Future investibility of Dutch Banks

'*How can investors help banks move in the right direction? They could encourage sustainable business models based less on risk-taking and more on a careful analysis of competitive advantage and operational efficiencies. And they should be wary of entertaining unrealistic expectations about sustainable rates of return. Only when solid business models and realistic commitments to sustainable returns are rewarded can shareholder value be reconciled with safe banking. Indeed, there is no other way.*'[1]

0. Summary

i. The purpose of this paper is to reflect Eumedion's views in the continuing debate on the Dutch banks' future. So far, the public debate on the banks' future structure has reflected the views of regulators, politicians and policy makers, e.g. the Liikanen Committee and the Wijffels Committee, but not the main providers of the banks' capital – the institutional investors. It is critical that the position of long term institutional investors is thoroughly understood and taken into account.

ii. The paper does not present another set of proposals on how banks should be structured to optimally safeguard their vital functions and to ensure financial stability. Rather, the goal is to identify key characteristics a (future) listed bank should have to run a sustainable business model that is attractive for long term institutional investors to allocate sources to.

Key points of this paper

iii. Since 2008 the European banking industry has experienced considerable volatility, contraction and falling returns on equity. Moreover the costs of funding through debt securities increased considerably across all types of securities, including covered bonds. Among those Dutch listed

[1] Speech by Mr Jaime Caruana, General Manager of the BIS, at the Morgan Stanley European Financials Conference, London, 27 March 2012.

companies acknowledged for their robust long term performances banks are currently hardly represented.

iv. More sustainable business models are needed to make banks more appealing for long term investors and to restore long term economic growth as a whole. Eumedion has identified seven arrangements that could be put in place to strengthen banks' long term profitability. These are:

a. Disintermediation and securitisation

b. Reducing risk premium by enhancing transparency

c. Cost reduction

d. Cultural change and financing innovation

e. Enhanced competition and reducing entry barriers

f. European supervision

g. Clear dividend policies

v. Eumedion does not believe there is an "optimal" business model for Dutch listed banks to ensure future long term profitability. Instead, we favour diversity in Dutch banks' business models, a mix of small, medium and large local banks as well as diversified cross-border banks. A proportional legal, operational and economical separation ('ring fence'), insulating banks' vital functions (which households and SMEs rely on) from problems elsewhere in the financial system, would offer good opportunities for diversified business models.

vi. Such a separation can help ensure financial stability in several ways. First, and most directly, it can shield the banks carrying out the protected activities from losses incurred elsewhere. Second, it can prevent taxpayers' funds that support the insulated activities (e.g. deposit guarantee schemes) from lowering the cost of risk-taking at other business lines. Third, it can limit the complexity of banking groups.

vii. As well as a sustainable business strategy, a robust governance structure at banks is a basic requirement for attracting long term institutional investors. Although boards of directors are primarily responsible for the governance of banks, long term institutional shareholders have their own interest and commitment to promote good corporate governance practices and risk mitigation.

viii. Eumedion believes a uniform and maximum harmonised European framework, rather than national arrangements such as the Dutch Interventiewet, is necessary to empower supervisory

authorities to take preventive measures and to allow them to guide a troubling bank towards recovery.

I. Introduction

1. This paper sets out the views of Eumedion on the future of banks. Eumedion is an organisation of 69 institutional investors – all with a long term investor horizon – and aims to promote good corporate governance and sustainability in Dutch and European listed companies, e.g. banks. Following on from the 2012 Liikanen report, the future structure of banking is currently subject of debate at the highest political levels in the European Union. In the Netherlands, the Wijffels committee is currently analysing the structure of banks. In that context we find it critical that the position of long term institutional investors (e.g. insurance companies, pension funds, asset managers and long term mutual funds) is thoroughly understood and taken into account, especially, given their role in providing capital and funding of the banking sector.

2. Many institutional investors have a complex and multiple relationships with the banking sector. They have a relationship as a corporate customer drawing on the full range of banking services and as an institutional investor investing in financial instruments, be it debt and/or equity, issued by banks. In this paper we primarily focus on the latter relationship.

