EFI EuroInvestors
The European Federation of Investors
Fédération Européenne des Epargnants

Rue du Lombard 76
1000 Bruxelles - Belgium

www.euroinvestors.org
info@euroinvestors.org

EUROPEAN COMMISSION CONSULTATION ON POSSIBLE FURTHER CHANGES TO THE CAPITAL REQUIREMENTS DIRECTIVE

EUROINVESTORS RESPONSE

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EuroInvestors (the European Federation of Investors or EFI) was created in the summer of 2009, following the financial crisis which demonstrated the limits of the almost exclusive dialogue between regulators and the financial industry, largely ignoring the user side. EFI aims at representing and defending at the European level the interests of financial services users in order to promote training, research and information on Investments, Savings, borrowings and Personal Finances of individuals in Europe, by grouping the organisations pursuing the same objectives at a national or international level. Already about 45 national organizations of investors and other financial services users have joined us, and EFI already represents about two million European citizens.

1. We are surprised about the inconsistency between the Commission's claim that this consultation is addressed – among others - to the EU citizens, and the inappropriate format of this consultation for the afore mentioned "citizens" as:
   - This consultation is only available in one EU language - English, de facto excluding the vast majority of the EU citizens from it.
   - The text of the consultation, although of great political importance, is 99 pages long, written in technical jargon, and without any specific attention given to or section for European citizens, or even retail banking services users.

   Unlike the providers' side, the users' side certainly does not have the resources[1] to analyse the whole 99 pages and 52 questions. We can therefore only respond in rather general terms. Because of this EC approach to consultations, there is a high probability that detailed answers

[1] The Commission had rightly identified this critical issue in its 4 March 2009 Communication on "Driving European recovery": *"The Commission will ... ensure that the voice of European investors* is *much more strongly heard on all financial issues. The Commission therefore proposes to provide direct funding to facilitate the capacity-building of investor stakeholders to represent their interests in financial services policies at EU level, through training, research and information. A proposal will be presented by the end of 2009"*. But this did not happen.

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to this very critical issue will come once again very largely – if not only – from the providers of financial services, i.e. the very institutions which created the problem in the first place. This is not good for democracy in Europe.

2. We do not believe a regulatory initiative such as the Capital Requirements Directive changes really addresses the major issue revealed by the financial crisis, which has then generated an economic and social crisis as well.
   The roots of the 2008 financial crisis are indeed clearly identified by now. Irresponsible mortgage lending to US households has been an initial trigger of the worst financial crisis since 1929. In turn, this irresponsible lending came largely from the quite recent development of the packaging of these loans through securitization, which – together with questionable accounting practices – enabled banks to take these loans off balance sheet. If these mortgage loans had stayed 100% on the banks' books, it is unlikely any "subprime" crisis would have occurred, at least with this magnitude.

   The development of capital markets and investment activities of commercial banks has not proved its social legitimacy, as, at the same time, commercial banks enjoy three unique privileges from Governments and regulators:
   - The right to collect deposits;
   - The access to central banks' funds;
   - The access to taxpayers' money when in danger of bankruptcy (at least for large banks).

   We believe these unique privileges - which are generating terrible consequences for consumers and taxpayers since 2008 – must have counter parties: for commercial banks to stick to their core economic and social role: collect deposits, and transform those into loans to the real economy, while keeping and managing the risks involved.

3. We therefore believe the approach recently communicated by the president of the USA and by the former Fed chairman, Mr. Volcker (but also by the current chairman of the UK FSA and the current governor of the Bank of England among others) is much more likely to address the real roots of the financial crisis. Unfortunately, despite the Commission writing that "*it is imperative that the more robust set of prudential capital requirements be applied consistently across the world*", the 99 pages consultation does not make any reference to this much more effective option to refocus commercial banks on their traditional business, a logical and fair limitation given the extraordinary public privileges granted on the other hand, as mentioned above.

4. As a second best to this option, the CRD should at least make it very costly for commercial banks to use depositors' and central banks' cash to venture into higher margin but more risky businesses (or businesses generating conflicts of interests) such as investment banking, securities trading, asset management, etc.
   More precisely, we believe the CRD reform should focus on two objectives:
   - Limit the unloading by banks of their credit risks to the markets or to third parties by securitizing their loans portfolio; banks should keep on their balance sheet more than 50% of

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any loan portfolio risks being securitized. They would then pay much more attention to these loans counterparty risks, which again, were and should still be commercial banks' core competency and business.

- Setting very high capital ratios on all banks assets linked to non commercial banking activities. For example, the regulators should put a low limit to the current investment of depositors and central banks cash into government bonds by financial institutions. This equates to a re intermediation of capital markets to the sole benefit of banks, which currently derive very large interest spreads from this activity, at the expense of taxpayers, depositors and borrowers.

5. We are also concerned with what we perceive as the inconsistency between:
   - current European plans to significantly increase the capital needs of financial institutions (CRD changes for banks and Solvency II Directive for insurance companies) on the one side,
   - and the quite negative impact of these and other European financial regulations on the demand side of the European equity markets on the other side.

   Indeed, impact studies show that the proposed CRD changes alone would require European banks to raise hundreds of billions of euros of additional equity capital. At the same time, Solvency II is pushing insurance companies – which are among the biggest European equity investors – to get further away from the equity markets because of the very high capital ratio required by Solvency II for insurers' equity investments, whatever the actual duration of the corresponding liabilities. Already several of the biggest European insurers have announced a sharp reduction in their equity holdings because of the upcoming Solvency II implementation. And the equity share of insurers' assets was already quite small compared - for example – to that of pension funds.

   At the same time, MiFID has further marginalized individual investors' share of equity markets, by increasing sharply the information asymmetry in favour of financial market participants, reducing the transparency of trade information, while failing to decrease transaction costs for retail investors.

   Also, European national governments have an objective interest to favour fixed income versus equity investments by institutional investors because of the huge amounts of public debts being issued currently. The Commission should take this into account.

   One risk among others is a creeping-out effect for capital issuers (other than financial institutions), and a disproportionate share of the financial institutions in the equity markets capitalization … like before the crisis.

   In all, we fear that the proposed changes to CRD will have a negative impact on capital markets and will contribute to their further re intermediation by financial institutions. Again, we believe it would make more sense to get commercial banks to concentrate again on their economically and socially legitimate business of collecting deposits and transforming them into loans to the real economy.