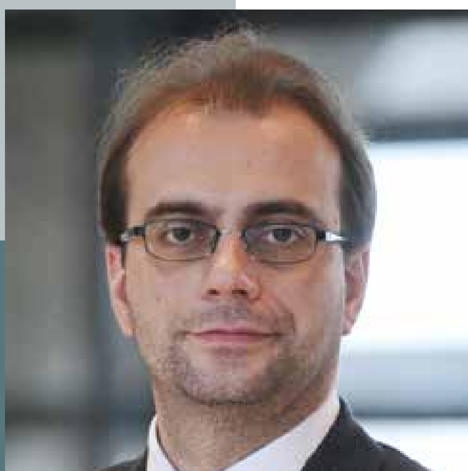
POLICY PRIORITIES FOR THE EU BANKING SECTOR



SEBASTIEN RASPILLER

Director, French Treasury, Ministry of the Economy, Finance and the Recovery Plan, France

The completion of the Banking Union should aim at improving the profitability and the competitiveness of EU banks

So far, the Banking Union (BU) agenda has been focused on building a more resilient banking sector, through stronger prudential requirements, addressing legacy risks, active supervision and preparation of resolution. The ability of the banking sector to continue funding the economy throughout the Covid crisis, supported by pragmatic regulatory and supervisory measures, proves that we have successfully built a resilient banking system. Some progress remains to be seen at individual level, notably on less significant institutions, but overall risk reduction has largely been achieved. However, risk reduction is not the only challenge facing the EU banking sector. It is not the only criteria to measure the strength and success of our BU. Today, EU banks are facing increased competition, at a time when Europe loses pace both globally and within the Single Market. Their market share has fallen over the last 15 years. Even within the Euro area, cross-border banking activity is on a continuous downward trend.

At the same time, although banking groups have to answer the immense funding needs of the twin green and digital transitions, they should be able to invest in their own digitization where there are many potential levers for growth: the EU payments initiative should strengthen the independence of banks and allow them to start (re) conquering important markets. The ongoing development of the regulation on crypto assets should allow EU banks to invest more in the market opportunities offered by this new segment.

> We should move beyond the "risk reduction-risk sharing" slogan, to gather on a vision of a diversified and profitable EU banking sector.

Moving forward, we need to address the lack of competitiveness and structural under-profitability of our banking system, which drives a persistent reliance on extraordinary public interventions. In 2019, return on assets was three times lower for EU banks compared to US banks, putting a drag on their ability to rebuild lending capacities to finance the recovery. From a financial stability standpoint, the weak profitability of the EU banking sector is a serious hurdle endangering public finances and market discipline.

Our focus must therefore shift from resilience to competitiveness and strategic autonomy. We should move beyond the "risk reduction-risk sharing" paradigm, which brings more divisions than results, to gather on a vision of a diversified, profitable and attractive EU banking sector. Concretely, this means:

- First, fulfilling the promises of the 2nd pillar of the Banking Union (i.e. no more bailouts, better protection of taxpayers, more market discipline and more consolidation). It implies more intrusive supervision for "less significant institutions" which concentrate most vulnerabilities in the current environment. Zombie banks cannot remain on the market at the expense of taxpayers and competitors, it is crucial to reduce overcapacities. If making resolution for more banks means reviewing the conditions to access funding in resolution for banks pursuing such market exit strategies, assorted with adjusted contributions to existing safety nets, this should be envisaged.

- Second, we need to reaffirm that we aim for a single jurisdiction in all prudential and regulatory dimensions, taking full advantage of our single currency and BU. It is greatly needed to develop European and international banking groups able to foster the international role of the euro and reap its economic and strategic benefits. Without it, there would be no "Union". Steps towards this goal – even small – need to be pursued in the shorter run.

Last but not least, we should be careful not to inflict new burdens on the competitiveness of our own sector, especially compared to our competitors' jurisdictions. In the short run, the implementation of the Basel 3 package may put the financing of the EU-recovery at risk. The forthcoming EU Commission proposal must respect the G20/ECOFIN mandate not to induce a significant increase of banks capital requirements.

France, with Germany, has proposed ways to achieve this in a compliant way with the Basel agreement, and counts on the Commission to take them into account, especially at a time when US authorities are considering a capital-neutral implementation. It is particularly important not to affect wholesale banking business and market activities: the EU's Capital Market Union cannot succeed without competitive EU banks able to serve corporates' needs globally.

FERNANDO VICARIO
Chief Executive Officer, Bank of America Europe

A harmonised banking sector is essential for financing the EU's twin transition

More than a decade on from the financial crisis and despite the unprecedented economic impact, the banking sector proved to be much better prepared this time in terms of resilience, capital, and liquidity. This is mostly due to the regulatory overhaul that the international community carried out over the last decade. In the EU, the ECB has responded swiftly to the pandemic by providing banks with regulatory / supervisory relief (such as capital requirements, liquidity) to allow continued lending to the economy.

