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Neither a weapon of mass destruction nor the armed branch of the States, corporate and investment banking is a strategic industry and an issue of economic sovereignty[1]

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The aim of corporate and investment banking (CIB) is often misunderstood. Yet it is a key element for economic development. CIB is neither a "veil" nor a virtual sphere, independent and disconnected from corporate life. It is, on the contrary, a powerful tool for economic development and an issue of sovereignty for States. Indeed, CIB plays a useful and fundamental role in the financing and hedging of corporate and infrastructure risk as well as public sector risk. This role is set to expand, due to the shift in the financing of economies towards a US model which places more of a focus on the financial markets. The French universal banking model, which combines retail banking know-how with the most advanced CIB techniques for the benefit of its customers, offers considerable advantages to provide France with a competitive edge in this field. On the condition that we do not get lost in the mass of current regulations: these regulations must guarantee the efficiency and security of the financing markets, without creating distortions in competition, by maintaining the necessary critical mass for French and European CIB and encouraging their competitiveness.

An efficient financial system supports economic growth. Indeed Schumpeter believed that the entrepreneur and the banker were two complementary players in the innovation process.[2] Academic literature assigns several functions to finance: it enables the pooling of savings via diversification and risk management, eases the exchange of goods and services through the reduction of transaction costs, improves capital distribution, and increases investors' appetite to finance new projects.[3]

The competitiveness and attractiveness of the financial industry, against an increasingly competitive European and international backdrop, is a key issue of a country's economic sovereignty. With players - including bankers, insurers and asset managers - among the top international rankings, and the major decision-makers in France, finance is a strategic industry in our country. Accounting for 4.5% of GDP and 5.3% of French private sector employment[4], the State cannot afford to be indifferent to its development.

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[1] At the time at which this report was written, the referendum result on the UK's future within the European Union was not yet known, with potential major consequences for Europe's integrity, the economy and the markets.
[2] Schumpeter, Joseph Alois (1912), "Theorie der wirtschaftlichen Entwicklung". *Dunker & Humblot*, Leipzig. "The Theory of Economic Development" translated by R. Opie. *Harvard University Press*, Cambridge, MA, 1934.
[3] Levine, Ross (2005), "Finance and Growth: Theory and Evidence", chapter 12, in: Philippe Aghion and Steven Durlauf, *Handbook of Economic Growth*.
[4] Insee.

Four of the nine largest euro zone banks are in France: very few economic sectors are in such a position. These banks produce all the financial services required by economic agents. The momentum and good quality of financing made possible by the banks has been underlined by the OECD, which listed this as one of the six main strengths of our country's economy.[5]

An innovative business model in the French banking sector, the universal banking model draws together a complete range of banking activities within the same institution. Corporate and investment banks, which represent 18% of the net banking income[6] of the major French banking groups[7], play a crucial role in the French economy. They provide companies with financing solutions and global access to markets with favourable competitive conditions. This is particularly important given that, as a result of banking regulations, the financing mix is increasingly favouring the market: the share of bank loans compared with market financing is currently 61%/39% for French companies, compared with 70%/30% at end-2009.[8] In infrastructures, CIBs are essential for project financing. They support major export financing. CIBs also play a key role in financing public debt: they are among the main resident holders of French public debt and act, in particular, as the contact point for debt agencies to distribute their securities.[9] By continuously transmitting buy and sell prices, to their customers or to the market as a whole, CIBs contribute to the liquidity of State and corporate financing tools through market making.

Having competitive, resilient CIBs, able to efficiently recycle throughout the territory high levels of savings (which is one of the main French and European commodities)[10], is therefore an absolute necessity to finance and drive the economy.[11] Due to the nature of their business, the size of these banks is paramount to ensuring ambitious financing projects. However, negatively impacted by current and forthcoming prudential standards and faced with historically and sustainably low rates, especially negative rates, post-crisis CIBs are no longer those of the beginning of the 2000s. This is particularly true in Europe. The profitability of the main French banking groups has fallen compared with pre-crisis levels: the net banking income of the main French banks relative to equity capital was 6.7% in 2015 versus 15% pre-crisis[12], in particular due to the increase in capital (the capital ratio of French banks doubled between 2007 and 2015 from 6% to 12%[13]).

