BETTER FINANCE
The European Federation of Investors and Financial Services Users
Fédération Européenne des Épargnants et Usagers des Services Financiers

BETTER FINANCE POSITION PAPER ON BANKING UNION

BETTER FINANCE, the European Federation of Investors and Financial Services Users, is the public interest nongovernmental organisation advocating and defending the interests of European citizens as financial services users at the European level to lawmakers and the public in order to promote research, information and training on investments, savings and personal finances. It is the one and only European-level organisation solely dedicated to the representation of individual investors, savers and other financial services users.

BETTER FINANCE acts as an independent financial expertise and advocacy centre to the direct benefit of European financial services users. Since the BETTER FINANCE constituency includes individual and small shareholders, fund and individual investors, savers, pension fund participants, life insurance policy holders, borrowers, and other stakeholders who are independent from the financial industry, it has the best interests of all European citizens at heart. As such its activities are supported by the European Union since 2012.

EXECUTIVE SUMMARY

The Banking Union initiative has reduced the number and magnitude of bank failures and the recourse to taxpayers' money.

But it has been up to now focused on prudential objectives, not on citizens as banking users' protection. This has too often generated significant detriment to consumers of banking services:

1. "Bail-in "never identifies nor targets the key "insiders" and the parties responsible for bank failures, and targets too much non insider clients of the "bailed-in" banks who were often sold banks' securities (shares and bonds).
2. The EDIS (European Deposit Insurance System) is still not implemented and there are still other significant barriers to an EU single market for banking services 62 years after the Treaty of Rome.
3. Due at least partly to the ECB policy, EU bank savers have been losing a lot of money after fees and inflation, and neither the banks or the regulator are informing and warning them about it.
4. EBA's consumer protection mandate has not been the priority of the European Supervisory Authority and has experienced serious shortcomings. EBA does not even collect, analyze and report data on the performance and costs of bank savings products, which are the number one financial saving product of EU households, despite its legal obligation to do it.
5. The current debate on NPLs (non-performing loans) is again focusing on helping banks to get rid of their NPLs portfolios, not on avoiding detriment to fragile debtors such as EU citizens and job-creating SMEs.

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BACKGROUND INFORMATION

The Banking Union Report is an annual report providing European Parliament's view and recommendations on the Banking Union. The last annual report was published in 2018.

BETTER FINANCE and EU banking policy

BETTER FINANCE is the user-side NGO that has most experts appointed by EU Authorities to their advisory bodies on banking services:

- 6 expert members in the EC FSUG (Financial Services User Group)[1], including the vice chair
- 2 expert members in the Stakeholder Group (BSG) of the European Banking Authority (EBA)[2]; a BETTER FINANCE Board Member vice chaired the BSG from 2016 to 2018.

Banking Union:

- **1st Pillar**: Single Supervisory mechanism (SSM)- Completed ✔
- **2nd Pillar**: Single resolution mechanism (SRM)- Completed ✔
- **3rd Pillar**: European deposit insurance schemes (EDIS)- Not yet established ✘
- **Single market for banking services**, e.g. savings accounts in euros (the Raisin case) ✘
- **Other measures** that need to be established to tackle the remaining risks of the banking sector:
  - Shortcomings of EU banking user's protection
  - Non-performing Loans (NPLs)

1. "Bail-in ": really making responsible insiders pay or rather non insider clients and investors?

Are banks unlikely to fail?

A BETTER FINANCE research on mis-selling and consumer detriment cases in financial markets revealed that the vast majority of cases concern failing banks and shows and that:

- Too often large banks fail;
- in all these cases, the bill has been passed out to retail savers;

Bail-in vs. bail-out: misunderstandings

Public authorities have drawn the line for bank recovery and resolution procedures at using public funds – "taxpayers' money" – to rescue banks that are "failing or likely to fail"; Article 123 TFEU prohibits monetary financing and Article 125 comprises the "no bail-out" clause.

On the other hand, bail-in has been commonly sold as the preferred, more equitable alternative to bail-out for using uses investors' money, those who took a risk and participated at the bank's profits and losses.

[1] https://ec.europa.eu/info/sites/info/files/fsug-members-2017-2021_en.pdf
[2] https://eba.europa.eu/about-us/organisation/banking-stakeholder-group

While there is merit to that, one must not forget that, judging by numbers, the majority of those sacrificed in bail-ins are still taxpayers, but in their capacity as retail investors which are sold, without un-biased advice, securities from banks.

Bail-in: privatising profits and socialising losses

In the majority of failing banks cases, thousands of individual clients / investors have lost their savings after being mis-sold bank securities (equities, bonds) without being properly informed about the risks. While bail-in is, in theory, preferable to bail-out, public authorities must pay close attention on who is actually getting the equity and debt haircut.

