply of liquidity to the system and/or provide useful hedging services to clients should remain in the main banking entity, while being subject to strict control and regular evaluation;

(v) Speculative activities that do not support the economy should be carefully assessed and, if necessary according to the specific circumstances, transferred to a separate entity with appropriate capital and liquidity requirements; and

(vi) High frequency trading should be strictly controlled if considered too risky or damaging for the economy.

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