



January 29, 2013

Why the French law to separate and regulate banks will separate almost nothing and change almost nothing

English language summary of Finance Watch's analysis and amendments (in French, 28 pages, [pdf](#))

Following the commitments made by the President of the French Republic, Francois Hollande, during his election campaign, **the Government has proposed a reform of the banking law with ambitious objectives**¹: "To put finance at the service of the economy and not of itself ", "To profoundly change the industry, to become a reference in Europe and to reshape our financial landscape for the next 20 years against speculation and for the financing of the real economy". We can only support such ambitions.

To achieve these objectives, the Act should include a principle of strict separation of banking activities so that **market activities and the financing of speculative activities are separated** from the collection of deposits and lending to the real economy, and where **activities deemed harmful to the economy and society are prohibited or restricted drastically**. The law should also **include mechanisms that allow, in case of crises, for losses to be borne by all bank creditors and not by taxpayers and society as a whole**. Finally, it must provide bank supervisors with sufficient means to be able to fulfil their mission.

Unfortunately, we find that in the current state of the bill, **none of these conditions are completely satisfied**; some are partially, others not at all. Therefore, the objectives announced by the Government will not be achieved.

In addition, the law makes **no mention of the need for country-by-country reporting** of banking activities and so fails to address the issue of French bank activities in tax havens.

In addition to problems with the content, there were material shortcomings in the legislative procedure leading to a lack of consideration for the public interest:

- **Lack of transparency in the consultation processes** carried out by the Government and the Parliament (content of the consultations, minutes of meetings and hearings...)

- **No quantitative assessment of the impact of the proposed separation**, even though this is a requirement of the "*loi de séparation et de régulation des activités bancaires*". The official reason is to protect commercial confidentiality; in reality this a case of private interests clearly outweighing the public interest.

The table below summarizes the amendments needed if the proposed text is to have any impact.

¹ As set out in the presentation of the bill by the Minister of Economy and Finance, Pierre Moscovici, in the introduction to the press kit ([available online on the website of the Ministry](#)).

<u>Conditions for achieving the bill's objectives</u>	<u>Condition satisfied?</u>	✓ yes ✗ no ● partially	
		<u>What the bill says</u>	<u>Why this is not enough</u>
1. Separation of market activities	✗	The bill would separate only a small part of the market activities of banks (trading for their own account, between 0.5% and 1% of the activities of major French banks, according to the banks' own estimates).	Keeping market activities in the same entity as the depository and lending parts of the bank means that a public funding subsidy is still extended to market activities, despite their lack of connection to the real economy (eg derivatives represent 12 times global GDP). These activities will still be able to grow far beyond the real economic value of the market and the hedging needs of businesses.
2. Separation of credit activities from the funding of speculation	✗	The text proposes to separate lending to hedge funds where those loans are not collateralized. However, given the risks they pose, hedge funds must in practice always provide guarantees to banks in exchange for a loan. The proposal therefore separates a practice that in fact does not exist.	Hedge funds borrow from banks to speculate using leverage (to 1 unit of capital, the fund will typically be able to borrow 3 and thus speculate on amounts up to 4 times its capital). The granting of such credits fuels financial speculation and must be separated from depository activities.
3. Prohibition of harmful activities	✗	The text proposes to stop banks from engaging in high-frequency trading or speculation on agricultural commodities for their own account. However, most of these activities are conducted on behalf of clients or in connection with market-making. This prohibition will have virtually no impact and the activities in question will not even be separated.	As recognized in the text submitted by the Government, high-frequency trading and speculation on agricultural raw materials are harmful activities. As a minimum, they must be drastically reduced.
4. Avoiding the need for the state to bear the cost of bank failures	●	The bill stipulates that a creditor of the bank must absorb losses if the capital held by shareholders proves insufficient. The categories of creditor affected, however, may be too limited to absorb significant losses.	The French financial system contains mega-banks whose failure could potentially jeopardize the public finances. The law must give the bank resolution authority the power to impose losses on all the creditors of the bank, otherwise bank failures will continue to be offset by taxpayers.
5. Principle of strict separation	✗	The proposal states that market activities can be separated by placing them in a subsidiary of the bank. According to this principle, the depository bank will still be able to support the liquidity and capital needs of the market subsidiary.	Only a strict separation into two independent legal entities will make economic sense. Otherwise, the depository bank and, through it, the taxpayer will continue to support market activities.
6. Address the presence of banks in tax havens	✗	The bill makes no mention of tax havens so, contrary to the commitments of the President, fails to propose any action to stop or even limit the activities of banks in tax havens.	Banks are major users of tax havens for tax as well as regulatory reasons. Country-by-country reporting should be introduced for all territories where banks are present, in order to shed light on their activities there.