3. Eumedion will not come up with another new set of proposals on the future of banks from a broad societal perspective, i.e. how banks should be structured to optimally safeguard their vital functions and to ensure financial stability for society as a whole. That is the core business of policymakers, regulators and the banking sector itself who together have made a large number of proposals, many of which are significant improvements that promote a stronger and safer financial system. This is to the benefit of everyone – the banking industry, users of financial services, taxpayers and institutional investors.

4. Our specific goal is to identify some key characteristics a (future) listed bank should have so as to run a sustainable profitable business in that it will be attractive for long term institutional investors to invest in. In this regard, we will take the potential impact of some of the most important proposals made (ring fencing, bail-in instruments, resolution plans) into account. The primary focus of this paper is on Dutch banks operating within the European context.

II. Institutional investors' duties and the banking sector

5. Institutional investors invest directly or indirectly at the expense and risk of their ultimate beneficiaries, i.e. the persons entitled to a pension, the employees who pay pension contributions, the policy-holders, the participants in long term mutual funds. Institutional investors must deal prudently with the financial resources entrusted to them in order to achieve a sustainable long term return. A safe, stable and efficient banking system is a prerequisite to meeting the requirements of their clients. To meet their liabilities and

fulfill their duties, institutional investors need a banking system which appropriately supports the real economy through providing crucial economic functions. These include providing safe deposit taking services and efficient and reliable payment systems, screening and diversifying risk, reducing transaction costs and providing capital and credit for businesses (SMEs) and households. Also banks should be able to provide access to derivatives and other products to allow corporates to manage their exposure to unwanted market risks.

6. For Eumedion, committing capital in well performing listed companies over an extended period fits in with the long-term horizons of the business model (as in life insurance) or of the underlying beneficiaries (as in pensions). Whether listed banks are attractive as investee companies for long term investors depends on various aspects. We highlight three aspects. First of all, a bank's attractiveness will be heavily influenced by individual bank-specific characteristics such as the bank's business model, size and financial strength. Secondly, enhanced regulation (e.g. higher capital requirements), however desirable from a macro prudential point of view, may impact the absolute and relative attractiveness of banks securities (risk reward balance). Thirdly, institutional investors' portfolio managers operate on the basis of fund mandates defined by their clients and to whom they are accountable. In some cases, investing in a certain securities of bank is prohibited in these mandates.

7. On a risk-adjusted basis, the return on banks' equity has been lower than the return on non-financial stocks over the last 40 years in a number of European countries. And banks' stocks somewhat outperform the rest of the market in good times, but seriously underperform in economic downturn (BIS, 2010). Following a sustained period of expansion and rising profitability during much of the previous decade, since 2008 the European banking industry has experienced considerable volatility, contraction and falling returns. In 2010 for instance, the European banks delivered a return on equity of 7.9%, while the costs of equity of EU banks were 12% on average in that year.[2] Equity returns have reacted negatively mainly to changes in the growth outlook and in sovereign risk. This is consistent with the existence of strong linkages between sovereigns and banks and a decreasing ability to provide credit, further damaging the growth outlook.

8. At the same time, evidence suggests that higher capitalization and lower leverage made banks' equity returns more resilient during the crisis.[3] Apparently institutional investors consider that more capital will help banks to raise cheaper financing, to strengthen credit worthiness and to borrow less in order to support a given level of assets.[4] However, there is a trade-off between capital and liquidity in terms of their positive effects on bank stock returns. The more stable a bank's funding, the less positive the effect of higher capital on its stock return.[5]

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[2] McKinsey, 2011.
[3] Caruana.
[4] Chan-Lau, Liu, and Schmittmann.
[5] Das and Sy.

9. Apart from equity, there are also problems in banks' bond funding. Institutional investors have reduced holdings of euro area bank bonds between 2010-2012. Issuance by euro zone banks halved in 2011 from its peak in 2006.[6] The costs of funding through debt securities increased considerably from 2008 across all types of securities, including covered bonds. Many banks have become highly dependent on funding by the ECB via the long term refinancing operation (LTRO). At the same time, spurred by the euro crisis, Basel III and various "bail-in" proposals, the share of covered bonds in total gross bond issuance by euro area banks increased from 26% in the first half of 2007 to 45% in the first half 2012.[7] Growing issuance of covered bonds has added to the concerns about the scarcity of collateral. Overcollateralisation also reduces the ability to issue senior unsecured debt, as the pool of assets pledged to covered bonds grows, holders of unsecured bank debt have a less certain claim in the event of the bank's insolvency.[8]