European CIBs are losing market share to their US competitors on their own territory. A recent study by the Bruegel think tank[14] highlights that, in just ten years, European CIBs have lost almost ten percentage points in terms of market share, to reach 46% of their domestic market at end-2015, almost entirely in favour of their US counterparts, whose market share increased from 37% to 45% over the same period. Although the trigger of the financial crisis was the collapse of Lehman Brothers on 15 September 2008, recent US banking mergers have created giant CIBs that have the necessary critical mass to support major financing projects and are on a mission to conquer Europe. At the same time, new banking regulations lean in their favour as these banking giants can offload whole sections of their business from their balance sheets through securitisation, which is mainly supported by US public authorities via the Freddie Mae and Fannie Mae agency which have no European equivalent.

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[5] "France 2015", *OECD Economic Surveys*, OECD, March 2015.
[6] Net banking income is the total revenue generated by a bank through its operations.
[7] "La situation des grands groupes bancaires français à fin 2015", ACPR, *Analyses et Synthèses* n° 63, May 2016.
[8] Banque de France, April 2016.
[9] Agence France Trésor, *Negotiable government debt by group of holders in fourth quarter of 2015*, Monthly Bulletin 31 March 2016.
[10] The household savings rate was 15.9% in the fourth quarter of 2015, according to the Banque de France.
[11] A film on the interest of CIBs, relies on the testimony of customers (Showroom Privé, Engie, Axéréal, Airbus, and the Ile-de-France Region) and can been seen online at www.fbf.fr.
[12] "La situation des grands groupes bancaires français à fin 2015", ACPR, *Analyses et Synthèses* n° 63, May 2016. The return on equity of US banks was 8.4% in 2015.
[13] Banque de France, *Introductory letter to the Annual Report*, 18 May 2016.
[14] "The United States Dominates Global Investment Banking: Does It Matter For Europe?", *Bruegel Policy Contribution* n° 6, March 2016.

This regulatory competition, and its consequences on financing channels and their location, is often misunderstood. It is nonetheless a major issue. Consequence: the Top 10 of global Corporate Investment Banks are dominated by US banks.[15]

CIBs must therefore reinvent themselves. New prudential regulations have made their business more expensive in terms of capital, at a time when they are also faced with the challenges of digital transformation. To offset this increase in costs, CIBs are restructuring and reorganising their businesses. In part, they have refocused on their domestic markets. Several large banking institutions have thus been forced to announce job cuts. Savings have also been made through the industrialisation of business lines, for trading operations through the switch from over the counter to electronic methods and the use of central trading platforms, changes in business model due to pressure on balance sheets (switch from originate-to-hold to originate-to-distribute models[16]), and the withdrawal from non-strategic regions or business lines. As is also the case in retail banking, the switch to digital presents an opportunity for CIBs to renew their model: this has led to the signing of several partnerships, the acquisition of FinTechs, and the purchase of electronic trading platforms, etc.

France is not always aware of the fact, but it has a major advantage as many institutions are among the most active European banks on the markets able to meet the European challenge of the Capital Markets Union. It is important to maintain this advantage, in particular in terms of market making, which should continue to be able to function under sustainable economic conditions. Finally, regulatory or fiscal projects must not be implemented, at either the national or European level, that would create distortions in competition at the expense of European players.

The financing industry is a strategic sector that is currently at a crossroads. Its regulatory, fiscal, competitive and technological environment is shaping its future outline. Let us act wisely to maintain, in France and continental Europe, a competitive and innovative banking sector. The future of our economy and its financial independence is at stake.

[15] Thomson Reuters, *Global Investment Banking Review*, first quarter 2016. Three European banks are included in this ranking.

[16] The originate-to-hold model consists in lenders holding loans on their balance sheets. The originate-to-distribute model consists in lenders issuing loans then selling them on to remove them from their balance sheet.

Incoherence between monetary policy and supervision in the euro zone