Chapter 17
"Volcker/Vickers Hybrid"?
The Liikanen Report and Justifications for Ring Fencing and Separate Legal Entities

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ABSTRACT

Whilst some valid and justified arguments have been put forward in favor of ring fencing, that is, constructing a fire-wall between consumer and investment banks, and that such activities can be achieved without restructuring banks into separate legal entities, the Liikanen Report highlights why there is need for such re-structuring. As well as considering the merits of ring fencing and the establishment of separate legal activities and entities, this chapter aims to highlight why a suitable model aimed at mitigating risks of contagion can to a large extent, be justified on a cost-benefit analysis basis. Furthermore, the chapter ultimately concludes that even though a greater degree of separation of legal entities and activities persist with the model which is referred to as "total separation", a certain degree of independence between bank activities would also be necessary under ring fencing if its purposes and objectives are to be fulfilled.

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INTRODUCTION

In the Final Report of "The High-Level Expert Group on Reforming the Structure of the EU Banking Sector, chaired by Erkki Liikanen,[1] the need for re-structuring banks into separate legal activities is highlighted. In assessing such a need, two considerations were given due attention (See page i of the Report):

The important role of recovery and resolution plans – whereby the decision on possible separation of bank entities was to be conditionally based on the assessment of such plans; The mandatory separation of banks' proprietary trading and other risky activities.

The Liikanen Review was established in November 2011 by EU commissioner, Michel Barnier, to conduct a full scale analysis of Europe's lending sector and recommend banking reforms for the region." (Varriale, 2012).

The mandatory separation of banks' proprietary trading and other risky activities could be distinguished from the case which exists with Volcker's Rule in that an outright ban or prohibition on proprietary trading (all forms of risky investment practices) and certain relationships with hedge funds and private equity funds is not implied under such mandatory separation.

The "Volcker Rule" which can be found under Section 619[2] of Title VI of the Dodd Frank Act states that:

1. ***Prohibition:*** *Unless otherwise provided in this section, a banking entity shall not*
   a. *Engage in proprietary trading; or*
   b. *Acquire or retain any equity, partnership, or other ownership interest in or sponsor a hedge fund or a private equity fund.*
2. ***Nonbank Financial Companies Supervised by the Board:*** *Any nonbank financial company supervised by the Board that engages in proprietary trading or takes or retains any equity, partnership, or other ownership interest in or sponsors a hedge fund or a private equity fund shall be subject, by rule, as provided in subsection (b)(2), to additional capital requirements for and additional quantitative limits with regards to such proprietary trading and taking or retaining any equity.*

Whilst the Volcker Rule is considered by some commentators as being parallel to a separation of banking activities and entities, it is more draconian in the sense that the model allows for less scope and flexibility than the "hybrid" model which is

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