10. Among those Dutch listed companies acknowledged for their robust long term performances banks are currently hardly represented. Obviously, the currently reduced number of Dutch banks listed at all, since ABN AMRO and SNS Reaal were delisted/nationalised, plays a role here. On top of that the single major Dutch bank that is still listed, ING Group, has been dealing with severe restrictions imposed on its business operations as a consequence of government support received in 2008 and 2009. These restrictions continuously negatively affect the opportunities for share- and bondholders to achieve a sustainably return on investment. Yet, as ING Group has not issued any covered bonds, the banks' ability to issue senior unsecured debt remains relatively strong.[9] Finally, some smaller Dutch listed banks – Van Lanschot and BinckBank – have been performing rather unsatisfying.

III. Creating sustainable business models

11. How could Dutch listed banks generate long term sustainable returns, appealing to long term investors? We would argue that such returns can arise from a reconsideration of banks' business strategies. In fact, this is a development that is already taking place at many institutions; but it could be intensified to make the significant improvements needed for sustainable long-term returns. This is a daunting task as the weighted average cost of capital is rising as a result of higher capital requirements and likely structural reforms[10]; even though one could argue that by holding more capital banks are "safer" as they deploy less leverage and that would lead to, ceteris paribus, a lower cost of equity, in the long term. We believe that a combination of seven arrangements could be put in place by the industry and policy makers to make sure that banks are sufficiently attractive to invest in; i.e. increase the return on equity of banks above the cost of equity, without increasing leverage.

[6] ECB 2012.
[7] Van Rixtel and Gasperini.
[8] BIS 2012, DNB, ECB, Fitch 2012.
[9] ING Annual Report 2012.
[10] CRD IV, Liikanen, Vickers.

a. Disintermediation and securitisation

12. Dutch listed banks could delever by actively supporting and facilitating private placement of debt to investors in Europe and by more actively syndicating the issuance of bonds to investors in euros, rather than the banks taking on the credit risk themselves. This process of disintermediation is still nowhere near levels seen in the US, where capital markets provide 47% of the credit needs of corporations in 2011. The potential for disintermediation in Europe is significant, as here only 15% of the credit was provided directly by investors.[11] There is some evidence that already indicates a shift away from bank lending.[12] The extent to which this is caused by either the desire of banks to reduce credit exposure, or the desire by corporates to reduce debt (also because bank debt has become more expensive), is unclear. There is anecdotal evidence that banks have become more reluctant to lend to SME. This tendency has also become the subject of political debate.

13. However, there are limitations to the degree to which debt capital markets can replace bank lending. The current structure of debt capital markets is generally open to larger corporates that can raise finance with a bond size that is attractive to institutional investors. Most of these bonds tend to have credit ratings. SMEs in general are not yet accustomed to the requirements of debt markets including their disclosures, credit ratings and cost structures.

14. A change in corporate and regulatory culture is needed to extend the debt capital market where companies have realistic options to replace loans from banks by issuing public bonds to investors, or private placements with investors. This disintermediation may free up a significant amount of capital that then can be allocated to the smaller companies in need of credit. Additionally, some SMEs may benefit from securitisation concepts, as this could extend access to the debt markets to mid-caps and SMEs as suggested in the EC Green Paper on Long Term Financing of the European Economy.[13]

15. Revitalising the securitisation market, can also assist banks to meet their new regulatory capital targets while still providing finance to the economy. Yet new asset- and mortgage-backed securitisations should be much safer and less complex compared to the securitisations sold to investors before the crisis.[14] Originating banks should be induced to significantly mitigate information asymmetries between originating banks and improve screening and monitoring of borrowers.[15] Supporting the securitisation market by standardisation and enhanced transparency across the European securitisation markets might help to improve investors' confidence in securitised instruments.[16]

b. Reducing risk premium by enhancing transparency

[11] Llewellyn.
[12] Fitch.
[13] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2013:0150:FIN:EN:PDF
[14] Acharya, Schnabl, and Suarez 2012.
[15] Sarkisyan and Casu 2013.
[16] ECB 2012.

