FRENCH BANKS AND EUROPEAN BANKING REFORMS

March 2015

FEDERATION BANCAIRE FRANCAISE
FACTS AND FIGURES ABOUT THE FRENCH BANKING SECTOR

1. ONE OF THE MOST RESILIENT BANKING SECTORS IN THE WORLD DURING THE LAST CRISIS, WHICH WAS ALSO CONFIRMED BY THE RECENT AQR AND STRESS TESTS CONDUCTED BY THE ECB AND THE EBA

- No French bank has been bailed out by the taxpayer during the crisis, with the exception of Dexia (Belgian-French bank, with no deposits in France). Temporary financing was provided to the French banks at the height of the crisis (fall 2009) which was fully reimbursed in March 2011.
- France has granted an overall amount of €25 billion in recapitalization measures (State aid figures from the European Commission) between 2008 and 2012, which accounts for 6% of the European recapitalization measures, that is to say €413 billion. Most of this amount has been reimbursed in France in March 2011 except for Dexia (in which the French government’s holdings are 45%; € 3.6 billion were injected).
- Following the AQR and stress-tests exercise, no French GSIBs failed the assessment or as a result needed to raise further capital. Only one small bank in France failed the exercise but this bank (a refinancing vehicle for big French banks) raised sufficient capital earlier in 2014.
- Since 2008, all prudential ratios (capital, liquidity, leverage) have been significantly strengthened.
- Credit to the French economy has been continuously growing since the crisis. Outstanding loans have increased by 13% at end September 2014 (compared to end 2009), to €1,996 billion.

2. THE 2ND LARGEST BANKING SECTOR IN EUROPE

- The French banking sector (€8,130 billion) is the second largest banking sector in Europe behind the British banking sector (€9155 billion) and before the German banking sector (€7 746 billion).
- In Europe, amongst the 14 banks defined as G-SIBs (global systemic banks), there are 4 French banks (BNP Paribas, Crédit Agricole, Société Générale and BPCE) 4 British banks, 2 Spanish banks, 1 German bank, 1 Italian and 1 Dutch bank.
- The French banks' results are strong: €18 billion in 2013 compared to € 6 billion for HSBC, Barclays, Lloyds Banking group and RBS.
- The Return On Equity of our banks stands at 6% according to our Prudential Authority (8.1% in the United States).
- While the British banking sector lends more to households (€1564 billion compared to €1091 billion in France), the French banking sector is more focused on financing Non-Financial Corporations (€825 billion¹ compared to €512 billion in Great-Britain²). It represents 40% of the French GDP. The SMEs account for the main part of these credits granted (54.7%).
3. OUR MAIN CHARACTERISTICS

**French banks are universal banks** as it is proved by their source of revenue:

- 61.2% come from retail banking activities (46.5% in France, 14.7% abroad)
- 16.9% come from investment banking activities
- 10% from specialized financing
- 11.9% from asset management and insurance

This diversity of revenues explains the FBF’s position on the structure of banks and on the Financial Conglomerates Directive.

**The main saving products in France** (Livret A and Life Insurance), which have a favorable tax treatment, are sold by banks but the funds raised are not in their balance sheet which penalize liquidity management through current and expected liquidity prudential ratios

**French banks have good practices in terms of loans for house purchase.**

The credit risk in financing French residential properties is historically and intrinsically low (as an illustration, the rate of bad debt was 1.47% as at 31/12/2012).

The principal reason for this lies in the French banks’ practices (approval process as applied by French banks is mostly based on the risk profile of the borrower) and the application of property loan regulations that are very protective of borrowers:

<table>
<thead>
<tr>
<th>GREAT-BRITAIN</th>
<th>FRANCE</th>
<th>GERMANY</th>
</tr>
</thead>
<tbody>
<tr>
<td>Size of the banking sector in €bn</td>
<td>9,155</td>
<td>8,130</td>
</tr>
<tr>
<td><strong>Number of GSIB</strong></td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>Outstanding loans to Non Financial Corporations by the banking sector in €bn</td>
<td>512</td>
<td>825</td>
</tr>
<tr>
<td>Outstanding loans compared to GDP in 2013</td>
<td>27% du PIB</td>
<td>40% du PIB</td>
</tr>
<tr>
<td><strong>Level of satisfaction of credit requests</strong></td>
<td>67%</td>
<td>80%</td>
</tr>
<tr>
<td>Average interest rate on housing loans</td>
<td>3.22%</td>
<td>2.40%</td>
</tr>
<tr>
<td>Average interest rate on corporate loans</td>
<td>2.52%</td>
<td>1.70%</td>
</tr>
</tbody>
</table>

1. Source Banque de France
2. Source Bank of England
3. 1900 Mds€
4. 2066 Mds€
5. 2737 Mds€
6. ACPR study, May 2014.
The strength of the control over credit risk is reinforced by the involvement of surety companies, specialising in the management of such risk, that have developed very efficient processes and a robust economic model.

