Bundesverband
der Deutschen Volksbanken
und Raiffeisenbanken · BVR

Political update

Strengthening regional banks in Europe

Preserve diversity in the financial markets

10 positions for the European Elections 2019

on behalf of the National Association of German Cooperative Banks · BVR

In May 2019 Europeans will vote. But the upcoming elections to the European Parliament will be the first to take place without the participation of the United Kingdom. It is not only Brexit that is exerting pressure on the European Union (EU) – the (re-)nationalisation trend as well as rising populism in the remaining member states are having a similar effect. Some observers consider 2019 to be the year that will determine the EU's fate.

For the German Cooperative Financial Network, European integration is, without doubt, a unique prospect for peace and prosperity. We want a strong and united Europe. But to regain its strength and to retain its relevance, Europe will have to focus on its core values again: being diverse and decentralised, in a subsidiary structure – just like the cooperative banks. "United in Diversity" is the motto of European unification, and rightly so: national and regional diversity should not be seen as disadvantages; in fact, they are what makes Europe special. Instead of trying to find 'one-size-fits-all' solutions, involving excessive and overly bureaucratic regulations, we should preserve European diversity and subsidiarity. However, we also need more European cooperation: in areas such as research or the protection of Europe's external borders, cooperation offers added value in every way.

For the banking sector and the capital markets, regulations at a European level, imposed in the wake of the Lehman crisis back in 2008, have provided key contributions to improving financial market stability. Yet it is necessary to ensure that regulation is sufficiently differentiated in order to preserve diversity in the banking and financial markets. The German Cooperative Financial Network clearly supports the objectives of regulatory measures. But when we are surrounded by so many rules, we often miss a sense of proportionality and subsidiarity. An institution with a regional business must not be treated in the same manner as an international investment bank: doing so holds the threat of damaging successful, decentralised business models such as the cooperative banking sector.

The present legislative period of the European Parliament – now coming to an end - has been a **regulatory phase**. Whilst the German cooperative banks believe that regulation has been properly implemented, with the right objectives, achievements should now be scrutinised: do the regulations adopted serve their purpose? Are they practicable and proportionate? Were the objectives really achieved? Is relief required – especially for less complex banks financing small and medium-sized enterprises (SMEs)? The existing regulatory framework should be consistently reviewed in these respects during the next legislative period. This is why we are calling for a **consolidation phase** for regulation of banks and financial markets. The focus of financial market policy for the next years must be on 'better regulation'.

The cooperative banks' business model has been a paragon of stability, even throughout the financial crisis. Yet unfortunately, it is particularly the smaller banks with regional roots that are bearing a disproportional burden of regulation from Brussels and the Basel Committee – even though these banks were not amongst those institutions which triggered the financial crisis. Disproportionate financial markets regulation thus also affects regional SME financing, and therefore the competitiveness and attractiveness of the regions. Long-term stability for the financial markets can only be achieved if the economy is robust and keeps growing across the board – not just in a few of our country's metropolitan areas. Strengthening – not weakening – the role of cooperative banks will remain important over the coming years. This means that the political direction of the next few years requires a stronger focus on regional banks. In this context, we have set out our positions below:

Implementing a sense of proportionality in regulation – introduce a Small Banking Box

Regulation, supervision and control are important – yet a better sense of proportion is required. Regional banks must not be treated in the same way as internationally active institutions with systemic relevance.

Existing regulation of the banking sector and the capital markets has a much higher impact on small and medium-sized institutions than on large banks, especially given the limited personnel resources of smaller banks. This is a paradox, since regional credit institutions were not amongst those responsible for triggering the financial crisis; they are generally not systemically relevant. Instead, the financial crisis has shown that especially the German cooperative banks, with their local roots and their comparatively low-risk SME business, are guarantors of a stable and functioning market. They have supported, not threatened, the banking system throughout the crisis. For this reason, the future European banking policy must focus on mid-sized banks more strongly than before. The principle of proportionality must actually be applied across all legal acts; failing that, the diversity of the European (and the German) banking system will be at stake. Whilst we welcome the relief measures for regional institutions which have been incorporated within the framework of the revision of European capitalisation and liquidity rules (CRR II and CRD V), this can only be the starting point for a sustained review of proportionality aspects. Therefore, the concept of a Small Banking Box must remain on the agenda, e.g. for Basel III implementation.

