Representation of the public interest in banking

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Finance Watch
Making finance serve society

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How can the public participate in decision making and come to better represent their own interests?

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Foreword

Most of us have little or no say in what banks can and cannot, should and should not be doing, yet in Europe in 2016 we are all deeply affected by the activities of banks. This report investigates the numerous ways in which the public is blocked from participating in influencing the activities of banks and from representing its own interests in banking.

What is the focus of the report? The report examines the banking sector in Europe, concentrating on a sector which, despite competitive and technological pressures, remains core to the wider financial system, be it through bank credit money, payments and retail banking or via market-making in financial markets. Next, it looks at a number of ways to interpret “public interest representation” in banking. The findings of our initial research and above all of participatory workshops led us to concentrate on the ways in which the public could participate in decision making and come to better represent their own interests and less on technocratic fixes that would “improve” the banking system (according to experts).

The report is made up of six chapters:

1. The Problem
2. The Project
3. The Public
4. The Banks
5. The Regulators
6. The Proposals

The report is part of a two-year joint project between Finance Watch and the Hans-Böckler-Stiftung that used participatory research methods in the form of a series of workshops with CSOs, academics, unions and others as well as more traditional research methods.

This report will form the input to a conference in December 2016 to discuss public interest representation in banking and to launch a network of those interested in continuing this work.
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We are all implicated in the banking sector, yet public participation in the governance and regulation of banks is low; the public do not manage to represent their own interests when deciding what banks can and cannot, should and should not do. This report tries to understand why that is and which policies could help improve public interest representation in banks. It does so by drawing on two years of research including workshops with participation from civil society organisations (CSOs), trade unions, academics and others.

The report examines the core relation between the public and banks through the lens of various stakeholders arising from bank activities: depositors, borrowers, employees and so on. Compared to senior bank management, other stakeholder groups face two fundamental disadvantages when it comes to representing their interests: multiple, often conflicting interests, and difficulties of coordination. In contrast, the senior managers of banks have relatively aligned interests and are a small cohesive group with fewer coordination problems. CSOs and unions can help to improve coordination problems among stakeholders, but a focus on single issues can also bring its own problems. To successfully represent the public interests in banking such groups must transcend their own interests to form collaborations, and link their own issues to banking. The problems of mobilising the public are perhaps most clearly seen in the large discrepancy between the resources available to the senior management of banks and to the wider public.

These problems are exacerbated by the current structure of the European banking sector. Thirty to forty banks dominate the sector, using similar business models and accounting for around three-quarters of total assets – a small group with aligned interests. Unlike the rest of the sector, the threat that these banks pose to the system (too big to fail) and the international nature of their business grants them structural power to impose their interests on other stakeholders, on taxpayers and on the rest of society.

Europe’s banks are also divided by governance model. Most are so-called shareholder banks but here too shareholders usually face coordination problems and have few possibilities to represent their interests compared to senior management. This is reinforced by the nature of financial markets in Europe today where the public are likely to be shareholders in the bank via pension and insurance fund managers who rarely exercise their governance rights. A significant minority of Europe’s banks are stakeholder banks, including co-operative and public banks, and banks with employee representation. Stakeholder banks offer considerable potential for public interest representation but great care must be taken to ensure that governance arrangements balance the power of different stakeholders and that banks remain subject to restrictions on their activities.

Bank regulation is an essential way to convince the public that banks are safe but offers too few possibilities for public interest representation. Regulation and regulators are close to banks, creating a domain of technical experts that offers few possibilities for public interest representation. Bank activities and regulation have become increasingly complex in a self-perpetuating cycle and the regulatory process itself is correspondingly long and complex. This further tilts the playing field in favour of senior bank management away from other stakeholder groups who are less able to negotiate these complexities.

Policies to improve public participation and interest representation must therefore concentrate on organising civil society, reigning in the power of the largest banks, encouraging stakeholder banks, simplifying regulation and the regulatory process, and improving the public’s access to it. Some ideas, emerging from participatory workshops are presented in the last chapter of the report.
Banking affects us all

In Europe in 2016 we are all implicated in the banking sector. Almost all of us have bank accounts\(^1\) and bank credit money dominates other forms of money, indeed many of us need bank accounts, for example to get paid, to pay taxes or to receive government benefits.\(^2\)

The trend is for ever more penetration of banks and bank credit money into daily lives, through technological and other means.\(^3\) More generally the economy is debt dependent, with firms of all sizes running on both short and long term debt. Finally, of course, the banking crisis which began in 2007-2008 has impacted us all though bail-outs, credit crunch, recession and the austerity choices of governments that followed. Exclusion from banks is less and less a problem for Europeans, rather the opposite: financial precarity has replaced financial exclusion as the defining characteristic of our relation with banks and finance – precarity of indebted households and SMEs\(^4\) and systemic precarity as bank failures and crises continue to loom. In short, banking matters to all of us, perhaps more so than it ever has.

Yet despite that, participation in the governance and regulation of banks by groups other than the banks themselves is low.\(^5\) The public generally do not participate in influencing the activities of banks and do not get to present their interests.\(^6\) Academics note that (non-business) civil society’s ‘infrequent mobilization means that they seldom represent a significant share of mobilized dissent’ and that ‘organized opposition to the financial industry is relatively weak [and] relatively disjointed.’\(^7\) What’s more low participation is linked with poor representation of the public interest. Nongovernmental organizations (NGOs), labour unions, faith-based organizations (FBOs), and other social movements continue to play a fairly marginal role in the politics of commercial finance, thereby largely surrendering the advocacy field to industry lobbies and established think tanks. As a result, civil society efforts to steer financial markets in the common good remains mostly muted and ineffectual, and governance of finance generally eludes democratic accountability.\(^8\)

A common sentiment expressed in the workshops conducted throughout the project was that individuals and civil society organisations (CSOs) did not feel able to participate in influencing bank behaviour. They judged the efforts high, most especially because of the (perceived) complexity of the subject, and the chances of successful intervention low; therefore, they often judged that their scarce resources were better used elsewhere.

In the current environment the best the public can hope for is to be a model consumer, and even this is often not possible. Mainstream economics and finance theory contains various schools of thought on the need (or not) for banking regulation, but these theories invariably rest, in one way or another, on deviations from perfect markets for finance. In a perfect market, the theory assumes, everyone would be well served; but this is simply asserted from the outset with little evidence that it can ever be true. What’s more,
these theories leave no room for the public to have a say, for people to represent their own interests. Rather mainstream finance theory tells us it is the job of experts to make technical interventions to allow the closest possible approximation to perfect markets, with no need for public participation. The problem is presented as technical and not political. Given the domination of mainstream economics and finance in academia and in government such thinking percolates throughout banks, regulatory agencies and other arms of the state and itself forms a blockage to public participation and interest representation in banking.

In this set-up the only role for the public is to act as a good consumer, a price taker from many sellers who switches banks to maximise utility according to their individual utility curve. In the UK, for example, the Competition and Markets Authority (CMA) offers no more radical solution to the country’s banking woes than technical fixes to make accounts more portable (yet acknowledges that customers rarely switch accounts). No solutions are offered which increase the chances for the public to participate and to represent its own interests. In the workshops throughout the project we heard that individuals and CSOs consider the problem to be political rather than technical, that what is missing is for the public to have a real voice in influencing how banks can and cannot, should and should not behave, for example in defining the purpose of banking and in limiting its activities.

In short, the banking system penetrates ever more of our economic activities, binding us all to it, and in times of crisis costs us dear. In the choice between ‘exit’ and ‘voice’ as means to exert influence, the exits from the banking system are closed for most of us, leaving ‘voice’ as the only way that public interests can be represented. Yet research shows the public’s voice is weak and is not being heard. Therefore, this report asks: what blocks public participation in influencing the activities of banks, what blocks the public from representing its interests in banking, be it via regulation, via governance mechanisms or via other means, directly or through the state? Following that: what routes can be explored to unblock participation and improve the representation of public interest in banking?

Before beginning the analysis it is useful to briefly note the central role that banks continue to play in our society. As mentioned above almost all Europeans have a bank account and bank credit money is the most prevalent form of money in Europe in 2016. What’s more there are numerous forces pushing for its continued expansion, most importantly the banks themselves. An important driver is the continued facilitation of payment by debit and credit cards including promoting payment terminals and contactless debit cards. Internet banking and internet shopping also exert pressure for more of us to have bank accounts and to use electronic money. Aside from technological pressures firms increasingly pay salaries in bank credit money and significantly the state also exerts pressure to pay and receive money from citizens using electronic money. Credit is also increasingly replacing public provision e.g. in education. Bank lending also remains critical for Europe’s businesses.

9 Hirschman, 1970
10 The dominance of bank credit money differs across nations and sectors and can be measured in different ways. According to the Bank of England, “Of the two types of broad money, bank deposits make up the vast majority — 97% of the amount currently in circulation. And in the modern economy, those bank deposits are mostly created by commercial banks themselves.” (McLeay et al 2014). Meanwhile ECB data shows that, as at end Sept 2016 in the Eurozone, Currency in Circulation was 1.1tnEUR while M2 (a broader measure of money including some bank credit money) was 10.6tnEUR, almost 10-times larger, even before including the vast deposits of MFIs (and of central government). http://sdw.ecb.europa.eu/browse.do?node=9691114
11 For example, a major initiative has been launched in Greece in the last few years to switch from cash to electronic money payment in shops, an area where Greece lagged behind the rest of Western Europe. This despite, or perhaps because of, the ongoing banking crisis (Euromonitor 2016, Harris 2016).
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Banks also remain at the heart of financial markets. The false distinction between bank-based finance and market-based finance continues to hold influence, not least in the rhetoric accompanying the Capital Markets Union. Nevertheless even a cursory look at how financial markets operate, let alone the events of the financial crisis, show that banks remain central to the functioning of financial markets. Banks remain market makers in financial markets (ordinarily providing liquidity) and bank losses in financial market instruments were and are at the heart of the financial crisis (one need only recall the worries about Deutsche Bank in 2016 to see how much banks still matter).

The current challenges to banks do not look terminal. Illiquid lending such as peer-to-peer lending, despite growing relatively fast since the crisis, remains an insignificant percentage of credit provision. Fundamentally banks remain the only institutions that can provide liquidity based lending. Challenges from new technology such as block-chain are often appropriated by large banks mainly because they are best able to mobilise funds for large scale acquisitions and research. Finally, new entrants that lend money and in doing so create deposits which can act as money are essentially banks ... and not a new species of institution. For example, Paypal now offers credit on top of its transaction services, begging the question is it not simply becoming a bank, albeit one based entirely on the internet?

In summary, banks remain central to our financial system, economy and society and their influence is not decreasing.