Such surety companies, like the lending banks, are all subject to prudential regulations that lead each of them to mobilise capital to cover such credit risks in relation to the same loan portfolio. The adequacy of the level of risk coverage by mobilised capital must, therefore, take into account this dual creation of capital for the same underlying risk. Once this feature is taken into account, the mobilisation of capital in France to cover such credit risk is substantially higher than that observed on average for European banks.

This financing French residential properties feature can be seen as being even more conservative from a risk standpoint versus other European countries - a guaranteed loan is ultimately backed by a promise to mortgage (“promesse d'hypothèque) in the event the mortgage insurer defaults. This is why French banks ask this system not to be penalized by international standards like the revised long term liquidity framework (NSFR)7.

A significant European and International presence

The international exposures of our 5 larger members (BNPP, BPCE Group, Crédit Agricole Group, Crédit Mutuel Group, Société Générale) represent €2,550 bn8.

<table>
<thead>
<tr>
<th>Ranking in Europe</th>
<th>Country</th>
<th>Billions euros</th>
<th>shares of their international exposures</th>
<th>Aggregate shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Italy</td>
<td>274.1</td>
<td>11%</td>
<td>11%</td>
</tr>
<tr>
<td>2</td>
<td>United Kingdom</td>
<td>190</td>
<td>7%</td>
<td>18%</td>
</tr>
<tr>
<td>3</td>
<td>Belgium</td>
<td>178.9</td>
<td>7%</td>
<td>25%</td>
</tr>
<tr>
<td>4</td>
<td>Germany</td>
<td>171.6</td>
<td>7%</td>
<td>32%</td>
</tr>
<tr>
<td>5</td>
<td>Spain</td>
<td>91.1</td>
<td>4%</td>
<td>36%</td>
</tr>
<tr>
<td>6</td>
<td>Netherlands</td>
<td>87.3</td>
<td>3%</td>
<td>39%</td>
</tr>
<tr>
<td>7</td>
<td>Eastern Europe*</td>
<td>82</td>
<td>3%</td>
<td>42%</td>
</tr>
<tr>
<td>8</td>
<td>Luxembourg</td>
<td>78.4</td>
<td>3%</td>
<td>45%</td>
</tr>
<tr>
<td>9</td>
<td>Ireland</td>
<td>28.7</td>
<td>1%</td>
<td>46%</td>
</tr>
<tr>
<td>10</td>
<td>Portugal</td>
<td>12.6</td>
<td>0.5%</td>
<td>46.5%</td>
</tr>
<tr>
<td>11</td>
<td>Greece</td>
<td>3</td>
<td>0.1%</td>
<td>46.6%</td>
</tr>
<tr>
<td>Eurozone</td>
<td>943</td>
<td>37%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>European countries</td>
<td>1326</td>
<td>52%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Estonia, Latvia, Slovakia, Slovenia, Bulgaria, Croatia, Hungary, Lithuania, Poland, Czech Republic, Romania
European exposures regarding French banks account for 52% of their international exposures (see details below). This presence is important for the Capital Market Union since international banks are needed to realize this project.

The banking book accounts for 67.4% of their international exposures, that is to say €1718 bn, while the trading book represent 32.6% of their international exposures, that is to say €831 bn.

4. THE FINANCING MODEL OF CORPORATES IS CHANGING

Bank lending benefits principally very small enterprises (VSEs) and small and medium-sized enterprises (SMEs), while direct recourse to the financial markets by corporates is growing, as required by the regulations currently being implemented in Europe.

- In France, loans to VSEs/SMEs accounted for 45% of total loans made available. The trend in outstandings for these companies was +0.5% over the last 12 months⁹.

- In addition to bank lending, companies and especially the largest companies have direct recourse to the financial markets. This diversification of their financing sources is a means of enabling them to constitute or increase their capital, or of financing projects and short-term requirements, in a regulatory environment that restricts the conditions for granting loans by the banks. Companies are assisted in these processes by corporate and investment banks (CIB).