16. Some of the largest Dutch banks remain complex, with legal entities that push up costs and trap scarce capital. This makes it difficult for bank management and the board of directors to exercise control throughout the organisation. Also it is difficult for institutional investors and external parties to monitor effectively the behaviour of banks.[17] Further, less complex banks are easier to supervise and to resolve.[18] Therefore, banks, already streamlining their activities in response to regulatory pressures, should seek to reduce this complexity, potentially moving to less complex business models.

17. More relevant disclosures of banks could help institutional investors better understand banks' risks exposures and risk management practices and, thus, reduce investors' return premiums required for uncertainty and contribute to broader financial stability. Information on 'lessons learned' in the wake of the financial crisis and the level of investment in banks' risk-management technology designed to enhance and integrate risk reporting are important in this respect. The Enhanced Disclosure Task Force, commissioned by the Financial Stability Board has formulated very suitable recommendations for enhancing risk disclosures in addition to what IFRS requires. This Enhanced Disclosure Framework ('EDF')[19] includes meaningful disclosures on risk governance and risk management strategies, capital adequacy and risk-weighted assets, funding, market risk and credit risk (e.g. comparability of loan books across the industry). Although these recommendations are not binding, Eumedion considers that they, when properly applied, could significantly help address some institutional investors' concerns about the quality and transparency of banks' risk disclosures and, in this way, can help banks look less complex.

18. The Dutch banking sector is a sector where more often than not large non-controlling interests in group income and equity are present. Therefore, banks should improve their disclosures following the requirement in IFRS 12 'Other entities'; i.e. that an entity should provide insight in the effects of partly owned subsidiaries on the group's financial statements. The relevance of these disclosures are explained in an Eumedion 2012 position paper.[20]

19. Still, even with all appropriate disclosures in place, analysing a bank is a formidable task for an investor, since banks are particularly complex to analyse. This complexity currently causes investors to require an additional risk premium for investing in equity of banks. One cause of complexity is that most banks operate a number of business models. Banks can help investors, and themselves by innovating the way they communicate with investors. We encourage banks to embrace the recently issued draft integrated reporting framework of the International Integrated Reporting Council[21], in addition to the Enhanced Disclosure Framework mentioned above, to rethink effective communication with investors.

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[17] Liikanen report.
[18] Boot.
[19] https://www.financialstabilityboard.org/publications/r_121029.pdf.
[20] http://www.eumedion.nl/en/public/knowledgenetwork/position-papers/position_paper_full_consolidation_of_partly_owned_subsidiaries_requires_additional_disclosure.pdf
[21] http://www.theiirc.org/wp-content/uploads/Consultation-Draft/Consultation-Draft-of-the-InternationalIRFramework.pdf

c. Cost reduction

20. Banks should also seek sustainable profit less in revenues and speculation than in operational efficiency. Especially cost efficiency can powerfully contribute to bank earnings. Evidence shows on average across countries, a 4% reduction in operating expenses translates into roughly a 2 percentage point increase in return on equity.[22] In order to achieve a 12% return on equity, it is estimated that European banks need to cut costs by 10-25%.[23] As sales and service continue to move online, branch network costs can be removed. The ongoing mobile banking reforms heighten this opportunity.

d. Corporate culture and new forms of financing innovation

21. In a world of lower leverage, lower underlying economic growth, banks have more then ever before to serve the interests of their clients and be innovative in order to obtain access into new pools of demand and to perform long term profitability. We recognise three methods to achieve this:

- The corporate culture of every financial services firm must above all be to serve the interests of its clients. In the current staggering economy, banks growth should mainly come from outperforming other banks in mature markets, capturing market share from competitors, and deepening customer relationships ('de klant centraal'). The latter involves better tailoring of products to the individual needs of clients. By delivering value to clients, the firm will prosper for the long run.
- An appropriate tone and standard of behaviour at the top of a bank is another key condition for improvements in standards and culture. The tone in the middle and at the bottom are also important. Unless measures are taken to ensure that the intentions of the top are reflected in behaviour at all employee levels, fine words from the post-crisis lessons learned will do little to alter the fundamental nature of the organisations they run.[24]
- Selective new 'risk' taking is the second element. Whereas new regulatory frameworks such as Basel III is focused on de-risking the banking system, industry innovation will continue to develop and new demands for bank financing will definitely emerge. Financing innovative companies is a welcome development as long as new risks are taken consciously by having in place robust risk control functions and strong risk capabilities.[25]

e. Enhanced competition and reducing entry barriers

22. Ensuring sufficient competition in the Dutch banking market is in the interest of the banking industry's long term health and its capital providers. On the supply side, the market should eventually be neither highly concentrated nor significantly state funded. The level of concentration is also impacted by the opportunities of new entrants to enter and credibly challenge existing parties. On the demand side,