12 Lindo, 2013; Gabor & Vestergaard, 2015; IMF, 2010
13 Movements in interbank rates remain a key barometer of crisis.
14 The European Commission (2016) found 4.1tnEUR of crowdfunding in the EU in 2015 and that it is ‘has been developing rapidly’. Meanwhile Eurozone banks only (monetary financial institutions) had 17.2tnEUR of loans outstanding in the Eurozone alone at the end of 2015. Securities issuance is of a similar order of magnitude to loans. Note the first of these measures is the amount raised in one year, the second an outstanding balance. Never-the-less the magnitude of the difference suggests crowdfunding will remain marginal for some time.
15 Arnold, 2016
16 https://www.paypal.com/uk/webapps/mpp/paypal-virtual-credit
Project outline

Aims
As an NGO and a membership organization, Finance Watch has the representation of the public interest in finance at the heart of its mission. Despite the challenges that finance and banking pose to our society, and as described in the problem statement above, experience so far has shown that, for a number of reasons and despite many ideas being developed by civil society groups and academia, gathering forces and building-up meaningful support on finance-related issues remains difficult.

The question was not new to Finance Watch and similar organisations but the project reflects a need to think in a more systematic and encompassing way on how banking relates to the public interest, to develop a method of analysing the representation of public interest in banking, and to elaborate policy proposals that civil society organisations and the public could take forward.

We therefore found it crucial to avoid a top-down approach and dedicated a significant part of the project to gathering input from civil society organisations, including whenever possible those not yet involved in banking-related advocacy. Putting the consultation of civil society organisations at the centre of the research was in itself a contribution to what became a key theme of the project: the issue of participation. In the workshops we asked and were asked: how can the public’s interests be represented in politics, in bank board rooms, in the media and in the public debate, if only a narrow minority are ever involved? Then came secondary questions, such as why would the public participate in the first place? How can we make participation effective so that it has an impact? How to organise participation?

Workshops
We recognised from the outset of the project that part of the problem of participation and interest representation was insiders pronouncing on all aspects of banking, while other voices (i.e. the large majority) remained silent or unheard.

We therefore wanted our research to:

1. examine the process of participation, interest representation and decision-making rather than simply make technical prescriptions for bank behaviour, examining for example the regulatory process itself; and
2. draw directly on the experience of unheard voices by gathering the input of so-called non-experts from around civil society as well as the input of academics who are not always present in the policy arena. In some ways we tried to echo the participation and interest representation in banking that we were investigating with participation and interest representation in the research process.

As a result, a large part of the research for the project involved bringing together CSOs, academics, unions, and others to discuss public interest representation in banking, bringing their own experiences of participating in the public conversation about banks and the
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results of their studies in this area. The workshops also held a unique and important place in
the project by being both an input to the research process and an output of the project.17

- As an input: the workshops contributed both to the general direction the project should
take and to developing a better understanding, both practical and conceptual,
of the challenges faced by CSOs and the broader public when trying to
participate and represent their interests in banking.
- As an output: it also quickly became clear that knowledge-building and collaboration
among CSOs and the broader public were both very important for effective public
interest representation and very difficult to achieve. A further aim of the workshops
therefore was to provide a safe space where participants could build knowledge and
create networks with others working in this area.

In total we organised:

- Eight participative one-day workshops made up, largely, of representatives of
CSOs (including NGOs, trade unions, citizens’ groups and consumer groups) and
academics. These workshops took place in Paris, Berlin, Brussels and London: a first
round of four workshops in 2015 to discuss the subject generally and a second round
of four workshops in 2016 to follow up and more closely discuss policy proposals. In
total, 64 individuals participated in the workshops, with some attending more than
one workshop.

- Three advisory committee meetings made up of academics, union
representatives, journalists and CSO representatives appointed by the Hans-Böckler-
Stiftung to discuss the interim findings of the project and ways in which to move the
project forward.

- A one-day academic workshop in Paris bringing together researchers in the area of
civil society action in finance.

- A special panel at the EAEPE (European Association for Evolutionary Political
Economy) annual conference in summer 2015 involving academics and a
representative of an association of German co-operative banks.

- A conference call in spring 2016 to share the results of the first round of workshops
with participants and get feedback from participants on the write-up of what we
learned. This call was in response to a demand from participants who wanted to hear
from the workshops taking place in other cities.

Desk based research

The participative research was supported by desk research. A literature review surveyed
academic and other research (e.g. from CSOs) regarding public participation and interest
representation in banking and forms the backbone of this report. Data analysis primarily
examined the structure of the European banking sector and the nature of the largest 30-40
banks (and is taken up in Chapter 4). Case studies – including bank structural reform,
capital adequacy regulation, cooperative and mutual banks, the future of bailed-out banks
and the UK banking sector – serve as recurring and / or extended examples throughout the
report.

17 As Tuncau et al (forthcoming) note: ‘An important feature of participatory research is that it has two objecti-
ves – one is to produce knowledge and mobilise for action that are useful for a community or group and
second to empower people through the process of inquiry and knowledge producing, as through this process
they are able to understand power imbalances.’
How we think about the problem

Stakeholders
During the course of the workshops and other research it became clear that three considerations were important to us when thinking about public participation and interest representation.

First, in Europe in 2016 we are all implicated in banks (as discussed in Chapter 1). Second, there is not one public interest, but many (further discussed in Chapter 3). The question for our research is: by which means can we usefully categorise multiple, conflicting, overlapping and changing interests in such a way to successfully investigate public interest representation in banking?

Third, the scope of the project is to investigate how the public can impact bank activities. Therefore the choice of categories must be related to public participation and interest representation and to bank activities, anything else risks disconnecting the analysis from the aims of the research.

Combining these three concerns the project analyses the problem of public interest representation through bank stakeholders e.g. depositors, borrowers, employees, shareholders, other debt holders and senior management. These categories of stakeholders can be seen from the perspective of both the public and banks: they are, on the one hand, ways to characterise the public’s relation with banks and, on the other hand, ways to characterise the banks’ essential activities.

Contested discursive space and participation
Many of these stakeholder groups, certainly including the senior management of banks, claim their policy proposals to be in the general public interest. We can therefore also think of public interest as a contested space and/or a contested discursive space – an idea and phrase that arose in the participatory workshops. It is largely because interest groups can represent private interests while claiming to be acting in the general public interest that we stress the importance of participation and of the public themselves representing their own interests.

Note that when narrow private interests claim to be acting in the wider public interest they often use mainstream economics as justification, but, as seen above, this can lead to flawed logic: mainstream economics begins with an assertion of the very thing it is being asked to demonstrate, namely that public participation is not necessary.

Channels
Next we asked by which means can stakeholders influence bank activities, how can they participate, and by which means they can represent their interests?

Another idea that emerged several times from the participatory workshops was that of channels, such as access to the media, to elected officials, to regulators, to bank management. Different stakeholder groups have differing access to channels, and channels vary in their impact. As will be seen, many channels are simply not open to the wider public and/or are blocked by narrow interests.
The overall approach

We combine these elements in our overall approach to the research process (see Figure 1). The model is circular in that it begins and ends with banks’ actions, these actions establish categories of interest (stakeholders) that have varied access to more and less effective channels of representation. The result of (uneven) representation is a construct (contested and discursive) which is claimed as the general public interest and which impacts banks’ activities, for example via regulation. The question of the paper is: how can stakeholders better participate and represent their interests such that the balance of represented interests better reflects that of the public as a whole and not of those narrow private interests with privileged access to channels of representation?

Figure 1: Model of research approach
We start our exploration of the blockages to public participation and interest representation by examining the problem from the perspective of the public. The chapter has five sections.

We start by exploring the two main obstacles to public participation and interest representation:
- First, the public has many interests.
- Second, the diffuse nature of the public leads to so-called collective action problems.

We then explore how:
- Third, Civil Society Organisations (CSOs) can help overcome problems of multiple interests and of coordination but can also create fresh barriers to co-operation e.g. between single issue CSOs.
- Fourth, this is perhaps most powerfully expressed in the relatively small amounts of money that the public manages to mobilise from all across society for putting forward their interests.

Finally,
- Fifth, we briefly outline the role for any policy proposals in this area, to be taken up in Chapter 6.

Many interests

It quickly became clear, especially during the workshops, that there is not one public interest. There are only ever many different interests, changing over time, sometimes conflicting, and sometimes aligned. For example: borrowers might want low interest rates and slack lending conditions, while depositors might want the opposite; consumers (e.g. depositors and borrowers) might have different interests to employees; finally, and perhaps most fundamentally, consumers and employees (whom we might think of as sources of profit) might have different interests to senior management and shareholders (who might be thought of as the receivers of profit).

In these circumstances the blockages to public participation and interest representation are of a political nature: which stakeholder groups have more power to effectively represent their interests? How can other stakeholder groups overcome their differences to work together? These problems are reflected in the more apparent technicalities.

First, more powerful stakeholder groups generally have better access to the channels by which banks can be influenced, and to more effective channels. For example, and as will be explored in Chapter 4, in the majority of banks formal governance rights are granted to shareholders only (not to other stakeholders). In another example, further explored in Chapter 5: the broader public has access to only a small portion of the regulatory process, e.g. through public consultations, where the necessary form of public participation is often ineffective. What’s more, powerful stakeholder groups can use their position to take

18 Krawiec, 2013; Krawiec & Liu, 2015
measures which perpetuate their powerful positions, for example, as explored in Chapter 5, the senior management of the largest banks can lobby for regulation suiting large shareholder banks and not smaller / stakeholder banks.

Second, research has shown that coalition building is important when trying to influence bank behaviour, e.g. through regulatory channels. But if stakeholder groups have conflicting interests how will this coalition building occur (and note that even within stakeholder groups conflicts will occur)? Take credit allocation for example. What is the purpose of bank lending? Is it to support a transition to renewable energy or to build transport infrastructure such as airports? Is it to support small and medium sized enterprises (SMEs) or multinationals? Is it to maximise profits or lend to low-growth regions? Even within the stakeholder group “borrowers” it could be difficult to align interests. Overcoming multiple and potentially conflicting interests, even within stakeholder groups such as borrowers, will be difficult but without it the public remains fractured and unlikely to successfully represent its interests in the face of more powerful stakeholders.

Cooperation or collective action problems

The second major problem for representation of interests is that of collective action. There is a fundamental lack of cohesion within and across most stakeholder groups that makes acting collectively very difficult.

As individual bank customers we feel very little power to influence how banks behave. This could in part be overcome by acting collectively, so barriers to collective action are also barriers to public participation and interest representation. Currently we feel little in common with other bank customers, however much we might feel in community with them on other matters. For bank employees, collective action is possible via their trade union however union membership in general is dwindling.

Collective action problems in banks are recognised in mainstream economics, classically in bank runs. ‘Bank runs are essentially a collective-action problem among depositors. If, for any reason, large, unanticipated withdrawals do begin at a bank, depositors as individuals may rationally conclude that they must do the same to avoid being left with nothing…, but their inability to coordinate their response to the problem can lead to a seemingly irrational response.’ The difficulty of shareholders acting collectively to prevent senior bank management pursuing their private interests is another example (explored in Chapter 4). These well-known examples demonstrate the nature of the problem, but not the scope, which in practice is wider still: as noted above the concept of individuals as more than homo economicus and of the public participating and representing their own interests is beyond the domain of mainstream economics.