The top "insiders" and the ones mostly responsible for bank failures in most cases are the top management of the failed banks but clawing-back on top management bonuses and other compensation components are not even listed in the EU BRRD Directive among the "bailinable" assets.

Bail-ins are carried out at the expense of the savings of small individual investors: "preferred" shares (Bankia), subordinated bonds (Slovenian banks), common equities (Banco Espirito Santo/Banco popular).

In most of the cases, "insider" investors (professional individual or institutional investors) saw the "likeliness to fail" shortly before supervisors did and sold out; for example, in the Slovenian banks case, the latest publicly available audited statements were disclosing a large positive net equity. The Deloitte valuation report commissioned by the ECB computed on the contrary a large negative net equity position, enabling the ECB to ask for a bail-in. Then, like in the case of the Deloitte report it commissioned for Banco Popular, the ECB refused to disclose these evaluation reports to the victims (individual investors). BETTER FINANCE has no knowledge that the audit firms were ever made responsible instead of the non-insider and misled individual investors in the banks' securities.

Without thorough supervision on insider information and movements shortly before the bail-in decisions, public authorities have "privatized profits and socialised losses"

Therefore, public authorities should focus more on the equitability of the debt haircut and ensure that the management of the failing bank and "insider" investors don't get to keep their hefty profits while savers and the economy suffers. Public Authorities should also become much more transparent with regards to the EU citizens who are the victims of bail-in procedures, disclose the basis for their decisions to them and explain why they came up with totally different figures and opinions than the statutory public audit reports.

Bail-in: no creditor worse-off

The Bank Recovery and Resolution Directive provides a fundamental principle for bail-ins that no creditor will be worse off in bail-in than in an ordinary insolvency procedure. However, this has not been the case, as Banco Popular, Cyprus banks in 2013 and the Slovenian banks' scandal of 2013-2014 (where the ECB requested Slovenia to implement BRRD rules although they were not yet in force)– to name a few - shows that individual investors have lost all their savings.

In the Banco Popular case, based on available information and data, we estimate that a potential total loss of an individual investor that bought shares in the June 2016 IPO of Banco Popular may have been as high as -99.9999998447386%, while the real loss (until 07/06/2019) was of -74%. Therefore, mathematically, the actual loss due to the transfer decision could have been of €644.1 million for all former shareholders of Banco Popular.

In addition, in the Slovenian banks case, a total of €963 million worth of equity and subordinated bonds have been written off.

2. European deposit insurance scheme (EDIS)

Background information:

- December 2018, the Euro Summit called for the work on the Banking Union to advance, and **to define a roadmap for starting political negotiations** on the European Deposit Insurance Scheme (EDIS).
- December 2018: The Eurogroup set up a **High-Level Working Group** (HLWG) in the level of Ministries of finance' deputies **to further progress on EDIS**.
- The report from the Chair of HLWG on EDIS outlined an "illustrative transitional path to the steady state Banking Union" consisting of four pillars : **(i) EDIS; (ii) framework for bank supervision, resolution and insolvency, including resolution financing arrangements and further harmonisation of insolvency law; (iii) sovereign exposures and financial stability implications and (iv) enhancing market integration by means of enhanced supervisory arrangements to defuse home/host issues.**[3]
- The Eurogroup is expected to report back again on these issues in December 2019 to the Euro summit. It plans to define the sequence of the decision-making process, including the "development of a roadmap towards beginning political negotiations on a European deposit insurance system (EDIS)".[4]

The trust of EU citizens in the EU's single financial market was seriously undermined as result of the financial crisis and to the on-going mis-selling scandals as well as poor real returns. In fact, Retail Finance is yet again ranked as one of the worst performing consumer markets "where consumers suffer the highest detriment (financial loss or waste of time) in case of problems" [5]. Current deposit insurance arrangements in the EU need to be changed as they match neither market integration nor savers expectations. As stated by the **European Commission in a 2013 staff working document**, "the crisis has increased savers' distrust in financial institutions and markets". The Commission also pointed out that "other reasons for not saving long-term are the often-poor performance of financial intermediaries to deliver reasonable return and costs of intermediation".[6]

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[3] http://www.europarl.europa.eu/RegData/etudes/IDAN/2019/634374/IPOL_IDA(2019)634374_EN.pdf

[4] ibid

[5] Based on the worrying findings of the newest 2018 edition of the "EU Consumer Markets Scoreboard"; See 2018 Consumer Markets Scoreboard "Making markets work for consumers" https://ec.europa.eu/info/sites/info/files/eujus15a-1816-i02_-_the_consumer_markets_scoreboard_2018_-_accessibility_final.pdf, page 9.