- Today, 38.5% of corporate debt stems from market financing, which represented EUR 518 billion at end-November 2014¹⁰, and an annual flow of nearly EUR 21 billion, mainly due to large companies and partly to intermediate-sized enterprises.

7. The revised NSFR framework gives preferential treatment to the funding of mortgage loans with mortgage loans have an RSF factor of 65%, whereas property loans backed by an instrument other than a mortgage, including guaranteed loans, have an RSF factor of 85%.

8. The figures come from a study from our Prudential and Resolution Authority, as of 31/12/2013- they are also confirmed by a BIS’ study.


After five years of comprehensive regulation (CRR-CRD4, Resolution Directive, Banking Union, EMIR, MIFID2), which led to large-scale adjustments by banks, the results of stress-test and an asset quality review monitored by the ECB and the EBA, which were released in late October 2014, pointed to the robustness of the European banking sector and French banks in particular.

Against this backdrop, the FBF is pleased with the new European Commission’s priorities in financing and accompanying economic growth by launching the investment plan of Jean-Claude Juncker and the Capital Markets Union (CMU). As it stated in its document “2009-2014 priorities”, the FBF would like any new reform to be judged against the yardstick of economic growth.

Even so, the FBF calls for more overall consistency. The FBF raises the issue of the consistency between the objective of developing the financial markets under the CMU and the shrinking of market-making activity that would result from the draft regulations on banking structures. Similarly, does it make sense to want to call in private funds massively as part of the investment plan for Europe while making it impossible to fund infrastructures if these businesses are spun off?

And, lastly, the FBF also wishes to sound the alert on the challenges posed by international negotiations, notably on loss-absorption capacities in the event of default by a systemic bank (TLAC), which are reflected only to a small degree in European regulatory discussions.

The FBF has thus summarised its positions on the main European and international issues in the following files:

- International regulations’ heavy impact on the French banking sector, which should be reflected in European discussions;
- The bank structural reform proposal must be revisited in depth;
- The revision of the Payment Systems Directive (PSD2) will generate serious security problems in payment means. Improvements are still necessary and are possible without fundamentally undermining the text;
- Money-market-fund regulation should not penalize the financing of the economy
- Regulation on benchmarks: a necessary project but some adjustments are required;
- The FBF is pleased with the Investment Plan that has just been proposed by the Commission;
- The FBF recalls certain conditions for making the CMU a success and proposes seven concrete measures.
- The proposal on European Financial Transaction Tax is contrary to the interests of a Single European market
INTERNATIONAL REGULATIONS’ HEAVY IMPACT ON THE FRENCH BANKING SECTOR MUST BE REFLECTED IN EUROPEAN DISCUSSIONS

The French banking sector, which includes four systemic banks, is Europe’s second-largest, after the UK banking sector. It has been heavily affected by new regulations decided at the international level, such as the Total Loss Absorbing Capacity (TLAC):

- The objective of this new requirement on equity and subordinated debt (which would be the first to absorb losses) is to allow a bank to continue its essential activities even after a loss absorbing all of its regulatory capital. This proposal aims to identify the debts that would be first in line to absorb losses (called subordinates). This would facilitate the organisational model of bank holding companies, whose issued debt is considered subordinated and hence eligible and priority for absorbing a bank’s possible losses.

- This new requirement is twice as high as current requirements, i.e., between 16% and 20% of risk-weighted assets or twice the leverage ratio, i.e., 6% currently if this requirement is higher.

- This new requirement only slightly reflects the Bank Recovery and Resolution Directive (BRRD), as MREL may only be recognised at the level of 2.5% of risk-weighted assets.

- Banks in developing countries like China (which has three systemic banks) are exempt from this requirement!

This is why French banks are paying close attention to the current study on the impact on the real economy, which was obtained with the Commission’s strong support;

The reference to double the leverage ratio is highly debatable as that is becoming the most binding requirement, whereas the leverage ratio should remain a complementary tool for supervisors (a backstop). Systemic banks summoned by the Basel Committee on 14 January agreed unanimously on this point, including banks in English-speaking countries.

French banks alert the Commission to the toughening of EBA criteria with regard to MREL, which go beyond the bank crisis resolution directive. While the TLAC is currently being calibrated and will not be applicable until 2019, the EBA must not try to adapt MREL to the TLAC at this stage. The Commission will have the opportunity to do so in 2016, as provided in its work schedule.