[22] Basel Committee.
[23] Morgan Stanley and Oliver Wyman.
[24] UK Parliamentary Commission on Banking Standards 2013.
[25] McKinsey, 2011.

competition between banks on accounts should not be limited by difficulties of switching between providers and by lack of transparency about banking services provided.

23. Effective competition means that banks compete to best serve customers' need rather than exploiting lack of customer awareness or regulation. The introduction of more account fees transparency and an improved switching system for personal and business current accounts, as proposed by the European Commission on May 8th, 2013. will help improving the competiveness of the Dutch banking sector. However, additional measures are deemed necessary reduce inappropriate barriers to market entry, including maximum harmonization of the regulatory assessments requirements of acquisitions and increases in holdings of European banks ('Antonveneta Directive').[26] We believe that the European Banking Authority (EBA) should be directly and exclusively empowered to do these assessments, at least in cross border situations. Enhanced responsibility for the European Supervisory Authorities (ESAs) will further minimise the scope for national competent authorities to invoke prudential rules in order to hinder cross-border mergers and acquisitions for protectionist reasons.

f. European supervision

24. Regulatory and public supervisory arrangements should facilitate sustainable business models and thereby concentrate on improving present set-up as well proactively reducing potential future weaknesses (e.g. dealing with asset bubbles, limiting national differences in guidance and rules as well much stronger European coordination between national regulators and supervisors). It is also fundamental that authorities ensure deposit-holders' confidence in the effectiveness and sustainability of the deposit guarantee schemes. To date, deposit guarantees continue to rely above all on schemes set up and financed at the national level.

g. Clear dividend policies

25. Long term institutional investors need to understand how a bank determines the balance between dividends, incentive payments and retention of earnings to ensure the capital base. In this respect, for investors a clear and reliable dividend policy is vital. Dividends remain a key signal of management confidence and will be interpreted as an indicator of sustainable prospects. Whilst lower dividend pay-outs are likely to prevail at Dutch banks for the foreseeable future, the positive message that a clear path to meaningful and sustainable dividend payments will convey, together with a stronger capital base, should not be underestimated.

IV. Diversification

26. Establishing effective sustainable business strategies by implementing the seven arrangements mentioned, so as to raise banks' return on equity back up to or above the raising cost of equity is going to

[26] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2007:247:0001:0016:EN:PDF

be a huge challenge. Yet sustainable profitability is essential not only for the attractiveness of banks' securities but also for the long term economic growth as a whole. Eumedion does not believe there is an "optimal" business model for Dutch listed banks to ensure future long term profitability. In this regard, no particular business model fared particularly well, or particularly poorly, in the financial crisis (Liikanen report).

27. Instead, we favour diversity in Dutch banks business models, a mix of small, medium and large local banks as well as diversified cross-border banks with diverse sources of income,[27] as various models (either retail of investment driven) have the potential to achieve long term performances. As well as providing long term return for institutional investors, diversity increases systemic resilience as the probability of two banks failing at the same time is significantly reduced if banks have different structures, exposures, and activities. However, proposals to completely separate between retail banking and wholesale/investment banking are not the most appropriate method to increase the diversification among firms. Apart from the extra economic costs incurred will it lead to sharply increased, double funding costs and not necessarily improve financial stability. We feel that a proportional legal, operational and economical separation (ring fence), insulating banks vital functions (which households and SMEs rely on) from problems elsewhere in the financial system[28], would offer good opportunities for diversified business models.