19 e.g. Pagliari & Young, 2014, 2015
20 As we saw above we rarely even switch banks (Competition and Markets Authority, 2015)
21 http://www.worker-participation.eu/National-Industrial-Relations/Across-Europe/Trade-Unions2
22 Macey & O’Hara, 2003:97
Civil Society Organisations (CSOs)

CSOs are one, potentially important, way in which public stakeholders can improve coordination and mobilisation. Nevertheless they present their own challenges. Civil Society can be defined as ‘a political space where associations of citizens seek, from outside political parties, to shape societal rules’. CSOs such as Finance Watch and many of its members undoubtedly go a long way to tackling the co-ordination problems of individuals, allowing them to attempt to “shape societal rules” via the associative form of these organisations.

To bring about this co-ordination CSOs very often focus on a single issue. This helps to stimulate cooperation and action on that issue but can harden boundaries between single issue CSOs, making collaboration on other issues more difficult. In Europe few CSOs concentrate on banking and the required co-operation between other CSOs remains limited. Other CSOs approach banking from their particular perspective such as poor-country debt, food speculation, ecology, inequality, excessive corporate power, transparency and so on. Figure 2, shows a highly stylised and finance-centric map of issues facing CSOs. If they are to work together on banking CSOs face a two-stepped challenge: i) to relate their single interest to banking and ii) to transcend their own particular interest and connect to other single interest groups.

Different CSOs also take a different approach to shaping societal rules, which can be a strength but which can also further complicate coordination. For example, aiming for more or less profound societal change, or using mass publicity campaigns versus targeting politicians or advocating direct interaction with corporations such as in divestment campaigns.

Figure 2: A map of civil society issues

23 e.g. see Kastner, 2014 regarding consumer groups.
24 Not fully explored here Amoore & Langley (2004) question the prevailing academic understanding of ‘global civil society’, calling for deeper reflection on the part of academics, CSOs and others.
25 Scholte, 2013: 134
26 As recorded by academic researchers (e.g. Scholte, 2013) and as was clear in our workshops.
Ways in which they can come together?

Coordination of different interests and CSOs is, however, possible despite the difficulties, as recent examples such as the Financial Transaction Tax (FTT) or Transatlantic Trade and Investment Partnership (TTIP) campaigns have shown. These examples show that both a campaign that proposes and one that opposes can mobilise and overcome the co-ordination problems of a multitude of interests.

Two factors stand out. First, as financialisation continues and the danger to society posed by banks and finance grows then so too does the imperative for different stakeholders and CSOs to act together. Second, there can be efficiencies in specialisation. If CSOs can find a way to work together then the very specialisation that threatens to separate them can be turned into an advantage. For example, pulling environmental specialists into banking debates that impact directly on the environment can be enormously powerful. What’s more it can be cost efficient as organisations contribute their specialist knowledge to a common cause, saving others the expense and time of learning new subjects in detail. Such collaborations require opportunities (space and time) to develop and trust among CSOs.

Money

One of the main reasons that CSOs gave for not working on banking and finance (or only being able to allocate a very limited amount of time to it), and for not forming collaborations is a lack of resources. Nearly all CSOs are resource constrained, many severely so, and banking is usually not their primary focus. This became clear during the project in several ways. First, many friends of Finance Watch reported that they simply don’t have the time and / or staff to dedicate to a full-day workshop on banking, a non-core, non-funded issue for them. Second, some of those who did make it to the workshops profess great difficulty in understanding the problems of banking and did not feel that they have the legitimacy, the time or the staff to try and learn. Most non-banking-specialist CSOs find it difficult to justify engaging on matters of banking and finance.

In contrast and relative to other stakeholder groups, the senior management of banks have comparatively enormous budgets available to them to represent their interests and to participate in shaping the environments in which they operate. This begins with the resources dedicated to financial innovation and the creation of new banking instruments, but encompasses research, publicity, conferences, advocacy, and so on. Given the total resources available to the public this spending mismatch can be seen as a further element of the co-ordination problem: the resources to counter banks’ spending on interest representation exist in the rest of the economy, the problem is to mobilise them (in competition with many others issues).

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CSO coordination can make the most of specialists

We lack resources: funding is too scarce for us to work on bank-related issues.

Workshop participant

CSOs lack resources compared to banks

Money

We lack resources: funding is too scarce for us to work on bank-related issues.

Workshop participant

Most non-banking-specialist CSOs find it difficult to justify engaging on matters of banking and finance.

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28 Further examples include campaigns on MIFID regulation on food speculation, CMU and others. Even if the immediate legislative outcome of these campaigns was sometimes limited, they demonstrated that co-ordination is possible.

29 Several times in the participatory workshops CSO representatives discussed, with no decisive conclusions, if co-ordination was easier for campaigns that proposed new measures or for those that opposed measures proposed by others. The latter offer a focus against which people can rally while the former is more aspirational.
Lobbying in particular has been highlighted where banks (senior management) massively outspend CSOs.\(^\text{30}\) Banks have ‘significant lobbying war chests’.\(^\text{31}\) Conservative estimates suggest ‘the financial industry spends more than €120 million per year on lobbying in Brussels alone and employs more than 1,700 lobbyists.’\(^\text{32}\) Changes in disclosure rules also highlighted how much individual banks spend: e.g. the Financial Times reported that Deutsche Bank spent €4m on lobbying in the EU in 2014, UBS €1.7m and Goldman Sachs €700,000-800,000, figures that almost certainly underestimate the real lobbying expenses.\(^\text{33}\) In comparison the typical budgets of CSOs are negligible e.g. ‘Finance Watch, the only dedicated public interest advocacy group working on European financial regulation, operates on a budget of less than €2m.’\(^\text{34}\)

We should note that it is not just the public that struggles to mobilise society’s resources compared to banks. Regulators themselves must also compete for funding and often work on much smaller budgets than the banks they seek to regulate and supervise, with a ‘constant pressure’ on resources.\(^\text{35}\) For example, Bloomberg recently reported a regulator struggling to attract enough funds to properly police high frequency trading.\(^\text{36}\)

By way of conclusion: Organising civil society

In short, stakeholders other than senior bank management face problems of multiple, often conflicting interests and of co-ordination when trying to represent their interests effectively. Policy proposals should seek to redress the balance and to facilitate coalition-building among CSOs. One clear area would be to increase the funding of both civil society and regulators. Another is to create safe spaces where civil society can inform itself about banking issues, understand how to transcend their own interests, relate their single issues to banking, and create alliances, for example to leverage speciality knowledge that already exists across CSOs.

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30 e.g. Hacker and Pierson, 2010; Johnson and Kwak, 2010
31 Pagliari & Young, 2015: 1
32 Corporate Europe Observatory, 2014
33 Robinson & Braithwaite, 2015
34 Finance Watch, 2016:12
35 Froud et al. 2012
36 Hamilton, 2016
One stakeholder group, senior bank management, enjoys considerable advantages with regard to the main blockages to public interest representation discussed in the last chapter. It has a relatively better aligned interests and fewer coordination problems. Importantly the structure of the European banking sector further exacerbates their inherent advantage.

First, senior managers of banks taken as a whole, to a great extent, aligned interests in securing the conditions and framework within which they operate and compete. Second, they are a very small and cohesive group and can easily co-ordinate their actions. This is true within the hierarchy of a single bank and across the European banking sector more generally. Senior bank management also benefit from numerous ways to co-ordinate their interest representation. Explicit devices include national and European banking associations and banks are often the driving force behind other trade associations such as the International Swaps and Derivatives Association (ISDA). Subtler co-ordination devices include educational and cultural homogeneity (to say nothing of gender homogeneity\textsuperscript{37}). For example, a recent report highlighted how important cultural fit was for job prospects in investment banking and how ‘the concept of ‘fit’ is often determined by whether aspirant bankers share a social or educational background with current hiring managers’.\textsuperscript{38} The overall result is a stakeholder group that is considerably easier to co-ordinate than other groups.

This chapter:
• first, shows that the current structure of the European banking sector reinforces and exacerbates these advantages of senior bank management; and
• second, examines bank governance models to see how they impact public participation and interest representation.

Anatomy of Europe’s banks and dominance of TBTF banks

Size of banks
Europe’s banking sector is dominated by around 35 large banks that are qualitatively bigger than the rest of the sector (around 45 times bigger than medium sized banks and 1,740 times the average size of thousands of small banks). As Table 1 shows, large banks are the 1% of Europe’s banks – just 1% of domestic institutions by number, they account for 72% of domestic banking total assets. Small and medium banks are the 99%, more than 3,000 banks account for the remainder. These consolidated statistics are confirmed when examining the individual balance sheets of almost 400 of the EU’s largest banks. Figure 3 graphs their total assets ordered by size and it is apparent that the large banks

\textsuperscript{37} \url{http://www.ifre.com/more-action-needed-on-gender-diversity/21260460.fullarticle}
\textsuperscript{38} Social Mobility Commission, 2016
are qualitatively different than the long tail of medium sized banks.\textsuperscript{39} What’s more, since 2008 deleveraging has reduced the overall size of the bank sector but the average size of domestic large banks has grown from almost €600bn to almost €700bn (see Table 1).

Table 1: Large, Medium, Small and Foreign Banks 2008, 2015 in the EU

<table>
<thead>
<tr>
<th>Year</th>
<th>Large Domestic</th>
<th>% Domestic</th>
<th>Medium Domestic</th>
<th>Small Domestic</th>
<th>Foreign</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>Number</td>
<td>35</td>
<td>1%</td>
<td>548</td>
<td>2,695</td>
</tr>
<tr>
<td></td>
<td>Total Assets (billions EUR)</td>
<td>24,376</td>
<td>72%</td>
<td>8,365</td>
<td>1,058</td>
</tr>
<tr>
<td></td>
<td>Average Size (billions EUR)</td>
<td>696</td>
<td>15</td>
<td>0.4</td>
<td>9</td>
</tr>
<tr>
<td>2008</td>
<td>Number</td>
<td>49</td>
<td>1%</td>
<td>577</td>
<td>3,302</td>
</tr>
<tr>
<td></td>
<td>Total Assets (billions EUR)</td>
<td>29,323</td>
<td>78%</td>
<td>7,443</td>
<td>1,004</td>
</tr>
<tr>
<td></td>
<td>Average Size (billions EUR)</td>
<td>598</td>
<td>13</td>
<td>0.3</td>
<td>7</td>
</tr>
</tbody>
</table>

Source: ECB, Consolidated Banking Data (http://sdw.ecb.europa.eu/browse.do?node=9689685)

Figure 3: Total Assets of 397 Large and Medium Sized banks sorted by size (EUR millions)

Source: SNL Database (http://www.snl.com/)

Activities of large banks

The business model of the largest banks is also different from that of the medium sized banks. The consolidated data for the whole sector shows 33% of large bank assets are classified as ‘cash, trading and available for sale’, compared to 20% for medium sized banks (see Figure 4). Most importantly, \textit{large banks engage in derivatives trading, an activity}...
almost entirely absent from medium sized and small banks. Large domestic banks have €3.2 trillion of derivatives assets on their balance sheets (matched with approximately the same amount of derivative liabilities it should be noted). Given their much larger size and their higher share of derivatives per bank, large banks account for 95% of all derivatives assets among the EU’s domestic banks (see Figure 5). Studies have shown that dealer banks are the hub of derivatives markets, meaning that this extremely large market is dominated by just a handful of very large banks and makes them highly connected to each other and the rest of the financial system.