**NSFR**

French banks will be penalised also by the long term liquidity ratio named the Net Stable Funding Ratio (NSFR). The purpose of this ratio is to require banks to fund their assets – even short-term – with longer-term liabilities (with a maturity of at least one year).

Some points penalise French banks due to excessively cautious short-term funding:

1. The revised NSFR framework gives preferential treatment to the funding of mortgage loans11. The problem is that a significant portion of the French banking system is comprised of loans secured by a guarantee, which cannot qualify for this favourable weighting. And yet, the Basel Committee clearly acknowledged the soundness of the French guaranteed loan system in the August 2013 Joint Forum document on mortgage insurance. Differentiated treatment between mortgage loans and guaranteed loans makes even less sense if you consider that the features of both types of loans are completely similar in terms of maturity and liquidity matching. They are also very similar from a risk standpoint: a guaranteed loan is ultimately backed by a promise to mortgage (“promesse d’hypothèque”) in the event the mortgage insurer defaults. It is therefore unacceptable for this unique feature of the French market to go unrecognised within
the framework of the NSFR. If this were not the case, French banks would have to increase the amount of their over one-year term funding by tens of billions of euros, generating a hefty additional cost that would have to be passed on to retail customers in the form of higher rates on mortgage loans.

2. Repurchase agreements on the European repo market are predominantly under three months and total more than €5,500 billion. Requiring 50% of such transactions to be funded with over one-year term liabilities will inevitably raise costs, while the margins on this activity are already low. In fact, repos could even cease to be profitable altogether. And yet, a repo is a loan that is guaranteed by a form of collateral that in itself does not generate liquidity risk. Furthermore, in Europe, about 80% of this collateral consists of sovereign bonds, with the aim of funding market-making in sovereign debt. The liquidity of sovereign debt and the ability of national governments to obtain funding under optimal conditions could be significantly undermined as a result.

3. The 50% stable funding requirement for international trade finance loans is disproportionate and thus liable to have an adverse effect on the price and availability of this type of export loan. These loans, secured by exported goods, are usually short-term and serve to finance the real economy. From that standpoint, they present low liquidity risk.

4. The same is true for factoring, with the operating loan needs of businesses hitting a record high in 2013 owing to persistently lengthy payment deadlines. The measure under consideration could further penalise an activity already encumbered by the anxiety gripping VSEs and SMEs over their short-term funding and cash flows. Factoring has become the No. 2 go-to solution for short-term bank funding for businesses, after overdrafts.

5. There is no economic basis for the long-term funding requirement on equities, and particularly equities held to cover short-term commitments. The treatment recommended by the Basel Committee is detrimental for companies seeking to raise money on the primary market. This is especially true for ISEs/SMEs, due to the lower liquidity of their stocks, resulting in a long-term funding requirement of 85%. It also heavily penalises equity derivative activities, in which French banks have established extensive commercial franchises and would therefore find themselves facing a long-term funding requirement of 50% to 85% even though their actual commitments are short-term.

- **Leverage ratio**

A delegated act was adopted recently by the European Commission. A mandatory disclosure of this ratio will be made by the banks, as of 1st January 2015.

The final calibration of the ratio needs to be based on a thorough impact study. This ratio could be a constraint for banking activities, especially lending activities, as the cost of risk for French banks is low. The leverage ratio should not be more punitive than the capital adequacy ratios which take risk weighted assets into account.

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1. Mortgage loans have an RSF factor of 65%, whereas property loans backed by an instrument other than a mortgage, including guaranteed loans, have an RSF factor of 85%.
2. For example, equity derivatives, repos/reverse repos, securities borrowing/lending.

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**THE BANK STRUCTURAL REFORM PROPOSAL MUST BE REVISITED IN DEPTH**

The FBF welcomes the tone of many amendments from the Rapporteur of the European Parliament: his analysis of the need for invest-
ment in Europe, recitals highlighting the crucial role of market making activities, the amendment improving the definition of these activities, the analysis of trading activities based on risk and not simply on the size, the separation being a last resort tool for the supervisor based on his risk analysis. However, the FBF is concerned by the current compromise amendments in the European Parliament, which are taking opposite direction to the draft report.

At the same time, the FBF is concerned about the proposals of the Latvian Presidency which can lead to a separation for the most active banks in market making activities without enough consideration of the risks taken. With the traffic light approach put forward by the Latvian Presidency, even if there will be no automatic separation in the red zone, French banks will be stigmatized. This raises huge concerns especially in a context where banks that will be in the red zone passed successfully the ECB asset quality review and stress tests last year.

