in the euro area, which started in mid-2007 and has yet to be fully resolved, has sparked considerable debate and reform, most notably the initiation of bank union starting in mid-2012. But one issue that has been largely overlooked in the debate is the peculiar ownership and governance structures of euro-area banks. European policyma ers and analysts often appear to assume that most banks are publicly listed companies wit ownership scattered among many institutional investors ('dispersed ownership'), a structu in which no single shareholder has a controlling in uence and that allows for considerabl exibility to raise capital when needed ('capital exibility'). Such an ownership structure i indeed prevalent among banks in countries such as Australia, Canada, the United Kingdo and the United States.

This Policy Contribution shows, however, that listed banks with dispersed ownershi are the exception rather than the rule among the euro area's signi cant banks , especially one looks beyond the very largest banking groups. e bulk of these signi cant banks are g ernment-owned or cooperatives, or uniquely in uenced by one or several large shareholde or otherwise prone to direct political in uence.

As a result, the public transparency of many banks is low, with correspondingly low ma

The euro area's significant banks

e new framework of European banking supervision, also known as the Single Supervisory Mechanism, established the European Central Bank (ECB) as the licensing authority for all banks in the euro area as of 4 November 2014. As a result, and despite many lingering national idiosyncrasies (ECB, 2016a), the euro area can now be considered a single jurisdiction for banking sector policy.

European banking supervision distinguishes between banks labelled signi cant, known as 'signi cant institutions' (SIs), and all other banks in the euro area, known as 'less signi cant institutions' (LSIs). SIs include all euro area-headquartered banking groups, and euro-area branches and subsidiaries of groups headquartered elsewhere, that have at least €30 billion in total assets, and others that have speci c signi cance in their respectnc/here5 (b(b)-2 (eller (in)4 (g.9 (S)1

euro-area system[4]. Table 1 illustrates the dominance of SIs[5] and that euro-SI assets are almost equally divided between the eight G-SIBs and the 89 other euro-SIs.

of the eight euro area G-SIBs are cooperatives)[9].

- 'Public sector' governance: banks created by (local or national) governments and/or that ful ll a public interest, non-commercial objective. ese include national policy banks in some member states, dedicated to funding local government activities (eg Finland's Kuntarahoitus, France's SFIL or the Netherlands' BNG Bank), international development (France's AFD), or small businesses and innovation (bpiFrance), as well as Germany's elaborate network of local savings banks (*Sparkassen*) and regional banks (*Landesbanken*) and other public banks such as La Banque Postale in France or Caixa Geral de Depósitos in Portugal.
-

category, even though the analysis presented here is agnostic about it.

Appendix A presents ndings on each euro-SI. Table 2 summarises the ndings in terms of governance categories. It also indicates the split between listed and unlisted groups. Fewer than half (42.3

shareholder[14]. An additional eight banks, representing €1,597 billion in assets, have as their largest (minority or majority) shareholder a regional or national foundation, which is typically controlled or in uenced by political interests (all of them are in only three countries: Austria, Italy and Spain)[15]. Taking into account the fact that cooperative bank governance models are also often politicised, one can reasonably presume that there is some political interference in the governance of at least 64 percent of all euro-SIs, representing €13.5 trillion or 61 percent of total assets[16].

ese ndings focus on ownership structures and as such cover only some aspects of the euro-area banks' governance idiosyncrasies. ere are also many speci c legal and practical arrangements under which, for example, board members are assessed, selected and renewed. Even among companies with dispersed ownership, in at least some countries, rules and practices can enable a small subset of shareholders, incumbent board members, employees' unions and/or the bank's managers to wield disproportionate in uence[17]. 'Shareholder democracy' is not perfect anywhere, but just like political democracy, it is more distorted in some jurisdictions than in others. An analysis of such di erences would complement the results presented in this Policy Contribution.

Unsurprisingly, these euro-area ndings mask signi cant diversity among EU member states. While not the main focus of this Policy Contribution, Table 4 shows the governance structures of euro-SIs by country[18]. One must keep in mind that these are only a current snapshot of a con

Table 4: Governance structures of euro-SIs by country

International perspective

is section compares the euro area's larger banks with banks of similar size in Australia, Canada, the United Kingdom and the United States, taken as representing the dispersed-ownership model. e 'large euro-SIs' are those with total assets above €30 billion. is subsample comprises 84 of the 97 euro-SIs as of mid-November 2016, representing 99.3 percent of aggregate euro-SI assets. A parallel sample of 'Anglo-Sis', comprising all banks headquartered in the four selected countries with total assets above €30 billion, is based on a reference ranking of global banks (e *Banker*, 2016)[20]. is sample consists of 53 groups, as summarised in Table 5 (coincidentally the two samples cover about the same amount of aggregate assets).

