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BUSINESS MODELS AND BANKING STRUCTURE FROM A FINANCIAL STABILITY POINT OF VIEW

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Summary. The article dwells on the commercial banks as a key factor for financial stability of the country and the efficient business models used by the banks in the crisis period.

Key words: *banks, business model, financial stability.*

Introduction. It is accepted, that banks are one source of the economic crisis. The next crisis could be the last for the global economy. Although significant steps have been taken to improve the resilience of banks, additional structural reforms are necessary to avoid crisis in the future.

Since the beginning of the ongoing crisis some rules, reports and recommendations have been developed: Volcker Rule (USA, 01/2010), Vickers Report (GB, 09/2011), Liikanen Report (EU-Commission; 10/2012). In Europe two questions are still unanswered: What is the right business model for banks to avoid the next crisis? In which way do business models have to be changed?

Non efficient business models are responsible for the financial crisis. In general, there is a relationship between the individual business models and financial stability: The business model is the generic code for a business bank. All business models are the generic code of the financial system.

Before the financial crisis some business models shifted from a traditional commercial banking approach to more risk-orientated models. **On the asset side:** The traditional approach is for banks to check the creditworthiness and the collaterals. In time of securitisation of credits (Asset Backed Securities) for some banks it was not efficient any more to check the single credits. Rating agencies accepted this responsibility and the investors took over the credit risk. Since the beginning of the crisis a lot of banks bought ABS-products for themselves; others had the problem of selling their credit portfolios.

On the liabilities side: Some banks shifted from deposits to short time market-orientated and off balance sheet vehicles. In times of missing trust and liquidity it was impossible to find follow-up financing.

To avoid a deeper economic crisis states and central banks all over the world had to support the banks; at least the taxpayer had to pay the losses.

Special-versus Universal banking models: impact on financial stability. Some politicians and academics postulate now that investment banking should be separated from commercial banking. This separation could be the end of a universal bank model. The following arguments for separating the investment banking activities from commercial banking are:

– The supply for credits could be guaranteed.
– The commercial banking could be protected from high risks, especially proprietary trading.
– The supervision of banking groups would be less complex, more transparent and simple.
– The liquidation of a bank could be easier to manage without risks to financial stability.

But does separation really solve all the problems? At first it is very difficult to separate traditional banking services from capital market services. Especially from the financial stability aspect another point is crucial. Although separation would reduce the interconnectedness, the infectiousness is not avoided. During the financial crises the states have supported investment banks, too. The Lehman Brothers were supported because of their infectiousness and not because their deposits were in danger. They were supported because of their connection to other financial institutions. They were an important counterpart especially for derivates. The Hypo Real Estate, the biggest German failure, was supported because of the domino effect for the covered bond market, other banks and insurance companies. In addition, systemic risks also appear in commercial banks and are not only a question of size. The Spanish cajas are a good example of this. Normally, saving banks could be in trouble, if they granted unlimited mortgage credits.

Conclusion: Although a separation will lead to smaller institutions, but it is not necessarily the best regulative solution. More critical is the threat of a plausible liquidation of a bank, where the investors (shareholders and creditors) could lose their money. A total separation or creating a legal holding structure – as recommended by the report of E. Liikanen – will not solve the systemic risks, instead of this it is necessary to concentrate on the source of them. Nevertheless, a concentration on the proprietary trading is important – but instead of trying to separate them, we should focus on supporting the risks with adequate capital! The crisis had clearly highlighted that the capital was insufficient for the excessive risks being taken.

Key factors for financial stability. So one key factor is an adequate, risk-oriented capital buffer! In addition, strengthening the governance and control of banks (for this the Liikanen's report might be a blueprint) could be helpful. That means:

– Establishing a risk culture at all levels of financial institutions;

– Remuneration schemes, which lead to long-term sustainable performance;

– Risk disclosure requirements for banks should be enhanced and made more effective;

– Effective sanctioning power to enforce risk management responsibility;

– Developing banking recovery and resolution plans (the Commission proposed a Bank and Recovery Directive (BRR) in June 2012, but the negotiations are still at an early stage).

Results and perspectives.

1. The business models have changed, some banks preferred an excessive risk taking strategy.
2. Higher risk means higher volatility.
3. The «Too big to fail» problem has to be solved – but this is more a question of systemic risks than of business models.
4. An adequate, risk – orientated capital requirement is one of the key factors for financial stability.
5. Additional measures have to be installed – some of them could be taken out of the Liikanen's report.

As Michael Barnier, the EU-Commissioner for internal market and services once said: «Do not ask now, what will be at the end of the road».

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