In the eyes of the FBF, the project needs to be revisited in depth:

- it is necessary to take into account the opinion of the ECB of 19 November that highlights the essential role of market making for financial stability and in terms of liquidity provision. This is why the FBF asks for the exemption of market making activities from the scope of separation.

- the red zone in the council version should be withdrawn.

- there is a growing consensus concerning the evaluation of trading activities conducted by the supervisor. This evaluation should be based on risk indicators and not size. At present, the ECB, as provided by the CRD IV, is putting in place risk indicators based on the recommendations of the SREP (Supervisory Review and Evaluation Process) dating back to December 2014. The FBF suggests to trust the supervisor and to rely on the SREP. We need to trust the new single supervisor and its judgment: separation should not be an automatic process.

- In addition, the FBF proposes that the derogation under Article 21 is not limited to the Vickers reform and open to countries which adopted a national law with the same objectives.

- If this proposal is not revisited in depth, French banks will no longer be able to raise funds for the expansion of a Polish container terminal facility as they did recently or to finance a road project in Hambourg in Germany for example.

**PSD2 WILL GENERATE SERIOUS SECURITY PROBLEMS IN PAYMENT MEANS. IMPROVEMENTS ARE STILL NECESSARY**

At a time when the adoption of the PSD2 is entering a decisive phase with the start of the triilogue meetings, the FBF is eager to provide consumers with a high security level and is actually still concerned by the following issues:

- **Lack of AISP supervision (article 27A):** Account Information Services Providers should be submitted to a stronger supervision. At present, they are subject to a simple registration with no prerequisites (in terms of capital for example). In the same way, they should respect anti-money laundering requirements and should not benefit from a lighter regime. How indeed ensure strong authentication of a TPP if it does not respect the procedures on Know Your Customer?

- **Security Threats:** The FBF is still against any transmission of customer’s credentials to third party providers (TPP). But taking into account the texts used during the triilogue meetings, the FBF suggests transferring the encryption system of credentials provided for in a recital by the Council version in an
article and making sure that this encryption is systematic (Article 87). It's a minimum in a context of fast growing identity fraud and fight against terrorism.

- **Responsibility and end-to-end traceability (article 65):** the bank may not be held liable for damage caused by a TPP, since such a regime would be contrary to the general principles of the main Member States’ Legal framework. As a consequence, the TPP must be held directly liable if fraud or an incorrect transaction is attributable to it (for example following an attack on the TPP’s information system or an execution error).

- **Transposition: unrealistic application time (article 102):** It does not seem right to have the same timing for the publication of the text and its application. Its implementation will largely depend on technical standards that may be revealed only at the end of transposition time. Meanwhile the consumer safety will stay unsecured.

### The MMF Regulation Should Not Penalize the Financing of the Economy

MMFs are an important source of short-term financing for financial institutions, corporates and governments. The FBF believes that the role of MMFs in financing the EU economy should be supported. The FBF reminds that this proposed regulation is key for the Paris financial market, due to its important asset management activities and recognized expertise in this field. MMFs established in France are VNAV MMFs, whose stability has been acknowledged by international institutions such as Financial Stability Board and European Systemic Risk Board.

However, some adjustments to the Commission proposal regarding eligible instruments (securitization, shares of MMFs), diversification rules and liquidity ratios would be welcomed.

### Diversification rules:

As acknowledged by the Commission, MMFs represent a crucial link bringing together demand and supply for short term financing: 40% of short-term debt issued by the banking sector are held by MMFs. Banks have traditionally been the most important financial intermediaries in continental Europe. The share of the banking sector in the EU is large by international comparison (75% of the financing of the economy), especially compared to the US (25%), reflecting the important role of banks in the intermediation.

The diversification rules for MMFs should be carefully designed to avoid the unintended side effect of penalizing the European market model. A too restrictive limit on one single body may lead to undesirable effects on the financing of the economy. Short-term MMFs should be allowed to invest up to 15% of their assets in a single body as it is proposed for standard MMFs in the Commission proposal and in the ECON report.

### Liquidity rules:

The FBF supports the inclusion of units of MMF and highly liquid government securities in the liquidity ratios. In addition, the portfolio requirement of at least 20% of weekly maturing assets as it is proposed in the initial text of the Commission is an exaggerated liquidity obligation. The FBF is in favour of 15%. As second best option, the FBF is in line with the text of the ECON report regarding standard MMFs, which sets a 20% threshold, while money market instruments, including shares of other MMFs, may be included within the weekly maturing assets up to 5% providing they may be sold for settlement within the next 5 business days.