Although the ECB does not disclose which banks classify as large banks, analysis of individual bank balance sheets shows most that of the largest banks are ‘investment banks’. Ayadi et al (2016) identify the ‘investment bank’ as typically the largest of the five business models in their study, with above average trading assets (representing 60% of total assets in their study), lower-than-average deposit funding and higher-than-average debt liabilities. On the other hand, the various types of retail bank they identify generally map to small and medium sized banks.

Figure 4:
Selected Balance Sheet items for Large, Medium and Small Domestic banks (EUR billions)


40 Derivatives account for almost 13% of assets at large banks but only 4% at medium sized banks (small banks have less than 1%). Source: ECB, Consolidated Banking Data (http://sdw.ecb.europa.eu/browse.do?node=9689685).

41 It should be noted that European banks report derivatives differently from American banks. IFRS reporting does not allow banks to net contracts even those within ISDA agreements, ie between the same counterparts, while US GAAP does. This might be thought to overstate the derivatives exposure on the European balance sheets as generally ISDA agreements have appeared to work in the case of counterparty failure. On the other hand gross accounting does highlight the fundamental nature of derivatives portfolios as accumulated piles of individual contracts which banks hope will offset. Balance sheet reporting of derivatives is generally based on fair value, an attempt to measure the market value (notional values are recorded in appendices). Market values of derivatives can be particularly volatile, which can result in rapid changes in the composition of bank balance sheets as apparently offsetting assets and liabilities rise and fall.

42 Lindo, 2013

43 Analysis suggests there are a smaller number of very large ‘diversified retail’ banks amongst the 30-40 largest banks with fewer trading assets than pure investment banks but nevertheless with higher than average market based funding.

44 We would note that examination of the individual bank balance sheets of around 400 banks would appear to indicate a small number of medium sized boutique investment banks with extremely high levels of cash, trading and available for sale assets.
Too-big-to-fail banks still pose a systemic threat

Europe is home to 13 out of 30 banks that the Financial Stability Board (FSB) determines to be Global Systemically Important Banks (G-SIBs), as well as being home to others, such as Lloyds and Dexia that were previously on the list. Given this, the huge and rising average size of large banks and the qualitative difference between large and medium sized banks it seems safe to continue to label Europe’s largest banks “too-big-to-fail”. The term, first used in the 1980s, encompasses more than size, taking in other ways in which the failure of such a bank can pose a broader systemic threat to the banking, financial or economic system. The largest banks are also often too-complex-to-manage and to-rescue, and too-connected-to-fail. Their high quantities of financial market activities in particular bind them to the rest of the financial system, for example the BIS statistics consistently show that non-financial firms make up less than 10% of banks’ OTC derivatives counterparties.

Structural blockages

These features of the European bank sector exacerbate the problems of public interest representation identified at the start of the chapter. In particular, senior management of the very largest banks have privileged access to channels of participation and interest representation relative to other stakeholders (more so than the management of thousands of small and medium sized banks).

First, they are small in number, 30-40 large banks, meaning coordination is relatively easy compared to stakeholder groups with much larger constituencies. Second, their business models are broadly aligned with “investment banks” dominating, and therefore the interests of senior management are also broadly aligned when it comes to setting the framework within which to compete. What’s more, each of the large banks is a formidable lobbyist in its own right, for example we saw in Chapter 3 that a single bank easily declares much more spending on lobbying alone than Finance Watch uses for its entire budget (and of course this excludes the more diffuse ways in which banks influence their environment, not least financial innovation, conferences, research, banking associations and advertising).

Figure 5: Share of all domestic banks’ derivatives assets


Large banks are a small, cohesive group

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45 Financial Stability Board, 2015
46 The phrase was first used in the 1980s: “[I]n September 1984 the Comptroller of the Currency testified before Congress that some banks were simply ‘too big to fail’ and that for those banks total deposit insurance would be provided’ (O’Hara and Shaw, 1990: 1587).
47 https://www.bis.org/statistics/aboot_derivatives_stats.htm
The senior management of the largest and too-big-to-fail banks can exert structural power to promote their own interests and block the interest representation of other stakeholders. The very notion of too-big-to-fail stems from the belief that society is obliged to bail out the largest banks because of the systemic risk they pose with no chance for most stakeholders to participate in the decision making process. As we have witnessed in recent years, such bail-outs usually involve measures with large and lasting consequences.

Since 2008 banks have benefited from a wide and imaginative array of measures including equity purchases by the state, continued and unprecedented liquidity provision, government guarantees of bank debts, extraordinary restrictions on the use of bank credit money in particular areas of the Eurozone (i.e. Cyprus and Greece) and so on. Most stakeholders have lost out: shareholders have lost out as share prices have more than halved (see Figure 6 below); borrowers have lost out as lending was ‘crunched’; employment in the broader economy has fallen, and employment in banks has fallen through bank failures and cost cutting as branches close and retail banking moves online; conditions for depositors have not improved and on occasion have been severely curtailed; and of course the public more generally has lost out through the cost of bail-outs and the austerity choices that followed the bank crisis and ensuing credit crunch. These stakeholders seem to have little chance to represent their interests. Meanwhile senior bank management have sometimes lost their jobs but have usually remained unscathed with past pay intact and with little or no further consequences (despite the ever growing list of bank misdeeds).  

Finally, analysis shows the largest banks are also the most international and this is a further source of structural power.

Governance: shareholder and stakeholder banks

The formal governance arrangements of banks are another channel by which the public can potentially represent their interests. Here we distinguish between Europe’s shareholder banks and stakeholder banks and examine the possibilities of each.

Shareholder banks

Shareholder banks are understood as those where management formally answer to shareholders as the owners of the company e.g. via votes at general meetings, and management’s official duty is to maximise returns to shareholders. Such banks tend to be larger and more engaged in trading activities (which overwhelmingly entails trading with other financial firms) and more international than stakeholder banks. Shareholder banks also predominate among those banks that failed in the crisis of 2007-9 and were nationalised.

49 Culpepper and Reinke, 2014
50 Berry et al, 2016
The very largest banks and those categorised as ‘investment banks’ are almost all shareholder banks. Most obviously shareholder banks explicitly exclude participation by other stakeholders in the formal governance of the bank. Management have few duties to other stakeholders other than those imposed by law and regulation e.g. employment laws, laws on fraud etc. While profits can be made by offering a good service to customers or treating employees well, there can clearly be conflict between the goal of maximising shareholder value and representing the interests of other stakeholders. The recent trend for digitalisation and related branch closures offer a relevant illustration: senior management of banks judge that a move to internet banking and away from branch-based banking can reduce costs and increase profits. Branch closures are however often concentrated in rural areas and in poorer areas, where internet usage and access is also lowest. Employees and customers, who are adversely affected, have little or no possibility to participate and to represent their own interests in these decisions.

How senior management dominate shareholders

However, theory and evidence show that shareholders too are often blocked from participating and representing their interests in influencing bank actions. Economists, for example, have long noted the principal agent problems that shareholders have in controlling managers, including a collective action problem due to the fragmentation of shareholders.

Numerous devices are theorised to economically align management incentives with those of shareholders e.g. performance related pay, management share ownership (often with lock-up periods) and clauses to reclaim pay after the fact in the event of heavy losses. The effects of these are muted by high salaries however (which often rose after the crisis, compensating for falling bonuses), such that senior bank management face a payoff profile which rewards them extraordinarily well in good times but is still very comfortable in bad times. The resulting economic incentive is still to take high levels of risk with “Other People’s Money” (OPM).

Moreover, this focus on economic incentives ignores the lack of opportunities for participation and direct interest representation by shareholders. Again this is exacerbated by the current structure of banking and finance in Europe. Shareholders can vote at general shareholder meetings but, first, management control the agenda of such meetings and thereby restrict available choices. Second, as Europe has become more financialised the wider public are often shareholders in banks via fund managers that pool together the investments of many pension-fund and insurance-policy holders. Pooling allows fund managers to largely separate their liability management from their asset management (i.e. premiums and pay-outs on one side, buying and selling financial instruments on the other). Freed from liability-driven liquidity demands, asset managers can concentrate on trading to capture changes in price (buy low – sell high). Given the performance incentives that most face, and in this era of high speed trading, very few asset managers actively exercise their governance rights in banks, preferring to “vote with their feet” by selling stocks whose price they think will fall.

While banks have generally returned to relative profitability since the crisis, once the crisis is factored in then it is clear that shareholders of Europe’s banks have not had a good ride in recent years. Figure 6 below shows the Stoxx Bank 600 index of bank equity.

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51 Greenham & Prieg, 2012; Ayadi et al, 2016
52 Evidence from the United Kingdom shows branches closures (especially closure of ‘the last bank in the village’) depresses SME credit provision and impacts on the local economy. Closures are most often in poorer and rural areas new branches are more likely to be in wealthy areas. Travers-Smith 2016 & http://neweconomics.org/taking-control-of-rbs/
53 e.g. Jensen and Meckling, 1976
54 Lindo, 2013
Representation of the public interest in banking

prices, the index is at approximately one quarter of its high in March 2007. The bank bailouts privatised gains and socialised losses via the state but most shareholders (often the broader public via pensions and insurance) have also paid a heavy price for the banking crisis compared to senior management.

Figure 6: Stoxx Bank 660

In short, the current functioning of shareholder banks in Europe mostly prevents meaningful participation and interest representation by their own shareholders and the formal governance arrangements explicitly exclude the participation and interest representation of other stakeholder groups.

Stakeholder banks

A significant minority of Europe’s banks are not shareholder banks but can be labelled stakeholder banks. Stakeholder banks ‘explicitly aim to deliver a range of broader benefits to stakeholders while earning sufficient profits to ensure financial sustainability and security.’\(^{55}\) They include cooperatives and mutuals, savings banks and public banks\(^{56}\) as well as credit unions, community finance development institutions and public savings banks.\(^{57}\) In Europe, stakeholder banks are more likely to be small and medium sized banks, making them very unlikely to pose a systemic threat. They tend to undertake “boring banking”: lending to households and non-financial firms in their local economies rather than trading with other banks and financial firms. They are also overall less leveraged and managed to maintain good credit growth throughout the crisis (large investment bank lending to the “real” economy contracted).\(^{58}\)

Given their explicit support for other stakeholders, stakeholder banks offer more possibilities to improve public participation and interest representation, however experience shows that they also require careful governance arrangements and restrictions on their activities in order to be successful. Governance arrangements must carefully balance the voices of stakeholders, avoiding excessive influence for one or a minority of interests and/or paying lip-service to stakeholder participation.