Table 5: Anglo-SIs

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Source: Bruegel based on *T* , *B* , (2016) and a dollar/euro exchange rate of 1.087. Note: Assets are as of end-2015. SIs = significant institutions.

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e criteria for inclusion in *e Banker*'s ranking are not identical to the ECB's criteria for designation as SIs, but the di erences (and corresponding selection bias) can be considered insigni cant. In both cases, large nonbank public institutions are excluded, such as France's Caisse des Dépôts et Consignations or Germany's Kreditanstalt für Wiederaufbau in the euro area, or Canada's Caisse de Dépôt et de Placement du Québec or Fannie Mae and Freddie

- Fourth, the politicisation of management that results from many euro-area banks' ownership and governance structures often a ects their operations. It can lead banks to deviate from 'commercially driven' business decisions, for example, lending more to preferred borrowers or sectors or to the government itself, and/or during economic downturns (eg Sapienza, 2004; Bertay, Demirgüç-Kunt and Huizinga, 2015; Gropp and Saadi, 2015). is can in turn lead to detrimental trade-o s in terms of risk taking and pro tability. More straightforwardly, bank politicisation can lead to ine ciency, for example, by driving an outsized in uence of sta unions in the bank's decisions or by tilting recruitment policies towards bene ciaries of political patronage. To be sure, incompetence and poor risk assessment are regularly observed in all kinds of banks, including the most commercially run, but they can still be expected to be somewhat correlated with political interference.
- Fifth, the structures of euro-SIs may perpetuate the vicious circle between banks and sovereigns, which is now widely identi ed as a key driver of the euro-area crisis, in a way that is less obvious but not necessarily less powerful than visible nancial linkages such as national deposit guarantees or bank-held portfolios of home-country sovereign debt. Governments are likely to have stronger implicit guarantees for banks that they are linked to through the banks' governance and ownership. Conversely, banks owned or otherwise directly in uenced by governments tend to display higher home bias in their portfolios of sovereign debt (De Marco and Macchiavelli, 2016).

As for possible macroeconomic bene ts from banks owned or in uenced by the state, evidence is mixed at best. Even when lending by such banks is less procyclical (or in some cases, countercyclical) – ie their lending rises during economic downswings – state banking appears to be costly and ine cient compared with other countercyclical tools (Bertay, Demirgüç-Kunt and Huizinga, 2015)[27].

Shifting toward a greater share of listed banks with dispersed ownership can thus bring bene ts to the euro-area banking system, particularly in terms of capital exibility and the gradual elimination of the bank-sovereign vicious circle. In particular, this analysis suggests more reasons to privatise banks in public ownership, including those nationalised during the crisis, and to sell government-held minority stakes, beyond any obligations that member states might have under the EU state aid framework. Such sales should be made to the highest suitable bidder at any moment when market conditions are not evidently adverse, even if the sale price doesn't allow a government to recoup all losses from past interventions.

2014). EU legislation should also allow supervisors su cient discretion to impose requirements for additional capital above the regulatory minimum, known as Pillar II requirements in the Basel Committee's jargon[29]. In turn, euro-area supervisors should rigorously enforce the capital requirements framework, not only the ECB on SIs but also national supervisors on LSIs.

Beyond the prudential framework, policymakers at national and European levels should identify and dismantle other aspects of policy, especially (but not limited to) tax arrangements, that may distort banking groups' structures and be unfavourable to listed banks with dispersed ownership. Some of these distortions may be signi cant.

None of these recommendations go against the organising principles of the euro area's existing banking policy framework. Public authorities will have to be persistent in implementing them, given the heavy legacy of links – not only nancial but also political and social – between many of the euro-area banks and their local or national political systems. Since the initiation of euro-area banking union, many banks have gradually returned to soundness. More e ort is needed, however, for the system to acquire su cient capital and managerial exibility, so that it can respond more nimbly to future shocks than it has in the recent past.

References

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Appendix A: Euro-SIs (significant institutions headquartered in the euro area)

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