The time is not right for EDIS – no mutualisation of deposit guarantee schemes

A mutualisation of deposit protection schemes in Europe holds the threat of enormous risk transfers in the banking system, together with higher systemic risks. Instead, top priority must be given to a clear reduction of risks, and to the adequate pricing of such risks by the banks.

Establishing a joint European Deposit Guarantee Scheme (EDIS) would open up unlimited liability of banks for third-party risks. Given the vast differences between the individual banking systems, such a move would increase systemic risk across Europe, creating an unfair transfer system. Not all banks have sufficient buffers to cushion losses in case of a resolution; moreover, the requisite significant reduction of non-performing loans is far from being achieved. For instance, the NPL ratio in Italy is 9.4%; 12% for Portugal and as much as 43.4% for Greece. These are way above the 5% considered to be low-risk. In several countries, the inventory of domestic government bonds is too high, and is considered by the financial markets as having a potentially destabilising effect. Given these circumstances, a mutualisation of deposit guarantee schemes would not establish confidence in the safety of savings deposits in Europe – in fact, this would create conflicts. As long as the reduction of risk and the alignment of risk levels have yet to be sufficiently achieved, any mutualisation of deposit protection schemes in Europe must be excluded, since this would involve the threat of extensive transfers from stable to unstable banks – creating false incentives which would provoke moral hazard. As a consequence, it is the well-established cooperative deposit protection systems that would come under special pressure. The time is not right for EDIS. Instead, clear-cut reduction targets (or target quotas) for non-performing exposures – as well as sovereign bond holdings – should be defined on a single-institution level.

Supporting sustainable financing solutions, in a sensible manner

Sustainability has always been an integral part of the business model pursued by cooperative financial institutions in Germany. We therefore generally welcome the European Commission's objective of fostering investments for a sustainable economy.

The BVR supports the Commission's action to establish a uniform pan-European classification for sustainable financial products. Yet there should be no preferential treatment of capital markets products (such as green bonds) over traditional banking business: such products need to be incorporated into considerations concerning sustainability from the outset. Additional regulatory requirements for integrating environmental, social and governance (ESG) factors into banks' processes should be deferred until uniform criteria for the sustainability of financial products have been defined; the practicability of such criteria has been ascertained, and institutions have had enough time to adjust to these new rules. Moreover, a 'grandfathering' rule should apply to financial services entered into prior to the application of the taxonomy (which has yet to be developed). Transitional periods – which are undoubtedly necessary – may only commence once the legal framework has been finalised, including any related delegated acts. Moreover, requirements should be sufficiently flexible, to enable the market to develop practicable solutions. Overall, care needs to be taken to prevent any excessive increase in administrative expenses for banks and enterprises.

Exploiting the opportunities of digitalisation, safeguarding a level playing field

In the era of digitalisation, new technologies and competitors are changing the shape of traditional banking business. The regulatory framework must ensure investor protection at all times, whilst enabling innovation. Fair competition is needed, in line with the motto of "same business – same risk – same rules".

Customer proximity is the hallmark of cooperative banks. Digitalisation, as well as the dynamics of established peers and new competitors, changes customer behaviour and expectations. Cooperative banks have responded to this trend at an early stage. At the same time, a rising number of third-party providers – so-called FinTechs – have recognised the potential of digital banking, and are increasingly offering their own financial services. Market innovation is stimulating the banking business, creating new products and services for customers, but also for institutions' internal processes. At the same time, customer protection and a level playing field are our utmost priority. True to the motto of "same business – same risk – same rules", the BVR is opposed to so-called 'sandboxes' providing regulatory exemptions in the market. FinTechs are often backed by strong investors. A fair framework also needs to be established concerning the use of customer data. Digital processes are producing an ever growing volume of data. Using artificial intelligence, Big Data Analytics can analyse the constantly increasing (and mostly unstructured) customer data, providing tailor-made banking products and services for each individual customer. Banks also need to be able to use the new technologies.