### Eligible instruments:

Asset Backed Commercial Paper (ABCP) provides bank clients with a sustainable and resi-
lient funding alternative to borrowing directly from banks. The FBF regrets that the Commission proposal would severely restrict the eligibility of most securitizations backed by relatively short term high quality debt issued or originated by banks and their clients to fund the economy. The EC proposal basically limits eligible ABS and ABCP instruments to those which finance trade receivables. Excluding all other underlying collateral types beyond ABCP or ABS backed by corporate trade receivables would seriously undermine the role of securitization in the financing of economic growth, and in particular economic growth in a bank deleveraging context.

For example, the EC proposal makes ineligible for MMF investment securitized assets such as auto loans, auto leases, equipment loans, equipment leases, SME loans and certain types of non-mortgage related consumer loans. Additionally, the Commission proposal restricts eligibility to asset maturing in 397 days or less. As many of these real economy assets could have maturities beyond one year, the FBF would therefore recommend extending the maturity criteria for underlying pool assets to be consistent with the maturities allowed for other eligible forms of MMF investment. MMFs should be authorized to invest in eligible securitizations with an aggregate weighted average life (WAL) of no more than 2 years.

On the contrary, the FBF welcomes the inclusion of high quality liquid asset backed securities as eligible instruments for investment by MMF in the ECON report.

REGULATION ON BENCHMARKS: A NECESSARY PROJECT BUT SOME ADJUSTMENTS ARE REQUIRED

The French Banking Federation welcomes the legal form chosen by the European Commission for the legislative proposal. Adopting a regulation should mitigate any risk of inconsistencies in transposition into national legislations. Restoring trust in the integrity and accuracy of indices used as benchmarks for financial instruments is key for investors, markets and the wider economy.

French banks believe that some proportionality should be considered by calibrating requirements to the risks and specificities of different types of benchmarks. Critical benchmarks such as Euribor and Libor used to reference a systemically important number of financial instruments should be treated with a particular attention. Provisions of the proposed regulation should not impose too high constraints on financial institutions, which set up their own benchmarks.

Euribor, which issues the main benchmarks in the eurozone and used worldwide, is not subject to a legal framework and to a control through a supervision authority. These two gaps need to be filled.

In addition, the French Banking Federation would like to highlight some concerns on the assessment of suitability. The proposed regulation provides requirements of suitability where a supervised entity intends to enter into a financial contract with a consumer. The supervised entity shall first obtain the necessary information regarding the consumer’s knowledge and experience with respect to the benchmark, his financial situation and his objectives in respect of that financial contract, and assess whether referencing the financial contract to that benchmark is suitable for the consumer. These proposed requirements should be carefully analysed regarding their operational consequences for financial institutions.

We suggest replacing the suitability assessment by a pre contractual obligation of information of the consumer (as provided in equal terms in Directive on mortgage and Directive on credit consumers). The goal of protection of consumers will be better reached with this pre contractual reinforced information than with
a suitability test which will likely not reach the objective of protection of consumers.

Moreover, the proposed regulation requires a physical separation of employees in the front-office function and reporting lines, which involves that the persons reviewing the input should be separated from the submitters of these inputs. However, such separation would be inconsistent with the role of the persons reviewing data because, to have a proper view on the value of the data, they must be close enough to the economic reality that they measure, hence close to the submitter.

Finally, French banks consider that further clarity is required on sanctions, in particular in the way to distinguish between simple human errors and effective manipulations.

THE FBF IS PLEASED WITH THE INVESTMENT PLAN PROPOSED BY THE COMMISSION

The FBF is pleased with the Commission’s 13 January proposal creating a European Strategic Investment Fund (EFIS), managed by the EIB, which will underwrite it and assume the riskiest part of a project by covering its first losses in the event of a materialisation of risk.

Even so, the FBF regrets that this positive initiative comes in a broader context in which investment banking activities will be penalised by the aforementioned draft regulation on banking structure reform, which is at odds with the objective of raising large amounts of private funds.

To guarantee the plan’s effectiveness, the role of EFIS’s investment committee will be crucial in preventing haggling on the projects’ geographical location.

French banks will contribute to the project reserve mentioned in the proposal.