28. Such a separation, that should include proprietary trading of securities and derivatives, can help ensure financial stability in several ways. First, and most directly, it can shield the banks carrying out the protected activities from losses incurred elsewhere. Second, it can prevent taxpayers funds that support the insulated activities (e.g. deposit guarantee schemes) from lowering the cost of risk-taking at other business lines. Third, it can limit the complexity of banking groups.[29]

V. Banks' governance

29. As well as a sustainable business strategy, a robust governance structure at banks is a basic requirement to attract long term institutional investors. The way in which banks' securities are managed can play an important role in long-term institutional investor involvement. A well managed company is not a guarantee for good performance, but weak governance is a serious risk for failure. Good governance can also contribute to more stable and stronger banks[30], by increasing the effectiveness of risk oversight by boards and improving the status of the risk management function[31] and by promoting effective

[27] Sustainable Finance Lab.
[28] Liikanen Report, Vickers Report.
[29] Gambacorta and Van Rixtel.
[30] Liikanen Report.
[31] CRD IV, 'geschiktheidstoets'.

monitoring by long-term and considered shareholders (EU Corporate governance action plan[32], Green Paper on Long Term Financing of the European economy).

Shareholder engagement

30. Although boards of directors are primarily responsible for the governance of banks, institutional shareholders have aligned interests and a commitment to promote good corporate governance practices and risk mitigation. Fit for purpose shareholder engagement could support boards in better management of the bank's affairs and may lead to greater investor confidence in the strategy of a company and in its implementation. Engaged share-ownership is an effective instrument for institutional investors to serve the interests of their clients as ultimate beneficiaries.

31. However, shareholders' ability to monitor investee companies and ensuring that the governance and strategy is appropriate, depends on (i) effective disclosures, (ii) the attitude and responsiveness of boards (in a low growth environment banks should build support around a proposed way forward) and (iii) meaningful rights that can be enforced in practice.

32. In this respect, we are concerned about some ideas to limit shareholders rights at Dutch banks that are due to be listed in the years ahead.[33] Whereas anti-take over devices and/or other proposals to weaken shareholders' rights are meant to discourage short-termism, they equally inhibit long term institutional investors abilities to take their roles as engaged shareholders as well as their appetite to hold banks' securities at all. Therefore, we generally oppose introductions of measures such as certificates of shares, priority shares, multiple voting rights, loyalty dividends and/or binding nominations at Dutch banks. These arrangements not only negatively affect minority shareholders interests but could also result in higher costs of capital for banks. Further, anti take over devices are superfluous as European competent authorities are empowered to prudentially assess and (dis)approve acquisitions and increases in holdings of banks. Part of this regulatory assessment should be scrutinising the financial soundness of the banks' proposed acquirer and his experience and capabilities to oversee a wide range of various assets.[34] In any event, anti take devices should be proportional and only be applied under extraordinary circumstances for a limited period of time.

Remuneration

33. Another key aspect of corporate governance is remuneration. Many banks paid widely too much of their revenues to their staff even after the crisis had unveiled. Eumedion is very supportive of the objective of ensuring that remuneration schemes encourage long-term sustainable performance.[35] Indeed, following on from CRD IV, the 'Code Banken' and the 'Besluit beheerst beloningsbeleid', much

[32] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0740:FIN:EN:PDF
[33] 'Motie Van Hijum/Nijboer'.
[34] Sent.
[35] CRD IV.

progress has already been made by the Dutch banks in this direction. Variable remuneration are now more closely linked to long term sustainable performance of the bank, is deferred over an extended period of time, and is subject to malus and claw-back. Longer performance periods enforce a longer time horizon and bring a greater consciousness of the possibility of risks coming to pass within the horizon of payouts. Also we believe that a substantial part of any variable remuneration should be granted in shares and subject to deferrals and a rather long holding period.

34. However we are concerned that the Dutch government proposal to introduce a 20% cap on bank's variable remuneration might lead to unintended consequences. Such a requirement will probably lead to increased fixed remuneration. A bank with higher fixed costs is more likely to suffer losses when revenues drop. Increasing fixed remuneration and reducing flexible remuneration limit options for paying for performance, and, reduces one of the interventions available in a stress situation. Also Dutch banks may have difficulty competing for talent in a global industry as it creates an unlevel playing field with other countries. That may lead to Boards again announcing job cuts and lost of activities at bank offices located in the Netherlands. Eumedion stresses that the Dutch banking sector and its employees are still needed to put their skills to generating, rather than dissipating, earnings for the Dutch economy, albeit in a sustainable way.