Perhaps the best known kind of stakeholder banks are co-operative banks and similar structures which give a voice to account holders, for example granting each depositor one voting share. Problems at such banks often arise from pressure to grow that can be

\(^{55}\) Greenham & Prieg, 2012:8

\(^{56}\) Ayadi et al, 2016

\(^{57}\) Greenham & Prieg, 2012:4

\(^{58}\) Greenham & Prieg, 2012; Ayadi et al, 2016

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expressed in a number of ways. Growth tends to require capital-raising, which is difficult for many stakeholder banks and especially for those with coop and mutual like structures. In the UK this led most building societies to de-mutualise and transform themselves into shareholder banks. It can also lead to pressures to change business models or to engage in new activities. Famously, Northern Rock failed after trying to expand by moving to a business model where rapidly growing mortgage assets were moved into securitisations and funding moved from deposits towards market funding. Spanish Caixas had restrictions on their activities removed throughout the 1970s and 80s, ‘with the aim of allowing them to fully compete with commercial banks’,\textsuperscript{59}with catastrophic results once the crisis hit Spain.

Public banks in various forms also remain an important part of Europe’s banking sector, typically bringing democratically elected representatives into the decision making of the bank. Charges of poor accountability or even corruption at public banks seem misplaced (i.e. blaming public banks rather than corrupt individuals); nevertheless they highlight the need for carefully designed governance arrangements that balance the representation of interests between elected officials, bank management, employees and other stakeholder groups without allowing one group to have disproportionate influence (neither senior management nor elected officials, for example). If this can be achieved, the benefits of democratically elected officials having a say in the banks’ affairs are clear for public interest representation. Public banks have a long record of providing safe, “boring banking” services to SMEs (e.g. German Sparkassen) and long term infrastructure financing (e.g. KfW). Nevertheless they can also suffer without restrictions on their activities. After the decision to remove state backing for Germany’s Landesbanken, some moved aggressively into new financial instruments, notably US residential mortgage securitisations, resulting in huge losses.\textsuperscript{60}

A third example of a stakeholder bank is one where all employees have meaningful representation in the decision making process of the bank: if done correctly this clearly increases the participation and interest representation of a significant stakeholder group. Employees are also likely to be customers, and arguably their interests are likely to be more varied and long term than simply maximising shareholder returns. Codetermination, as is common in Germany for example, is one model for employee representation, whereby shareholders and employees jointly participate in governance arrangements. However, these arrangements must once again be carefully managed to obtain a true balance and ensure that management does not simply pay lip service to employee representation or that employee interests are not subjugated to more powerful interests.

The current environment for European banking provides further hurdles by tending to favour larger banks, resulting in higher costs/lower profits, pressures to grow, and/or pressures to behave as shareholder banks. For example, smaller banks tend not to have access to infrastructure such as payments systems on an equal footing with larger banks. Smaller banks (stakeholder banks are typically small or medium sized banks) must often use large banks to access such infrastructure, placing them at a disadvantage.

\textsuperscript{59} Greenham & Prieg, 2015:29
\textsuperscript{60} IKB also expanded from providing banking services to SMEs and also suffered crippling losses on US securitisations (Financial Times, 2007).
Similarly, the philosophy of the regulatory framework might be argued to suit large and shareholder banks better than small and stakeholder banks. The capital adequacy regulations provide a key example in a number of ways. The Basel Accords and their application in European and national law create a tendency for centralisation: not only does centralised netting tend to reduce capital adequacy requirements but the Basel Accords also require that internal procedures, especially risk management, follow the capital requirement calculations and are similarly centralised. Co-operative banks and networks of mutually supporting co-operative banks, however, operate on a decentralised basis. A networked / de-centralised model is arguably safer from a macro-prudential perspective and a local focus improves public participation and interest representation. Regulatory pressure to centralise therefore can go against the grain for stakeholder banks, forcing them either to hold more capital than equivalent shareholder banks or to change their business model to become more like shareholder banks. Similarly, and perhaps more importantly, use of the internal models approach to capital adequacy, which rewards banks with lower capital requirements, is only possible for the very large banks as its fixed costs make it unfeasible for smaller banks (i.e. for stakeholder banks that remain local and constrained in their activities).

In short, stakeholder banks potentially offer a powerful way for the stakeholder groups that make up the general public to better represent their interests. Nevertheless, measures are required which increase their effectiveness in doing so and which guard against them slipping towards shareholder bank behaviour. These measures include focus on governance arrangements, restrictions on activities, and infrastructure that supports networks of smaller banks.

By way of conclusion: Policies to make banks more open to public interest representation

This chapter has highlighted some ways in which the current structure of Europe’s banking sector blocks public participation and interest representation. The analysis suggests several areas in which policy changes could improve matters (taken up more fully in Chapter 6).

First, the dominance of the very largest banks exacerbates the ability of senior bank management to suppress the interest representation of other stakeholders. A rebalancing of the sector away from very large banks to a more diverse universe of small and medium sized banks is required, for the general good of Europe’s economies and for better public interest representation. Above all this requires an end to “too-big-to-fail”.

Second, it calls for policies to promote stakeholder banks, which tend to be smaller, more typically “boring banks” lending to the real economy (and not trading with financial firms), anchored in local communities and which present clear and direct opportunities for the public to be active in their governance.

61 In the workshops we heard tales of Directors of very small stakeholder banks spending months explaining their business models in an attempt to obtain a banking licence to regulators accustomed to dealing with large or shareholder banks.

62 Networked banks can only offer each other a limited amount of support, nevertheless it is possible to contain heavy losses in one bank without threatening the whole network (the opposite of the too-big-to-fail banks where losses in one part of the bank are highly contagious to the rest of the institution).

63 NEF recommends that stakeholder banks should be legally protected from privatisations, should be restricted geographically and in their activities, should exist in networks with tightly controlled central institutions and require patient, long term, low cost capital to avoid a rush for profits or public offerings. (Greenham & Prieg, 2012)
So far we have focussed on the relationship between banks and the public (either directly or via CSOs). Attention must now turn to bank regulation and the ways in which the public can participate in influencing banks’ activities via the regulator.

We approach bank regulation as an extension of the relationship between banks and the rest of society. While banks are society’s experts at judging (and enforcing) creditworthiness, their survival as deposit-taking institutions depends on the rest of society (i.e. non-experts in credit) judging them creditworthy and therefore avoiding a bank run. Banks develop a range of practices to convince the public of their creditworthiness and bank regulation can be seen in this light. An essential role for bank regulation is to convince the rest of society that banks are safe places to deposit their money and thereby to ensure their continued operation. Bank regulation can also be a mechanism through which the public can influence the banking system to serve the broader good of society.

The dominance of technical experts in banking regulation

Banking regulation both internationally and nationally is dominated by technical and expert rule-making and enforcement. This tends to block the public from participating and representing their own interests in the domain of bank regulation.

Historically, early banks managed their own affairs. Over time, regulation became more formal with a clearer distinction between regulator and regulated, but it remained self-regulation, e.g. via cartels or guilds, and regulators were experts drawn from bank themselves. As the role of the state expanded generally, including universal suffrage, so bank regulation increasingly became the role of the state and more formally defined but it retained a narrative ‘as a skill only available to those with tacit, practical knowledge of the markets – thus excluding actors from the new democratic politics’.\(^64\) For example, the Bank of England and the Banque de France were both originally private banks, then the bank of banks, and were only finally nationalised in 1946 (and remain institutions of banking experts).

If anything banks moved private governance into the state.\(^65\) This trend was clearly visible in the ways in which central banks and regulators kept the financial system alive during the financial crisis. For example, the operations of failed banks taken under national ownership have not been brought under the command of politicians (the UK state for example will not vote against RBS’s management); rather one part of the state is acting as a distressed asset manager, buying on the cheap and hoping to sell out for a profit.\(^66\)

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64 Johal et al, 2014: 406
65 Dorn, 2015; Froud et al, 2011
66 As Froud et al, 2011:109 observe: ‘As UKFI [the UK government entity established in 2008 to manage nationalised banks] elaborated its role and mandate, it increasingly represented, not the nationalisation of the banks, but the privatisation of the Treasury as a new kind of fund manager.’
The increased role of finance in society generally (financialisation) has been accompanied by a shift from democratic to expert regulation. A prime example was the shift to independent central banks, a critically important institution that moved away from the influence of democratically elected officials. The Bank of England for example was removed from parliamentary control in 1997. During this period ‘regulatory functions have increasingly been delegated to public bodies or agencies with a status semi-autonomous from central government’. This includes not just the official bank regulator but other wholly or partly private bodies perceived as technical specialists e.g. ISDA, credit rating agencies, or IOSCO (the International Organization of Securities Commissions).

The result is that bank regulation remains largely insulated from public participation and public interest representation, even via the channel of representative democracy. Technical experts, closer to banks in daily conduct and in culture, have a greater say in what banks can and cannot, should and should not do than the public or elected officials. One of the main causes of this is complexity, as we will now explore.

Complexity of activity and regulation: a vicious circle

The era of financialisation has witnessed a self-perpetuating cycle as complex bank activities and complex regulation feed on each other. This cycle has been fuelled by the freedom of banks to engage in new activities, which have required ever more rules.

Figure 7: De-regulation / Re-regulation (Cerny, 1991)

For over 30 years now global banking has been ever freer to engage in new activities, in a process widely known as de-regulation. For example, allowing banks to trade in OTC derivatives and to become the core of this excessively large market. But de-regulation alone is a misleading term, it has been accompanied by re-regulation allowing banks to undertake ever more activities has required ever more rules (Figure 7). Rules and regulations facilitate new activities in a number of ways, for example by letting all market

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67 Picciotto, 2011: 89
68 e.g. Perret, 2015.
69 Lindo, 2013
70 Cerny, 1991
participants (banks and clients) know what is and is not allowed and by reassuring bank equity and debt holders about the activities of banks.

A self-perpetuating circle has developed (illustrated in Figure 8). Given that banks are generally free to undertake new activities, the increase in number and complexity of rules has created more possibilities for them to innovate and banks have created new instruments that use regulation as an input, often taking advantage of regulation but abiding by the letter of the law, a process sometimes known as regulatory arbitrage.\(^71\) New activities necessitate new rules which provide new opportunities… and so the cycle continues.\(^72\)

The evidence is clear. Take, for example, the Basel Capital Accords. Basel 1 was 30 pages long, while Basel 2 was over 250 pages long. The EU’s implementation of Basel 3 (CRD4 plus CRR) totalled 675 pages and those interested in advocacy would have also benefited from reading supporting documentation such as the delegated acts (76 pages) and impact assessments (420 pages).

Figure 8: Cycle of regulation and financial innovation

The resulting quantity and complexity of rules acts as an additional barrier to public participation.