Lastly, the Commission plans a technical assistance programme to identify projects and make them more attractive to private investors. Technical assistance will be enhanced, with an investment advisory platform offering a one-stop-shop for project developers, investors and public administrations, in cooperation with the EIB and key national and regional players. The dovetailing of the various selection mechanisms remains to be defined, along with the link with the EIB to promote private sector involvement.

THE FBF RECALLS CERTAIN CONDITIONS TO MAKE THE CMU A SUCCESS AND PROPOSES SEVEN CONCRETE MEASURES

In the FBF’s view, the CMU may only succeed if some parts of existing or planned legislation that contradict it are revised or adjusted:

- Some capital or liquidity requirements for banks (CRD III, recalibration of NSFR);
- Some capital requirements for investors (Solvency II);
- Some financial disclosure requirements for issuers (prospectus, transparency, etc.);
- Structural reform of banks would throw the universal banking model into disarray (even though the model demonstrated its resiliency during the recent financial crisis), as well as European banks’ role on the markets;
- Revisit the planned financial transaction tax in 11 member-countries, which fragments the single market;
- Adjust securitisation requirements to promote safe and transparent forms of securitisation;
- Take MiFID’s impact on research into account on level 2.

Meanwhile, the FBF proposes a programme of seven staggered concrete measures:
- Create a common label for safe and transparent securitisations. This label based on transparency and security would receive special prudential treatment:

  i) EBA’s ramp-up in securitisation activities: Like the US model, which is supported by public agencies, the EIB has set up instruments to leverage private capital, particularly by securitising existing assets. Cooperation with major European institutions should help enhance resources for suitable infrastructure by using special co-financing mechanisms (in this case “securitisation funds”); these must allow public and private institutions to invest jointly via public-private partnerships in infrastructure projects that have been deemed of investment value and are funded by the Bank with the effect of drawing additional private capital through the securitisation of infrastructure assets.

  For securitisation of small and mid-sized companies, the EIB could be involved at the underwriting level, just like some member-countries’ national institutions. The guarantee on small or large projects should make them more attractive to investors. Such guarantees must cover senior or subordinate debt and be granted in conventional form or in the form of debt service guarantees, similar to those offered by financial insurance companies.

  ii) The ECB could buy these tranches, thus providing the necessary liquidity. Without the ECB’s purchases, which alone are able to enliven and deepen this market, securitisation can only developed very slowly.

  iii) For real-estate securitisation, a European label is also a good idea. And, lastly, the creation of a public Fannie Mae-like institution could be considered, in cooperation, where applicable, with national institutions (CDC, KFW, etc.) or European ones (EIB), which could also take over for it.

- Develop a European Euro-PP market. Companies’ euro-denominated private placement options should be developed, particularly those of mid-sized companies, by establishing best practices able to drawn in international investors.

- Promote a euro-denominated negotiable debt market. This would mean developing standards and practices on the European level for this market, which is a core mechanism in short- and medium-term corporate financing. Care should be taken to keep the proposed regulation on money-market funds from affecting its operations.

- Set up a common framework that fits small and mid-sized companies. With this in mind, a transversal text whose objective is to ease market access for small and mid-sized companies must be developed with its key principles being:

  (i) facilitation of market listings by setting suitable obligations for such companies with regard to the framework currently set by the Prospectus, Transparency, Market Abuse and other directives, which limit related costs, etc.;

  (ii) the retaining and expansion of tools that are vital for the functioning of markets and are accessible to small and mid-sized companies, in particular market-making and production of research (financial analysis).

- Set up a European framework for commodity markets. A European framework dedicated to commodities markets must be developed to reflect their special nature.
- **Develop market infrastructures.** First of all, the implementation of T2S must be continued, along with the harmonisation of clearing and settlement/delivery systems. For reasons of systemic risk and regulatory arbitrage, prudential regulations must be developed for clearinghouses. And, lastly, when these infrastructures operate in euros they should be domiciled in the euro zone.

- **Contribute to the development of long-term European investors.** The development of European markets requires a critical mass of long-term investors. This task, which was begun by the previous Commission, must continue to promote the emergence of long-term investment funds.

**THE PROPOSAL ON EUROPEAN FINANCIAL TRANSACTION TAX IS CONTRARY TO THE INTERESTS OF A SINGLE EUROPEAN MARKET AND TO THE DEVELOPMENT OF A CAPITAL MARKETS UNION**

11 Member States participating in the enhanced cooperation on the European Financial Transaction Tax (EFTT) renewed in January their commitment to reach an agreement in the view to create the conditions necessary to implement the European financial transaction tax on 1st January 2016. Contrary to the idea of a progressive implementation discussed in 2015, they decided that the tax should be based on the principle of the widest possible base and low rates, while taking full consideration of the impacts on the real economy and the risk of relocation of the financial sector.