[6] European Commission -Staff Working Document on long term financing of the EU economy (2013)

EDIS is still the third and missing pillar of the Banking Union. **The June 2019 Eurogroup and the subsequent Euro Summit have not made tangible progress in this field**. As noted by Commission in its June 2019 Communication on EMU, *"despite the significant risk reduction that has taken place in the EU financial sector, certain stakeholders remain firmly opposed to the pooling of resources and risk-sharing at this point".* However, as we learned yesterday (06/11/2019) Germany's finance minister offered hope of a breakthrough in plans to create a full eurozone banking union by ending Berlin's opposition to a common scheme to protect savers' deposits.

"The most surprising element in Mr Scholz's proposals is his plan for a common EU scheme to shield depositors during a banking collapse. Germany has previously rejected such plans amid public hostility to any perceived attempt to put taxpayers on the hook for shaky banks in other countries. The reinsurance system would act as a backstop to national funds, helping to ensure that governments can honour their legal obligation to protect deposits of up to €100,000 in the event of a banking collapse. His demands include amending EU capital rules to remove incentives for banks to buy up large quantities of their home country's sovereign debt; further action to reduce bad debts in the EU banking system; and the establishment of common European rules on calculating companies' taxable profits. Mr Scholz also wants the EU to harmonise bank insolvency law, saying a patchwork of national rules undermines EU attempts to make sure senior creditors share the cost of dealing with bank failures."[7]

Which are main benefits of the creation of a harmonized deposit insurance scheme?

- To ensure the establishment of a **protection system for EU savers** with low capital availability.
- To address the short-term problem, thus, removing the incentives for "**bank runs**" and reduce the severity of future financial crisis.[8] Uniformed degree of insurance for deposits will **reduce the vulnerability of national deposits** to large financial shocks, ensuring that the level of deposit confidence of the bank would not depend on the bank's location and weakening the link between banks and national sovereigns: **sovereign-bank doom loop**- whereby a decline in the creditworthiness of a nation's banking system that increases the cost of resolving bank failures impairs the government's creditworthiness.
- To address the **coverage of cross-border activities** for branches and subsidiaries (one of the main issues during the financial crisis) by creating an appropriate coverage of subsidiaries and branches in other countries. The problems that have arisen to protect and reimburse depositors across borders call for more harmonisation, since the system in place is clearly insufficient.[9]

EDIS needs to be built on the system of national **Deposit Guarantee Schemes (DGS)** regulated by Directive 2014/49/EU. This system already ensures that all deposits up to €100 000 are protected through national DGS. In addition, the level of harmonisation is too low. A multiplicity of deposit insurance schemes is maintained, with wide variations in coverage level, deposit/depositor eligibility, legal statute (private or public), governance, pay-out procedures and

[7] https://www.ft.com/content/8ea7e002-ffce-11e9-b7bc-f3fa4e77dd47
[8] https://voxeu.org/article/how-design-european-deposit-insurance-scheme
[9]ibid

funding mechanisms**. Therefore, the wide variety of deposit guarantee schemes has not proven to be crisis resilient.**[10]

Examples: Large government interventions were necessary to deal with failing banks in order to restore depositors' trust and stop bank runs, such as the Northern Rock one in the UK (2007) or Landsbanki in Iceland (2008). Several European deposit insurers were not prepared to deal with such extreme crisis situations and even less with the cross-border dimensions of them.[11]

3. The problem with low or even negative interest rates: the slaughtering of bank savers

Bank savings are the largest financial savings of EU households. They are not even informed that they have been losing money after fees and inflation for many years on their main financial savings products. In Belgium for example, BETTER FINANCE estimates the current annual loss at more than 2% after inflation. It seems that the EU Authorities have found yet another way to impoverish the European middle classes.

Now, several banks have even started to impose negative nominal interest rates on large deposits.

So extremely low interest rates are bad news for banks, which in turn might be bad news for economic growth. The upshot is a vicious cycle that pulls interest rates further and further down.[12]

4. EBA shortcomings on EU consumer protection issues

By EU Law (article 9 (1) of the EBA Regulation), EBA is legally required to:

- Collect, analyse and report on consumer trends
- Review and coordinate financial literacy and education initiatives by the CAs
- Promote simplicity

By EC 2017 request (following a 2015 proposal from BETTER FINANCE), EBA is to report on the actual performance and costs of long-term bank savings.

BETTER FINANCE believes EBA has mostly failed in all these regards. The EBA does not even know – and never tried to report on – the past performance of bank savings accounts in the EU, the biggest financial savings of EU households. This is despite its clear legal mandate to collect, analyse and report on consumer and market trends (the CMU action explicitly refers to this legal duty as proposed by BETTER FINANCE in 2015).

Despite the protests of user-side NGOs, EBA decided not to work on and publish any Consumer Trends Report for 2018, arguing about budget/resources issues. EBA then published a "2018-2019" consumer trends report, instead of an annual report as before. In addition, none of these Consumer Trends Reports give any information on the performance of bank savings products, the number one saving product in the EU.