First, the public are largely excluded from participating in regulatory debates because of the magnitude and complexity of both bank activities and the rule book. Again and again in the workshops we heard representatives of CSOs tell us that they could not spare the resources required to master the quantity and complexity of banking regulation. Without a good knowledge of bank activity and regulation they felt a lack of legitimacy that prevented them from expressing opinions on banking.

Second, even the more democratic arms of the state are largely excluded for the same reason. When a cross-party group of Members of the European Parliament in 2010 issued a ‘Call for a Finance Watch’ to civil society, they warned that ‘the lack of counter-expertise

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71 As Engelen et al (2012: 366) note: ‘…in the case of financial regulation, innovation ensures that activity characteristics can morph through and around events including regulation, which itself becomes a primary input.’

72 Note that length and complexity is often embedded in rules by direct financial sector lobbying, for example by requiring “exceptions” to the scope of application of a regulatory provision.
poses a danger to democracy. MEPs are generally not banking experts and face a daunting task when scrutinising proposals from the European Commission for new banking laws, proposals that are typically hundreds of pages of technical language. Again problems of multiple interests and collective action are at work. Banks mobilise large sums of money to study the complex rule book (both to innovate and to lobby); while civil society, dividing its attention across many interests (environment, equality, labour issues and so on) struggles to mobilise enough resources to match banks. Parliamentarians similarly struggle to match the attention that banks devote – MEPS, for example, face a raft of issues to address and yet have only limited resources to draw upon to study each problem (typically only two or three policy assistants per MEP, plus a small shared European Parliament Research Service).

Third, even regulators often struggle to match the spending of banks. This is one reason that we see a style of regulation, typified by the Basel Accords Internal Models approach, which starts from the proposition that “banks know best”, and which, crudely put, tries simply to audit what banks are up to.

Finally, we must look at the regulatory process itself. Initiating, writing and implementing banking regulation is a long, complex process spanning many years, agencies and geographies (and reflecting the complexity of banking activities and regulations themselves). The other blockages described in this report can be seen at work when examining the regulatory process: the relative cohesion of bank management compared to that of the wider public; the much larger resources that bank management can deploy; the dominance of a few, well-resourced and well-connected banks and their senior management; the self-regulatory nature of banking regulation; and the complexity of activities and regulation. Taken together, the result is that directly and via business associations senior bank managers are much better able to negotiate the long, complex regulatory process than the broader public is. The long, complex regulatory process acts as a further blockage to public participation and interest representation.

**Complexity of regulatory process**

Finally, we must look at the regulatory process itself. Initiating, writing and implementing banking regulation is a long, complex process spanning many years, agencies and geographies (and reflecting the complexity of banking activities and regulations themselves). The other blockages described in this report can be seen at work when examining the regulatory process: the relative cohesion of bank management compared to that of the wider public; the much larger resources that bank management can deploy; the dominance of a few, well-resourced and well-connected banks and their senior management; the self-regulatory nature of banking regulation; and the complexity of activities and regulation. Taken together, the result is that directly and via business associations senior bank managers are much better able to negotiate the long, complex regulatory process than the broader public is. The long, complex regulatory process acts as a further blockage to public participation and interest representation.

**Long and complex**

**First, the process is long**: moving from pre-agenda and standard setting through legislation to supervision, enforcement and judicial processes can take 15 to 20 years. At a given moment there are likely to be many different pieces of regulation at different stages of the regulatory process. Given their respective budgets and coordination devices it is obviously easier for bank management to successfully participate than for other stakeholders, either by following a single piece of regulation from start to finish or by participating in multiple debates at the same time.

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73 The MEPs’ call resulted in the creation in 2011 of Finance Watch as a civil society membership association to provide expertise as a counterweight to the financial industry lobby. For background, see [http://www.finance-watch.org/about-us/why-finance-watch](http://www.finance-watch.org/about-us/why-finance-watch); For further reading see Ford & Philiponnat, 2013.

74 Harruy & Scialom, 2015

75 The full policy cycle in the EU is typically 15-20 years but a forthcoming report from Enlighten will show this has been compressed to 8-12 years in high-pressure sectors such as post-crisis banking and finance. ([http://enlightenproject.eu](http://enlightenproject.eu))
Second, the process is complex. It is made up of many discrete stages involving multiple agencies often with overlapping and / or contradictory mandates and a variety of geographies (e.g. national, supra-national and international). Furthermore, different types of regulation take different routes through the process.

Not only are there many official agencies but private or semi-private bodies are also often implicated in banking regulations, e.g. rating agencies, ISDA, accounting standards boards and so on, which provide more or less explicit inputs to regulation. Lobbying efforts should therefore also target these bodies. Once again senior bank management have a great advantage over other stakeholders, for example ISDA is explicitly an association of derivatives dealers who we have already seen are mostly large banks.

Limited opportunities for public and political intervention
In addition, the public is generally granted few formal opportunities to intervene in the regulatory process. Academic studies of public participation in the process are forced to examine public consultation phases of regulation as one of the few places where clear explicit public participation is possible. Little evidence can be gathered regarding public participation elsewhere in the process because little participation is formally possible. What’s more by the time regulation arrives at the consultation phase the scope is already defined, the opportunities for significant change are reduced and the language used is typically already technically complex.

Furthermore, the diverse nature of the public and the difficulties of mobilising them means that even when they are interested the necessary form of their participation is less effective than the interventions of senior bank management. Mass standardised responses, where members of the public send almost identical letters, or heart-felt but non-technical responses do not carry as much weight with regulators as the wide range of technical arguments typically put forward by bank management. Overall the complexity of the subject and greater resources can lead to more effective participation by banks even in cases when they provide numerically fewer responses.

Even elected policy-makers have relatively few possibilities to intervene in the process. Academic models of banking regulation sometimes start with the idea that politicians initiate regulation and regulators merely implement the technicalities. In reality, regulation often begins and ends with the technical experts and with the banks themselves (via financial innovations which provoke a regulatory response). At the international level

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76 In the US for example the Federal Reserve (itself made up of many entities), the SEC, the CFTC, the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Agency (FDIC), amongst others, all share some responsibility for regulating banks (Baxter, 2012). Further different agencies often have different mandates, some explicitly supporting the sector, others indirectly / implicitly through financial stability and so on.

77 Ratings granted by Credit Rating Agencies are still – despite critiques (see Finance Watch 2014a) – central to the calculation of regulatory capital for banks.

78 ISDA, the International Swaps and Derivatives Association, defines standards for OTC derivative legal documentation.

79 e.g. Pagliari & Young, 2014, 2015.

80 In one example, the public consultation phase of the Dodd-Frank Act, public participation was high and fewer than 10% of responses were from banks. Nevertheless, 91% of all responses were almost identical standard letters originating from public interest groups and as a result the regulator gave each letter considerably less weight than responses which provided different argumentation. Those responses from the public that were not standard were often heart-felt but lacking technical engagement with the issues to be addressed and were also afforded less weight by regulators. Importantly, in the next phase of regulation banks followed up with 93% of all contacts (e.g. meetings) with federal agencies on the subject, with just 7% for public interest groups and similar, as banks took advantage of their much higher available resources and potentially close relations with regulators. (Krawiec, 2013; Krawiec & Liu, 2015)

81 Benjamin & Rai, 2008 also question the worth of public comments during regulatory consultation, they note high duplication with few new arguments brought through the comments process.
the process begins with international standard setters such as the Basel Committee on Banking Supervision (BCBS) and IOSCO, they set the agenda, and with it the terms of the debate. In Europe, the European Commission first proposes directives and regulations and the European Parliament and Council of the European Union work on the basis of those proposals. Towards the end of the regulatory process, technical experts again write the regulations and implement them. In between politicians have a window to participate but this moment in the process affords only limited scope to alter the proposed regulation largely because decisions made at the very beginning of the regulatory process fix what is and is not within scope and therefore severely limits the choices available to decision makers, often leaving outright rejection as the only effective choice available, a choice which is rarely productive and typically further lengthens the regulatory process.82

Furthermore, Europe sometimes witnesses apparently political decisions delegated to technical bodies – an understandable outcome given the diverse nature of EU political actors (such as the different nation states in the Council or national delegations and political groups in the Parliament) combined with long and complex regulation.83 As can be seen, the complex regulatory process cannot be separated from the other elements blocking public participation discussed in this report.

By way of illustration Figure 9 shows a stylised and simplified depiction of the regulatory process for capital adequacy regulation. Note that Basel 3 discussion began before the crisis and that it is still not fully implemented. Much is decided in upstream agencies such as the BCBS which admit little formal participation by public or elected officials. What’s more the capital regulations themselves draw upon the private credit rating agencies and other private bodies, which further complicates matters. CSOs such as Finance Watch have relatively few opportunities to intervene: they have responded to public consultations at the BCBS (with limited impact) and the European institutions and continue to advocate towards MEPs, including in the implementation phase, but have little capacity to intervene elsewhere (although Finance Watch has joined the stakeholders groups of the EBA and ESMA for the first time in 2016), and have no capacity to follow up the rules as they are translated, implemented and applied in Member States. In comparison, banks are known to be lobbying directly and indirectly at most or all stages throughout the process.

82 With regard to capital adequacy regulation, for example, the Bank for International Settlements (BIS), under its ‘Regulatory Consistency Assessment Programme’, undertakes and publishes ‘Implementation monitoring of the Basel standards’ and ‘Consistency assessments’ which deter deviation from the original standards. http://www.bis.org/bcbs/implementation.htm
83 These occur most explicitly via ‘delegated acts’ which, for example, occurred during the CRD4 regulatory process. See Footnote 103
By way of conclusion: Changes to the regulatory process to foster broader effective participation

While the next chapter will take up policy proposals in more detail there are several clear areas stemming from this analysis in which improvements could be made:

- Simplify and democratise the regulatory process, making it more transparent
- Improve the EC consultation process to lower the barrier to participation
- Fund civil society organisations appropriately and take steps to improve existing bodies aimed at representing non-bank stakeholders
- Grant more / better opportunities for formal public involvement in the regulatory process, especially in the agenda-setting phase
- Shift regulation away from “banks know best” (such as the internal models approach) to “regulators / elected representatives know best” and hence limit banks’ access to the regulatory process.
Introduction

Having identified low and ineffective participation as a key element blocking public interest representation in banking, the second round of workshops explored ways to improve public participation in banking. In particular, we focused on:

- strategies for civil society;
- policies to make banks more open to public interest representation; and
- changes to the regulatory process to foster broader effective participation.

The chapter discusses each of these areas in turn, laying out ideas that arose in the workshops and the broad areas which policy proposals might address.

The last section then lays out seven more specific potential policy proposals. They represent a selection of the ideas developed and discussed in the workshops among the diverse participants and should not be understood as Finance Watch proposals. As suggested by the research itself, different CSOs with different capacities, ways of acting and objectives will be better suited to taking the lead in developing, gathering support and taking such proposals forward, for example some of the proposals will require substantial work over the long term and are undoubtedly ambitious, reflecting the importance we attach to the subject. Our hope is that this list will act as a catalyst for a variety of actions. Importantly, it should be noted that to date none of these proposals is funded, and each would require financial support from public and/or private funders.