Designing the future of secure payments services

Whilst networking in a new digital ecosystem offers great opportunities, this also goes hand in hand with risks. At the end of the day, banks always have primary liability for payment systems – hence, the safety of payment systems is crucially important.

The EU's Second Payment Services Directive (PSD II) requires bank interfaces to be opened up for third-party service providers (payment initiation and account information services). This means that third-party service providers do not need to have any agreements in place with banks – and do not need to pay them anything, even though banks' infrastructure is being used. However, to preserve the safety of the payment system, it is essential for the account-keeping bank to actually be able to identify third-party service providers, given that these have far-reaching access rights. Care will need to be taken to ensure this within the scope of future revisions to PSD II. At the same time, regulatory provisions governing banks and third-party service providers will need to be interpreted and applied in the same way. Together with other European institutions, German banks will implement a uniform interface for third-party service providers, in line with the rules. Through this so-called 'dedicated' interface, banks will thus grant FinTechs, but also providers such as **G**oogle, **A**pple, **F**acebook and **A**mazon (the so-called GAFAs), access to customer data. Yet free access to the GAFAs' data and basic technical services (such as NFC, fingerprint interface as well as location and movement data) are blocked to other providers, including banks. This competitive distortion needs to be remedied.

European Monetary Union: the path of reform towards a stability union

The long-term success of the single currency depends upon a smart economic policy, and on sound public finances. A reform of the euro area will therefore have to focus on strengthening fiscal rules – as opposed to creating new transfers.

The euro area has made progress in overcoming the sovereign debt crisis. However, the crisis has clearly shown that euro member states must be more consistent in their efforts to align economic policies towards stability and growth. After all, only true economic convergence and sustainable public finances will safeguard the coherence of monetary union over the long term. This requires courageous reforms – not more redistribution among member states. The goal of monetary union (as well as the EU as a whole) needs to be a union of stability – not a transfer union. Unsustainable fiscal policies in euro area countries threaten the single currency, however, making monetary union more susceptible to crises. The euro area must become more stable, and more competitive. Yet current reform proposals, such as the concept of a euro area budget or a so-called 'rainy-day fund' are just not the right solution. We also reject the proposal for a European unemployment insurance, as suggested by the European Commission, amongst others. What applies to the mutualisation of bank deposits applies here too: such transfers bear the risk of providing false incentives – which might give rise to a less sustainable economic policy in euro member states, thus leading to less prosperity and stability in the countries affected. Hence, euro area reforms should predominantly be directed towards strengthening the adhesive power of fiscal rules. The ESM rescue fund should continue to provide assistance exclusively following a unanimous decision of the member states, and only subject to conditions imposing reforms. Likewise, rules should be introduced for sovereign insolvency proceedings: this is the only way to ensure that the euro area develops into a stability union, with rising acceptance of the Eurosystem amongst the population.

Strengthening SME financing when designing Capital Markets Union

Lending by regional banks must not be placed at a disadvantage when designing Capital Markets Union. What is required is to develop Capital Markets Union into a true SME offensive.

The German cooperative banks enjoy particularly close relationships with small and medium-sized enterprises. This is also evident in their structure: just like SMEs, cooperative banks have a decentralised structure. In fact, the financing needs of SMEs were a key factor for the establishment of cooperative banks. Hence, we generally welcome the objective of the European Commission, within the scope of Capital Markets Union, to particularly enhance access to finance for small and medium-sized enterprises. Yet the single promotion of capital markets financing holds the threat of missing the real needs of enterprises whilst promoting the development of shadow banking activities. This is why lending must not be placed at any disadvantage when establishing new instruments. Overall, future measures should be implemented in a targeted manner, avoiding any unnecessary regulatory burdens.

Establishing 'better regulation' as a permanent principle

Financial market regulation is not an end in itself. Good regulation is characterised by the fact that it creates more benefits to customers and enterprises than the burden it imposes. The impact of regulation must be constantly evaluated by reference to its consequences, and the principle of subsidiarity must be preserved.

