Association for Financial Markets in Europe

Press release

AFME study highlights costs of Bank Structural Reform proposals

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The EU's proposal for Bank Structural Reform (BSR) is likely to trigger a significant increase in the cost of market funding for banks, according to a PwC report commissioned by the Association for Financial Markets in Europe (AFME). Market liquidity would be reduced and costs would rise for market users such as companies and pension funds with a negative impact on economic growth and job creation, *Impact of Bank Structural Reforms in Europe* argues.

Simon Lewis, Chief executive of AFME, commented: *"We call on policymakers to carefully consider the negative consequences of the proposal and its consistency with other policy objectives. BSR as currently envisaged runs directly counter to the European Commission's goals of creating deep, liquid capital markets to support growth in Europe while maintaining a healthy banking system."*

The Report shows that the cost of separating banks would be substantial, with an estimated total annual cost for all EU banks affected of €21.2 bn. By far the largest element of this would result from higher funding costs averaging around 75bp. This is due to lower credit quality of the separated entities, primarily resulting from the loss of diversification benefits that previously accrued from being part of a larger single banking group.

The analysis further shows that very large European banks no longer benefit in their market funding costs from an implicit subsidy suggesting that they cease to be regarded as "too big to fail". This clearly owes much to the substantial regulatory programme that has been developed post the financial crisis and the proactive response of banks in implementing major structural and operational changes.

Based on the cost projections, and the absence of any mitigating actions, bank group-level returns could fall by 2 percentage points on average as a result of structural reforms and by 14 percentage points for standalone investment banking and trading activities. This would lead to negative returns for the separated trading entities of 7 banks out of the 18 included in the study and likely prompt market exits.

This in turn would lead to a concentration amongst market makers and further impact secondary market liquidity, leading to higher cost for borrowers. In particular we estimate that:

- Corporates would be subject to a 25% increase (30bps) in their typical borrowing spread (currently 125 bps) on debt issued through capital markets
- Investors in European corporate debt would be subject to higher trading costs (12bps), lowering their returns and leading to up to €82 bn in losses on corporate bond holdings

Please contact us to get a copy of *Impact of Bank Structural Reforms in Europe*, or go to the reports page on the AFME website, see link.

Note to editors:

In January 2014, the European Commission published a proposal for a new regulation on structural reform of the EU banking sector. Two main requirements of the proposal are the potential economic separation of trading activities that meet certain metrics and the prohibition of proprietary trading.

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Notes:

1. AFME (Association for Financial Markets in Europe) promotes fair, orderly, and efficient European wholesale capital markets and provides leadership in advancing the interests of all market participants. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME participates in a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) through the GFMA (Global Financial Markets Association). For more information please visit the AFME website, www.afme.eu
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