Organising Civil Society

General lessons

One clear message that arose in the project was the need for civil society to engage in its own knowledge building, to self-educate and become experts themselves on their own terms. This would help tackle several problems raised in the analysis above and in the workshops.

Even though we have a lot to say, we are not legitimate in the debate and every single word we say needs huge amounts of proofs that are too costly to produce. **Workshop participant**

First, it would build legitimacy, allowing civil society to escape easy dismissal by current holders of expertise. Second, this would in turn build much needed confidence when it came to tackling complexity of bank activities, regulation and regulatory process. Important in this regard is to show that civil society proposals can succeed.

The step is too high, no change will happen, it is too big, it has never worked so far. **Workshop participant**
Third, by working together to build knowledge civil society would be better able to **link banking issues to their own societal issues** in their own ways, and not rely on the received wisdom to do so (which rarely moves beyond the value of free markets). Linking to societal issues helps mobilise the public but also helps with the following two points. Fourth, coming together and understanding the particular view-points, capacities and knowledge of different civil society actors can lead them to **form more effective and efficient coalitions**. Examples include the regulation of derivatives and commodities’ trading in the US and in the EU, which gathered development and environmental NGOs together with consumer groups in advocacy work aimed at lawmakers. Fifth, and linked to the previous points, building their own knowledge in this way would also allow civil society to **find their own voice**. “This is how we want to talk about banking” was a phrase we heard in the workshops, and typically included not only a desire to de-emphasize the technical but also to address broader topics such as the social purpose of banking, which activities should be banned etc. Throughout the workshops many felt **banking should be treated as a public good or a public utility**, and in particular the essential functions of banking: payment systems, credit provision and simple deposit accounts. Participants also favoured **simple and transformative ideas**. While it was clear there was no silver bullet, no one single response, it was felt that other proposals can be developed and pushed forward around and behind simple demands that mobilise the public and gain attention.

Lastly building self-knowledge was felt important in preparing for the next crisis. A clear message from the workshops was that a new financial crisis is likely and should it occur could provide an opportunity for change. Crises and their aftermath, when salience is high, present opportunities for change, but as we see from 2012-2013 onwards salience can also decline as immediate dangers are managed (however unsatisfactorily), reducing the opportunities for change. Experience suggests that civil society should prepare in advance for windows of high salience, which may be brief.

Since 2008 there has been considerable academic research analyzing the causes of the crisis, the policy developments since, the reaction of civil society and so on. Similarly, civil society has begun to develop knowledge and expertise around banking. These beginnings should be built on to build civil society’s knowledge and expertise, to form networks, including links to academia, and to further build capacity to participate in banking debates.

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84 See Pagliari & Young, 2014, 2015
85 Recent events have shown Europe’s banks remain fragile, e.g. on-going banking crisis in Italy, problems in Germany, continued restrictions on banking in Greece (so-called capital controls), lay-offs and branch closures in the UK, Belgium and The Netherlands.
86 This idea was behind a workshop organized by the Transforming Finance Network in London in March 2016: preparing a plan involving various interest groups, the media and policy makers for the next crisis.
87 Pagliari and Young (2015) define salience as “the importance that the general public will assign to a specific issue compared to other issues on the political agenda.” They note that “salience is an environmental condition that can change. Policy domains, which usually remain outside of the spotlight, can rise to one of the main priorities on general public’s agenda as a result of events such as crises.”
88 For example the work of the Tax Justice Network.
89 Examples include the creation of several specialized organizations and networks such as Finance Watch in Brussels, the Finance Innovation Lab and the Transforming Finance Network in the UK, Collectif Roosevelt in France and Belgium, the international informal “G20 finance network”, Better Markets and FSB Watch in the USA, to name a few. Other CSOs, among them the largest NGOs, have also developed their finance and tax capacity, e.g. Oxfam, Friends of the Earth and others.
Proposal 1 addresses the need for funding such capacity building.

A safe space for civil society, academics and the broader public to work together would allow the self-learning to give civil society their own expertise, suited to them, and with the advantages discussed above. Debriefing sessions after the workshops were unanimous on the value of the collaboration between academia and civil society, and how it ought to be more frequent, and even permanent. Proposal 2 is for an annual conference on banking and finance that would foster such networking and collaborations.

More specifically, the need for training programs and working sessions for representatives of CSOs was systematically mentioned in the workshops. These programs could include: the basics of banking (including money creation, credit allocation and payment systems), the European regulatory process (including key stakeholders, decision making bodies, how to engage), why banking is a public interest matter, and what should be the purpose of banking.
Representation of the public interest in banking

Policies to make banks more open to public interest representation

**Ending “Too-big-to-fail” (TBTF)**

The dominance of TBTF banks in Europe’s banking sector is a major blockage to public interest representation in banking therefore ending too-big-to-fail and tackling the related moral hazard remains a priority.

Finance Watch has already written extensively on ending TBTF\(^90\), advocating in particular for a revival of “boring banking” over “market-based banking”\(^91\) and has proposed numerous policy changes, including:

- separate commercial and investment banking\(^92\)
- a cap on the leverage ratio\(^93\)
- moving away from a unique vision of risk and risk metrics\(^94\) and limit reliance on external credit ratings\(^95\)
- gross (not net) evaluation of derivatives in banking books\(^96\)
- redesign the liquidity coverage ratio (LCR) to promote stable funding over liquid assets\(^97\)
- stop pushing retail savings away from bank deposits\(^98\)
- curb the use of internal models in the calculation of regulatory capital\(^99\)

Many others have, of course, also put forward proposals to end TBTF, sometimes as part of a wider summary of civil society reform ideas.\(^100\)

**Encouraging stakeholder banks**

As well as trimming the power of the largest banks there is a need to encourage the growth of a substantial and diverse range of stakeholder banks as a way to foster public participation in banks.

Other organisations are already working on some promising policy proposals in this area and these were discussed in our workshops. Here we highlight two:

- State-aid guidelines for public interest banks (PROPOSAL 3)
- Public payment system for smaller banks to leverage on (PROPOSAL 4)

**Other measures.**

Numerous other proposals for banks came up in the workshops and through the project, including:

- Setting a policy agenda to simplify banks’ activities and pre-approve new instruments;
- Increase transparency of banks activities, starting with improved reporting of credit allocation by region and by type of activity;
- Improve the representation of public interest in shareholder banks with dedicated seats on the boards of banks to give effective power to employees, consumers and other stakeholders.
- Reduce reliance on external credit ratings in the regulation of banks.

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90 Including Finance Watch, 2014c
91 See Finance Watch, 2014a
92 See, for example: Finance Watch report 2013b; Finance Watch, 2014b; Finance Watch, 2015a; Finance Watch, 2015b
93 See Finance Watch, 2013a:4-5 and Finance Watch, 2016b
94 See Finance Watch 2016c
95 See Finance 2014a
96 See Finance Watch 2016d & Finance Watch, 2012a: 27-34
97 See Finance Watch 2012a
98 See Finance Watch, December 2014a
100 See in particular Fazi, 2016
Changes to the regulatory process to foster broader effective participation

This report has identified several features of banking regulation and the regulatory process that block public participation and interest representation. Many of these (and other) proposals, e.g. to end too-big-to-fail or to improve public interest representation in the regulatory process, have been advocated by interest groups in recent years but failed to be implemented. For some issues participation is low, complexity often deterring the public. In other cases, participation is higher but ineffective, for example because by the end of the long complex regulatory process proposals can be significantly watered down. More generally, the regulatory process has so far failed to implement transformative regulation for the banking system.

Given the complexity of the process, the number of institutions and regulatory steps involved and the limited resources of the project (including the format of one-day policy workshops), the detailed proposals that follow focus on the regulatory process at the European Commission, as the only European institution that can initiate regulation. We did not, however, dismiss ideas related to other regulatory institutions - some of which are listed below.

Improving existing opportunities for participation

Many organizations and coalitions are involved in improving or changing the EU regulatory process and have developed a full set of proposals to improve the representation of public interest in European law-making, across all sectors.101 Their recommendations cover, among other things, the stakeholder consultation process and the composition of Expert Groups, which advise the Commission ahead of the legislative process, and often recommend that these processes should be more open to non-industry stakeholders and more transparent to the general public (e.g. publication of detailed agendas and reports).

Partly in light of this work and as a result of the workshops, Proposals 6 and 7 put forward policies to improve existing possibilities for public participation in the current European Commission consultation process and in the Financial Services User Group respectively. (PROPOSAL 5) (PROPOSAL 6)

The European Commission recently released a call for applications for the creation of a High-level Expert group on Sustainable finance.102 Interestingly, while this call is led by the Directorate General (DG) for Financial Stability, Financial Services and Capital Markets Union (FISMA), it includes other DGs such as Environment, Research and Innovation, Climate Action, Energy, Justice and Consumers. This ad-hoc expert group’s mission is to ‘recommend a comprehensive programme of reforms to the EU financial policy framework, including a clear prioritization and sequencing’, while ‘assisting the Commission in relation to the implementation of existing Union legislation, programmes and policies’. This cross-sector approach is an interesting development that might help to break silos and contribute to a way of thinking about financial and banking regulation in terms of purpose, at the same time allowing for the broader participation of non-experts.

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101 These organizations include Alter-EU, the Better Regulation Watchdog, Corporate Europe Observatory, the former EU civil society contact group, Civil Society Europe, and others.
102 Call for application published by the European Commission, October 2016: http://ec.europa.eu/transparency/regexpert/index.cfm?do=groupDetail.groupDetail&groupId=3485&news=1
Agenda setting

Beyond improvements to the existing process workshop participants quickly identified that impacting regulation in the very early stages (the “agenda-setting” phase) before detailed regulatory work begins is a powerful way for public interest representation to influence regulatory outcomes and therefore bank activities. Influencing agenda-setting has two main advantages in this respect. First, it sets the scope of what is possible; later in the process the ability to introduce new elements or ideas is greatly reduced (sometimes leaving full rejection as the only alternative). Second, this phase allows for more political discussions, such as the purpose of the regulation, more suited to a public interest discourse; later in the process as regulation becomes more technical public participation becomes increasingly difficult, especially given the increasing number of delegated acts that tend to decrease the scope for political debates.

The public consultation on a Green Paper is typically the first public step to influence a regulatory project. However, much of the legislation proposed by the Commission in the field of banking these days is simply transforming international agreements into legal drafting, adding details and differentiating where needed (as with Basel 3 and CRD4). Still, stakeholders can respond to written Commission consultations in an attempt to influence the Commission’s thinking.

Proposal 7 therefore is for the creation of an agenda setting body in which public interest could be effectively represented. (PROPOSAL 7)

Moving further upstream, workshop participants also proposed that international bodies in charge of setting standards on banking regulation - such as the Basel Committee for Banking Supervision (BCBS) and Financial Stability Board (FSB) - should be further opened to stakeholder participation, while taking care not to increase the opportunities for advocacy by the senior managers of large banks relative to other stakeholder groups.