The French Banking Federation reiterates its opposition to such a tax which would apply not only on financial intermediaries, but also on companies and investors. The introduction of an EFTT would be particularly counterproductive, especially if it is finally designed on the widest possible base and low rates, at a time when the economy appears to be capable of a rebound and when the European Commission is willing to develop a genuine Capital Markets Union. The EFTT would in fact constitute a very strong barrier to the implementation of an efficient CMU.

- **The dramatic consequences of the tax**

  Under the current form of the Commission’s proposal and in the vast majority of cases, all transactions, on all markets, relating to any financial instruments will be taxed if one of the parties involved in the transaction is a financial institution based, established, or deemed to be established, in one of the participating States, or if the financial instrument is issued in one of the 11 States. Adopting the Commission’s proposal in its current form would seriously harm the competitiveness of financial markets and companies within the zone in question and would destroy wealth and jobs, at the same time misleading the signatory States with the promise of potential tax revenues.

  The survival of the eleven signatory States’ financial markets and all their strengths, especially in the refinancing of banks and in derivatives, are particularly at stake. In particular, an EFTT on equity derivatives would have devastating consequences on the markets concerned, especially in France, since French banks are market leaders in this industry (and in these
markets). France would be the first country affected and this could result in thousands of job losses, together with departure and relocation. This impact would be even stronger if the principle of residence were to be maintained as operators based (or deemed based) in the enhanced cooperation zone would be taxed on all of their transactions, not just on securities issued by entities based in this zone.

- **The drastic decrease of the competitiveness of banks and companies within the zone**

First of all, market making is included within the scope of the proposal which implies the taxation of the numerous buying and selling transactions involved in the management of a securities portfolio and, in particular, of derivatives. This would lead to substantial additional costs for financial operators within the zone, with a cascading effect that will not affect foreign competitors if they avoid transactions with a counterparty within the zone or transactions on securities issued within it. However, companies are required to carry out numerous financial transactions with banks to hedge foreign exchange, interest rate and commodities risks.

These companies will either avoid the tax by hedging these risks through their foreign subsidiaries with foreign banks based in London or elsewhere, or they will accept to pay the tax and continue to carry out these transactions in the enhanced cooperation zone. However, the banks in this zone will be hit hard by the cascading effect mentioned above compared to competitors based outside the zone. In the long term, they will be pushed out of the market.

Secondly, many transactions will no longer offer any economic interest given the scope of application, taxation conditions and rates applied. This will be the case in particular for derivatives transactions which require numerous upstream interbank transactions in order to meet customers’ needs, each of which will be taxed under this proposal. Capital market and bank refinancing activities will also be strongly disadvantaged by the penalisation or end of repo transactions which are currently one of their main sources of short-term liquidity financing and management.

The cumulative negative impacts of the introduction of an EFTT would be considerable at a time when the banking industry should, under Basel III and under Commission’s plans to develop a Capital Markets Union, be improving company financing through listed instruments.

- **A destruction of taxable basis without any of the expected tax revenues**

The assessment carried out by the Commission of the budgetary effects is totally unrealistic. The European Commission has estimated the total return from the tax, after taking into account adjustments resulting from the reform, at €31 billion, however, the introduction of the tax will not provide the expected return.

According to industry calculations, the proceeds should be much lower. In practice they will be limited to proceeds from transactions on shares. Moreover, rather than benefiting from a material tax windfall, Member States will be denied significant revenue from corporate tax, income tax and VAT due to the offshoring or end of these activities that nonetheless remain necessary for the development of companies within the zone.
Huge legal issues

From a legal point of view, the ECJ rejected the UK appeal on 30 April 2014 but it has not ruled on the substance of the tax, only on procedure.

The Legal Services of the EU Council have already stated that the so-called “residence of the counterpart principle” of the proposed directive which would catch financial institutions physically outside the FTT zone which transact with financial institutions inside that zone may be illegal.

More generally, the extraterritorial aspects of the tax which have been pointed out from the beginning are a serious obstacle and must be carefully examined. Although the tax is elaborated by the 11 participating States, the non-participating Member States will be affected as well. It is to be expected that they will challenge it actively.

As a conclusion, the Commission’s proposal is contrary to the interests of a single European market and the eleven countries to which it would apply due to its scale and structure.
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