VI. Failing banks

35. Despite the fact the banks running sustainable business models are less likely to fail, Eumedion believes a uniform and maximum harmonized European framework, rather than national arrangements such as the Dutch Interventiewet, empowering supervisory authorities to take preventive measures and to allow them to guide a troubling Dutch bank towards recovery is necessary. When recovery through early intervention would not be possible, an effective system must be in place to ensure that a bank could fail in a way which minimises disruption of the financial system without recourse to taxpayers funds. The Dutch government should put more effort on putting in place that EU harmonised framework shortly.

36. We are supportive of bail-in instruments as a resolution tool. We believe that bail-in should cover a wide class of unsecured liabilities to ensure greater loss absorbency and improve investor incentives. Restrictions on the scope and who may invest in any bail-in instruments should be avoided as this could decrease the marketability and dramatically increase the cost of such instruments. Clarity on the circumstances in which the bail in could be applied and the process that would be followed is deeply needed, so that investors are able to anticipate the eventual treatment of their instruments in the case of resolution.

37.The use of a bail in tool or any resolution tool can seriously harm the interests of shareholders and

(subordinated) creditors (as the SNS REAAL case has turned out), while the options for challenging an supervisory authority's actions with any success or for holding the relevant executives liable are limited in practice. The decision to use an early intervention or resolution tool should therefore only be taken after careful consideration of all the interests involved, including the interests of the shareholders and bondholders concerned.

38.In this respect clear triggers for early intervention or resolution are needed to increase the acceptance and transparency of intervention. This means that a resolution measure should only be taken when the insolvency of a bank is almost inevitable, and other, less drastic, recovery tools no longer provide a remedy. Consequently, the Dutch Interventiewet needs to be adjusted.

39. We believe that the proposed triggers should ensure that a resolution measure would really be a 'last resort'. Also the compensation for affected share- and bondholder should be calculated by an independent expert. As, the SNS REAAL case has proved, a resolution authority would have a strong incentive to keep the composition and, thereby, the costs of the resolution as low as possible.

VII. Conclusion

40. Institutional investors' main duties are to achieve long term returns to the benefit of their ultimate beneficiaries. Investing in well performing listed companies over an extended period fits in with the institutional investors long-term horizons. Banks have not been attractive investee companies over the past years due to considerable volatility, complexity, falling returns and a constantly changing regulatory environment.

41. More sustainable business models are needed to make banks more appealing for long term investors and to restore long term economic growth as a whole. Eumedion has identified seven arrangements that could be put in place to strengthen banks' long term achievements. These are

i. Disintermediation and securitisation
ii. Reducing risk premium by enhancing transparency
iii. Cost reduction
iv. Cultural change and financing innovation
v. Enhanced competition and reducing entry barriers
vi. European supervision
vii. Clear dividend policies

42. We do not believe in an "optimal" business model for Dutch listed banks to ensure future sustainable profitability, as various models (either retail of investment driven) have the potential to achieve sustainable long term performance. A proportional legal, operational and economical separation (ring fence), insulating banks' vital functions (which households and SMEs rely on) from problems elsewhere in the financial system offers good opportunities for sustainable, diversified business models.

43. As well as a sustainable business strategy, a robust governance structure at banks is a basic requirement to attract long term institutional investors. Although boards of directors are primarily responsible for the governance of banks, long term institutional shareholders have their own interest and commitment to promote good corporate governance practices and risk mitigation. In this respect, we are concerned about some ideas to limit shareholders influence at Dutch banks that are due to be listed in the years ahead. Whereas anti take over devices and/or other proposals to weaken shareholders' rights are meant to discourage short-termism, they equally inhibit long term institutional investors' abilities to take their roles as engaged shareholders as well as their appetite to hold banks' securities at all.

44. Despite the fact that banks running sustainable business models are less likely to fail, Eumedion believes a uniform and maximum harmonised European framework, rather than national arrangements such as the Dutch Interventiewet, is necessary to empower supervisory authorities to take preventive measures and to allow them to guide a troubling bank towards recovery. Clear triggers for early intervention or resolution are needed to increase the acceptance and transparency of intervention. This means that a resolution measure should only be taken when the insolvency of a bank is almost inevitable, and other, less drastic, recovery tools no longer provide a remedy. We are supportive of bail-in instruments as a resolution tool as long as it covers a wide class of unsecured liabilities to ensure greater loss absorbency and improve investor incentives.

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