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103 “Where the Level 2 measures concern purely technical matters and require the expertise of supervisory experts, it can be determined in the basic act that these measures are technical standards based on drafts developed by the European Supervisory Authorities (ESAs). A distinction can be made between Regulatory Technical Standards (RTS) which are adopted by the Commission by means of a Delegated Act and Implementing Technical Standards (ITS) which are adopted by means of an Implementing Act.”


104 For civil society this requires forming strategies early enough to participate in such consultations, this might be a possible purpose for a conference of civil society on finance (see proposal 2).

105 Several organizations (mostly informal networks) are trying to engage with policy makers at international level, such as FSB Watch, and the international NGO network advocating for appropriate financial regulation at G20 level. The issues they raise include the low representation of countries from the South in the discussion (international standards are largely imposed by countries from the North) and the over-representation of financial sector interests in the debate (see for example the “B20”, which provides representatives of major companies from the G20 countries with privileged access to finance ministries, or the FSB Task Force on green finance, composed exclusively of financial sector representatives). The European Parliament has also expressed views supporting the need for further transparency in the international regulatory and agenda-setting processes for financial regulation (see European Parliament’s ECON non-legislative report on “The role of the Union in international financial, monetary and regulatory institutions and bodies”, 2015)
Proposals from the workshops

1. More funding for civil society capacity building on banking and finance

**The case**
Civil society organizations have very limited resources to dedicate to research, advocacy and other activities in relation to banks and their regulation, hence a limited capacity to organize and have their interests represented in the debate. This is, in large part, due to a limited availability of funding, from both private and public sources.

**The proposal**
Public and private funders shall consider opening budget lines and mission statements to allow further work by non-profit organizations on banking and finance.

Such funding would primarily aim at supporting research and pedagogical materials that would link societal objectives such as the environment, poverty, development, education, etc., with the structure of the financial sector. This would help both to highlight the current negative impact of an inadequately regulated financial system on these societal objectives, and to allow for appropriate solutions to emerge for which specialized groups would be able to advocate.

Supplementary funding would also support the creation of training programs and working sessions by and for civil society organizations and other stakeholders, including established NGOs, grass roots movements and trade unions. Lastly, increased clarity and transparency on the operation of banks is likely to lower, not increase, funding costs.

2. Annual conference of civil society on finance

**The case**
Civil society organizations have limited dedicated opportunities to reflect together on banking and finance, to build expertise for their own needs, and build collaboration beyond their own interests with other organizations, academics and even policy makers. This is due to limited resources, but also to limited opportunities.

**The proposal**
An annual conference of civil society on finance could be a one or two-day conference organized by a consortium of organizations. Its target objectives and activities could be as follows:

1. **Create a space for non-industry stakeholders to develop a common language and expertise on banking** through working sessions, debates and other forms of participatory sessions that would allow the sharing of concerns, knowledge and projects.

2. **Connect a diverse group of non-industry stakeholders**, including large European NGOs, grass roots movements acting at local level, NGOs involved at national level, trade unions, consumer groups, possibly businesses (such as small and medium-sized enterprises), and academics from various fields of research including political sciences, geography, social sciences, economy, etc.

3. **Develop an understanding of how finance relates to the societal issues** that those groups are working on: finance and work, finance and the environment, finance and development, finance and local economies, etc., hence making finance a transversal issue for civil society.

4. **Build up influence and funding strategies.** This requires a diversity of groups to be involved, as research shows that impact comes with “unusual” alliances, for example where small businesses and/or grass root movements can be the game changers.

Such an event would of course require dedicated funding, in particular to cover travel expenses and foster the participation of local organizations. It would also need the commitment of a coalition of organizations and individuals to make such an event happen.
State aid guidelines for public interest banks

The case
Stakeholder banks have proved to be stable providers of essential banking services especially at local level, with branch coverage reaching out to local communities and contributing to local economies (in particular: SME financing) and social inclusion, thanks to public interest-oriented mission statements and inclusive governance. Stakeholder banks, however, tend to suffer from regulation designed for larger banks, and harsh competition from those same large banks.

Some form of public support would be beneficial to foster the development of stakeholder banking. It would allow for the provision of essential services at a fair price and in an accessible way, for example thanks to a comprehensive branch coverage that would maintain the delivery of accessible and “face-to-face” banking services in otherwise deserted communities and villages.

The proposal
Banks that provide services that correspond to a clearly defined list of public-service obligations (for example the maintenance of a certain amount of branches, credit quotas, representative governance arrangements, etc.) should be remunerated* under national legislation. It could be considered to amend the Commission Decision of 20.12.2011 (OJC L 7/3) on services of general economic interest by including such banks with special public interest obligations into the exemption section – alongside hospitals, social housing sector and others – so that the remuneration would be acknowledged as “state aid in the form of public compensation”.

* This remuneration would go along the principles as set out in the Altmark-Trans judgement of the European Court of Justice (C-280/00), thus not representing State aid within the meaning of Art 107 TFEU. The form of the remuneration would need to be further defined.

Publically-owned or cooperative payment systems

The case
Access to affordable and fair payment system is, and will continue to be, a crucial factor for smaller and local banks to emerge or develop. Several examples such as NEF in France, Banca Etica in Italy or NewB in Belgium recount how small banks have little choice but to use large banks and other companies (e.g. for credit cards) as providers for part or all of the payment services they provide their clients with. Yet payment systems can be understood as a utility, and their provision should be made accessible under public interest terms.

The proposal
Develop payment system platforms that are managed with a public interest mandate. These could be owned by the state or collectively by their users, the banks, on a one-bank-one-vote principle. A fall-back proposal could be that one of the existing networks operates under universal access conditions with access fees set by regulators.
Changes to the EC consultation process

The case
Public consultations are the main tool for stakeholders to participate at an early stage in the European regulatory process. They can also be a good way for interest groups to be part of the debate and contribute new ideas (and make themselves known to the European Commission). However, participation from groups outside of the financial sector is either very low (fewer than 10% of responses) or does not fit the expectations of the Commission. The input of ‘outsiders’ is sometimes barely reflected in the summary of responses. There is therefore a need to lower the barrier to participation in the process and to improve the way that responses are taken into account.

The proposal
Several changes consultations are suggested here:
- The language (English) is one of the barriers to participation: (a summary of) consultation documents should be translated into the different languages of the EU.
- The main objectives of the consultation should be written in plain language.
- The way that comments are be taken into account and reported should be explained in the consultation document, in particular, on which basis a comment can be dismissed.
- Impact Assessments should systematically include an overview of the possible impacts on broader societal challenges in relation to environment, employment, development and other major political objectives as set by the Commission (see for example H2020: banking regulation could be assessed against similar objectives).
- A more comprehensive overview could be conducted by EC services with a broad range of stakeholders (including a fair share of non-experts) for the sake of completeness.

Changes to the EC consultation process

Giving teeth to the Financial Services User Group (FSUG)

The case
The FSUG was created in 2010 by the European Commission and is composed of 20 members, representing consumer organizations, investors and small and medium-sized enterprises, as well as experts in finance providing a financial services users’ perspective.

The FSUG is asked to ‘advise the Commission in the preparation of legislation or policy initiatives which affect the users of financial services’ and ‘to proactively seek to identify key financial services issues which affect users of financial services’.

The work of the Members of the FSUG represents a total of 16 meeting days per year, which are covered by a budget of €10,000 for each member, for a total of 35 days of work (which includes two days to prepare each of the eight two-day meetings), i.e. €285 per day. The FSUG is also granted a budget of €150,000 for studies. These funds were to be used to help non-industry stakeholders to prepare and participate in meetings. However, as of 2016, this compensation has been cancelled. The budget was not allocated in 2016 despite FSUG plans to commission a study on national enforcement of consumer protection laws in the retail financial services area, making it impossible for the few civil society organizations representing end-users and academics coming from outside of Brussels to engage.

The proposal
Funding must be provided to foster relevant and balanced participation in the EC Structured Dialogue.

The mandate of the FSUG, currently quite limited and FSUG decisions do not bind regulators, needs to be enlarged to create a comply-or-explain mechanism for the Commission.

Lastly, the definition of ‘financial services users’ should be expanded. The current definition is rather narrow and encourages representation of business interests. Other stakeholders, for example, local authorities, civil society organizations working on issues like housing or social exclusion should be represented in the group.
The case
Agenda setting is recognized as the most important moment to influence regulation. It is however the least accessible stage of the process to the public and remains largely outside public debate. Opportunities to participate later in the regulatory process tend to be highly technical and offer little possibility to alter the scope of proposals and therefore tend to be dominated by banking interests.

The proposal
An independent body could be created with two possible mandates: generating ideas for policies to feed into the regulatory process; and acting as an oversight body – looking at regulation ex-post from a public interest perspective. Participants would include a range of representatives of civil society, for example, NGOs, trade unions, social housing organisations, consumer advocacy groups and so on. We note that similar bodies already exist but demonstrate practical limits (see proposal 7 relating to the FSUG). The challenge would therefore be to make this body representative and to grant it effective influence. In the EU currently, such a body would need to influence the European Commission.
This project was conceived as the start of a more ambitious, longer term initiative to address the under-representation of public interest in banking after the dramatic crisis that hit society in the late 2000s. That longer term work will necessarily involve many stakeholders and a diverse range of actions. Within two years, however, the project has managed to bring together a range of stakeholders and raise a number of questions for civil society, public institutions, policy makers and banks themselves about the participation of the public in a highly-relevant issue for the population at large.

We believe that the overview provided in this report will prove a starting point for this work, and hope that the proposals outlined in the last chapter will trigger new initiatives and serve as inspiration for civil society organisations, public institutions, law makers and bankers in the future. This will not happen, though, without a significant increase in civil society’s capacity to engage on banking and finance, to self-organise, build expertise and make banking and finance a transversal issue and challenge.

Finance Watch will remain committed to the agenda it has been pursuing since inception: contributing to the development of public-interest oriented financial regulation in the European Union. In particular, the organisation will continue advocating for regulation to end too-big-to-fail banking and avoid bail-outs at the expense of citizens. It also remains committed to its mission of supporting a broad European network of civil society organisations with its expertise, both in the making of regulation and in banking and finance.
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About Finance Watch

Finance Watch is an independently funded public interest association dedicated to making finance work for the good of society. Its mission is to strengthen the voice of society in the reform of financial regulation by conducting advocacy and presenting public interest arguments to lawmakers and the public. Finance Watch’s members include consumer groups, housing associations, trade unions, NGOs, financial experts, academics and other civil society groups that collectively represent a large number of European citizens. Finance Watch’s founding principles state that finance is essential for society in bringing capital to productive use in a transparent and sustainable manner, but that the legitimate pursuit of private interests by the financial industry should not be conducted to the detriment of society. For further information, see www.finance-watch.org