[10] http://aei.pitt.edu/30828/1/ECRI_Policy_Brief_4.pdf
[11] ibid
[12] https://www.investmenteurope.net/opinion/4001812/persistently-low-rates-aren-news

Following a proposal from BETTER FINANCE in 2015, the EC required EBA to produce a first report on the transparency and costs of long-term savings products end of 2018. EBA looked only at bank structured deposits and did not provide any performance or cost information on those.

How can an ESA supervise banking savings products if not aware of the actual performance and costs of these products and services for EU citizens?

BETTER FINANCE in its assessment of the three European Supervisory Authorities' reports on cost and past performance of EU retail financial products[13] pointed out to the scope of the products subject to the EBA's analysis. The EBA followed the mandate from the EC and focused only on structured deposits, although this is not by far the main retail investment or savings product sold by the banking sector to the general public. Moreover, unfortunately, the EBA considers the effort of aggregating data on the structured deposits (SDs) market in the Banking Union is unjustified and disproportionate, albeit due to several reasons[14]. Second, the EBA considers the process of approaching the industry directly and requesting data would be "burdensome and expensive for the EBA to pay". By such statements, EBA grossly ignores its legal mandates with regard to EU citizens as bank services users. Besides, BETTER FINANCE does not see this effort at all disproportionate, as it could have been done on a representative sample of the credit institutions and would allow the supervisory authority to properly measure and then supervise the market and determine those "segments and regions where investors are in a sub-optimal situation and identify those issues which call for careful analysis".

It is worth noting that in the Recommendations part of the report EBA points out to the fact that it will "reassess whether, taking into account the principle of proportionality, the size of the market justifies the effort that would be required to issue the EC reports". In this context, it is even more important to re-examine the EC request to the EBA and **include bank savings accounts in the scope**. For the time being it is evident that EBA remains voluntarily blind on the cost and past performance of the products it is supposed to supervise. Thus, it violated its legal mandate, as specified above.

The first EBA report on its review and coordination of financial education initiatives was issued in 2018.

Lastly, to BETER FINANCE's knowledge, EBA has never taken any significant actions to promote the simplicity of banking services and disclosures, despite its legal mandate to do so, and has not even talked about it. Given the low financial literacy level of bank users, the need for simple, understandable products and disclosures is crucial.

5. Non-Performing Loans (NPL)

NPLs directive – through this directive the EU is encouraging the development of secondary markets for non-performing loans (NPLs), which would allow banks more easily to manage or sell

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[13] https://betterfinance.eu/wp-content/uploads/ESAs-Reports-with-Assessment.pdf

[14] First, there was (before 1 January 2018) no pre-contractual information disclosure document for SDs at a panEU level; second, where applicable regulatory reporting varies greatly from one jurisdiction to the other; last, that colligating with national competent authorities (NCAs) would not improve the situation, as these "do not seem to have quantitative information on the size of the market for SDs"; last, that not even private or commercial databases do not have the necessary data and at a representative level in order to issue such a report.

bad loans. The aim of the new rules is to reduce existing banks' stocks of NPLs and prevent their accumulation in the future. [15]

However, one should not forget about the position of borrowers whose loans have been categorised as non-performing and sold on to third party debt buyers, and the Commission's current initiative to promote further sales of non-performing loans (NPLs). There have been many concerns voiced about this initiative, e.g. the Financial Service User Group (FSUG). "Behind the headline data on NPLs are millions of ordinary EU citizens and enterprises who may well have been victims of aggressive, irresponsible or unfair lending practices in the first place (resulting in over indebtedness). These borrowers were, and still are, in a very vulnerable financial position. Their debts may be sold on to third parties (possibly without their consent or consultation) and may find themselves at risk of being victims of further aggressive, irresponsible or unfair treatment and practices by poorly regulated debt buyers and debt collectors/servicers. There is clearly an interest in this market. From the available data, it would seem that the main buyers of NPLs are investment funds – particularly US hedge funds. These funds are not known for their social responsibility values and clearly see the potential for generating large returns on their investment. There is a risk that these returns will be generated by adopting aggressive/unfair collection practices against socially and/or financially vulnerable borrowers."[16]

6. EU gave up on **reforming bank structures**: EU central banks are still subsidizing non-commercial banking activities such as investment banking, fund management and distribution in closed architecture modes, and insurance activities ("bancassurance".

7. **Fintech**: The EU should ensure a regulatory level playing field among all providers (bank and non-bank).

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[15] https://www.consilium.europa.eu/en/press/press-releases/2019/03/27/non-performing-loans-council-adopts-position-on-secondary-markets-for-bad-loans/
[16] https://ec.europa.eu/info/sites/info/files/fsug-opinions-180227-npls_en.pdf