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Nordic Baltic response to the proposal from the Liikanen High-Level Expert Group (HLEG) on mandatory separation

The High-Level Expert Group (HLEG) on reforming the structure of the EU banking sector, chaired by Erkki Liikanen, has proposed a mandatory separation of certain trading activities, provided that these activities amount to a significant share of a bank's business or if the volume of these activities can be considered significant from the viewpoint of financial stability. Such a separation could have far-reaching effects for the universal banking model used by many Nordic-Baltic banks. In this letter we summarize our view on the proposal.

- First of all we would like to acknowledge the work conducted by the HLEG with the aim of a safe, stable and efficient banking system.
- The Nordic-Baltic banking associations fully support the comments from the European Banking Federation (EBF). EBF comments on certain elements and consequences of the recommendations made by the HLEG and we would like to give special attention to some of them.
- We support the HLEG conclusion that no particular business model did particularly well, or particularly poorly, in the financial crisis. A proper risk management is fundamental and in our view the traditional universal banking model represents a robust and sound model, including an efficient way of handling risk.
- The universal banking model has several advantages. First of all, corporate customers can use a universal bank as a "one-stop-shop" providing all kinds of financial services and products. Furthermore, an important aspect of a proper risk management for large banks is to have a diversified business, both in terms of geographic diversification and in terms of different business activities. For smaller banks a proper risk management can be expressed through a simple business model and a limited area of distribution.
- Norwegian, Danish and Swedish banks operate in open economies with their own currencies (NOK, DKK, SEK). As a consequence of this, it is crucial for both banks and their corporate and retail customers to manage risk of foreign currency exposures, interest rate risk in various

currencies, as well as converting non-domestic funding and investments to local currency through derivatives. Commodities' price risk for customers is also managed through derivatives. All financial instruments except equities are traded based on market making with the banks as counterparties in each transaction. Investment banking in the Scandinavian countries is thus highly integrated with the core commercial banking and retail/corporate banking activities. The Liikanen proposal on mandatory separation would therefore risk harming the function of the financial sector in a way that is detrimental to customers, especially so in the Nordic countries that do not have the euro.

- Against this background we oppose the HLEG proposal on mandatory separation. The possible problems with risky and speculative trading activities should instead be taken care of within existing or already proposed regulation, and be based on an institution-by-institution analysis rather than using general thresholds.
- We believe that the proposed separation principle is far too broad and captures many activities that are important for the efficiency of the Nordic-Baltic universal banking model. A forced break-up according to the method suggested by the HLEG would increase the costs for the banks' customers, without necessarily reducing the risk in the banks or in the financial system.
- One important aspect is that market-making is considered to be an activity that should be separated. In our banks market-making is certainly not a speculative and risky activity. Furthermore, in the Nordic-Baltic market the functionality and the efficiency of the markets for government bonds and covered bonds are more or less dependent on market-making activities of the universal banks. A separation of market-making would increase the transaction costs and have negative impact on the liquidity of the market. A lesson from the financial crisis is indeed that liquid bond markets are of utmost importance for financial stability.
- The substantial costs emanating from forced separation of trading activities will give incentives to keep trading activities below the first threshold, but will not necessarily provide an incentive to reduce the most risky part of the trading business.
- We also want to highlight the competition aspect for European universal banks vis-à-vis universal banks in third countries, where separation may not be mandatory, as well as the competition aspect within Europe regarding banks above respectively below the threshold for separation.
- Moreover, the proposal fails to address the fact, that Member states represent a great heterogeneity of business models. Thus proposing a "one size fits all" solution for all EU Member states will inevitably affect local business models that have continued to perform well during the crisis.
- If the Commission considers putting forward a legislative proposal on mandatory separation we would like to underline the importance of carefully evaluating the results of the ongoing global and European regulatory reform agenda prior to such a legislative proposal. The reforms already decided, or soon to be decided, will fundamentally change the regulatory framework of the banking sector. Several of the reforms are also targeted to the same kind of problems that are in focus in the HLEG report, namely the risks in banks' trading activities.

- The ongoing regulatory reform agenda will promote a more prudent risk management and will lead to substantially enforced crisis resilience among all banks.
- Finally, because of the severe effects that mandatory separation could have not only for universal banks but also for the financial markets and the economy as a whole, we consider it absolutely necessary to carry out a thorough impact assessment, taking into account the impact of the other ongoing reform initiatives. Such an analysis should be presented to all relevant stakeholders before the Commission takes any further steps.