Regulation of banks and financial markets must observe the principle of 'better regulation' – not simply 'more regulation'. As one of Europe’s fundamental principles, subsidiarity must also apply to regulation. This also means that there must be no undifferentiated expansion of authority for European supervisory authorities (ESAs), at the expense of national regulators. Since ESAs are not familiar with the specifics of individual markets, they must not formulate any strategic goals and priorities. Assigning direct regulatory powers to ESAs may only be sensible where these powers relate to pan-European issues. Moreover, the Basel III regime must be implemented within the EU with a sense of perspective. Implementing these rules simultaneously across all major jurisdictions is mandatory – failure to do so holds the threat of competitive distortions, to the detriment of European and German banks. As a matter of principle, regulatory measures should be reviewed with regard to their practicability and accuracy: drafts and regulations do not always achieve this goal – or only by imposing enormous administrative burdens. This means that regional banking service offers may be damaged, leading to disadvantages for consumers as well as for the economy as a whole. In particular, the goal of 'better regulation' requires legal certainty and sufficient implementation deadlines. This also applies to implementation of the Benchmark Regulation. In this context, successors to Euribor and Eonia will need to be established, in compliance with the Regulation. Moreover, transitional periods need to be extended until December 2021, in order to facilitate the smooth transition for providing and using benchmarks. Concluding, a standardised procedure for impact assessment should be part of any regulatory policy agenda. This is the only way to identify (and rectify) costly and time-consuming dual structures and counter-productive cross-relationships.

Designing consumer protection in financial products in a practicable manner

To the German Cooperative Financial Network, good consumer protection is a matter of great concern. When a product simply cannot be offered due to excessive bureaucracy, it does not help anyone. Consumer protection in financial products must strike a sensible balance between consumer and market interests.

Measures taken to protect consumers must be clearly defined, and their objectives must be reached. Yet if consumer protection requirements trigger costs for banks which are so high that product offers are being partially suspended, regulation drives products that are basically consumer-friendly out of the market. At the end of the day, this will push consumers towards shadow banks which are subject to little or no regulation and supervision. Whilst the BVR continues to consider the principle of 'investor protection through transparency', as promulgated by MiFID II, information and documentation requirements have turned out to be too complex in practice, which is why adjustments are necessary.

Bundesverband der Deutschen Volksbanken und Raiffeisenbanken · BVR

Giving up the financial transaction tax – avoid burdens to enterprises and savers

The financial transaction tax has not yet been implemented, and rightly so: it holds the threat of impeding private-sector savings and the financing of the real economy. European initiatives to introduce a financial transaction tax should be abandoned.

The proponents of a financial transaction tax assign high hopes to the concept: the plan is to raise the financial sector's contribution to financing public-sector budgets, and to provide incentives for cutting back high-risk financial transactions. Even though the proposed financial transaction tax is expressly aimed at the financial services sector, it will ultimately also hit the real economy, as well as savers. Enterprises exposed to international competition need to hedge a plethora of risks; besides currency risks, this also encompasses interest rate risks as well as commodity prices. Introduction of the tax would make hedging instruments much more expensive, thus burdening the export activities of many German companies, at the expense of growth and employment. Even if the tax was limited to transactions in shares only, this would burden private and occupational pension schemes, limiting their attractiveness. This would lead to the paradoxical situation where on the one hand, the state promotes private and company pension schemes (e.g. by providing subsidies or tax benefits, such as with the German 'Riester' pension plans) but on the other hand, takes away funds from savers through the introduction of a financial transaction tax. Even a gradual introduction would not avoid these problems. In essence, the only financial centres to benefit from a financial transaction tax would be those which do not participate, since trades would be shifted there. A financial transaction tax threatens to cause more damage than benefits, which is why it should be rejected.

Contact:

National Association of German Cooperative Banks (BVR)

Parliament/European Policy Liaison Office

Schellingstrasse 4	Rue de l'Industrie 26-38
10785 Berlin	1040 Brussels
Germany	Belgium

Your contacts: Thomas Stammen (t.stammen@bvr.de), Mirian Fabian Breuer (m.breuer@bvr.de), Dr Volker Heegemann (v.heegmann@bvr.de) and Selina Glaap (s.glaap@bvr.de)

Telephone: +49 30 2021 1605, +32 2 289 68 50
E-mail: bvr-europa@bvr.de and politik@bvr.de

Website: www.bvr.de