This decisive and coherent action would not have been possible without having a single supervisor across the continent. The pandemic showed us not only how important the recent reforms are, but also reminded us that completing the Banking Union and the Capital Markets Union remain fundamental to improving the efficiency of the financial sector as well as enhancing the financing options available for the real economy.

As a first positive step towards completing and strengthening the Banking Union, the EU should finalize the implementation of Basel III in a fashion that is as consistent as possible with the internationally agreed Basel capital framework. This will ensure a global level playing field and will limit the costs and risks of global fragmentation. The new iteration of EU's prudential rules should also address the issue of national ring-fencing: a true European cross-border banking sector should be fully integrated to reap the benefits of the single market. Trapping liquidity and capital behind national lines goes against the principles of the single market and does not help to foster economic growth in all member states. Introducing a fully-fledged EDIS is also key to solving this issue; in the interim, we welcome the recent ECB's position on the cross-border mergers of banks.

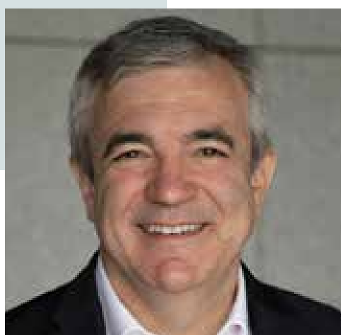
Intertwined with the Banking Union, the EU needs well-functioning and fully integrated financial markets, making the CMU project of paramount importance for the swift recovery from the crisis. CMU is needed to support the EU's Hamiltonian moment, but any future rules and frameworks in place should be outward looking, capital markets should not be ring-fenced across national lines. The EU's capital market should be developed in a global context. The transition to net-zero is also dependent on private finance - which in turn needs fully integrated capital markets to allow money flows to go towards green assets.

The new iteration of EU's prudential rules should also address the issue of national ring-fencing.

The pandemic has also made clear the importance of digital issues for the resilience of the economy and the financial sector. Technological development has also been identified as an essential component for building a solid foundation for long-term growth, supporting the EU's recovery and modernising its economy. In order to achieve these objectives, regulation and supervision should be technology-neutral - in other words it should be principle-based and forward looking. This is why tackling fragmentation is of utmost importance. Europe will not be able to compete globally if it has a fragmented legal and regulatory environment that stifles innovation and undermines scale efficiencies, not to mention an environment that opens the door to regulatory arbitrage. Above all, the EU must promote a level playing field around innovative technologies in financial services, ensuring that the golden principle of "same activity, same risks, same rules" remains the norm throughout the digital transition.

Last but not least, NPLs. With ECB projections showing that the pandemic is likely to lead to a significant proliferation of distressed assets, swift action by the EU must remain a priority. As such, a European unified approach to simplify and potentially harmonise the licensing requirements for third-party loan servicers or some common base parameters, would be a major step forward. Once again, harmonisation of rules and supervisory measures is crucial, and we support the recent plan to tackle Member States' divergences on insolvency, debt recovery and debt restructuring frameworks.

For all of these reasons, it is essential that the EU continues to develop a strong and integrated banking sector alongside deep and liquid capital markets in order to deliver the much-needed finance to support the twin transition of the EU – the digital and the green transformation.



LUIS GARICANO

MEP, Committee on Economic and Monetary Affairs, European Parliament

To have bank mergers the priority must be to complete the Banking Union

Over the last few months, the European Central bank has taken some steps to encourage consolidation in the banking sector. For instance, it published a new guide on their supervisory approach to mergers and suggested that they could start grating cross-border liquidity waivers if adequate intragroup financial support agreements are included in bank recovery plans.

These kinds of measures are welcome. However, they do not address the basic reasons why we have barely seen any interest from banks in undertaking cross-border mergers. It is quite simple: the central barrier to cross-border mergers is the lack of the single market for banks, and the reason for this lack of a single market is the fact that the Banking Union is not complete.

In this way, there are three political challenges ahead of us: the absence of a common deposit insurance, which means that banks are expected to build excessive buffers in host countries; the absence of a credible and predictable resolution framework; and addressing a whole host of other regulatory differences that make it extremely difficult to operate as "one bank" across the Union.

The EU should not try to undertake a new "industrial policy" for its banking sector. The priority must be completing the Banking Union.

It is well known that one of the main impediments to cross border mergers is the fact that banks have to meet capital requirements both at the European and at the national level. However, it is crucial to emphasize that this issue, the home-host problem, will not be solved until we have achieved a meaningful European deposit insurance. A common deposit insurance has been stalled for more than five years now, but recently the German government finally turned in favor of it, and there is a growing consensus on the so-called "hybrid" model. Indeed, the upcoming review of the crisis management framework presents the much-needed opportunity to finally get it done.

The second main obstacle we face is that our crisis management framework is not fit for purpose. European institutions went to great lengths to establish a common resolution framework and a Single Resolution Board. However, Member States, each in their own way, have figured out how to circumvent it.

Unless we have a predictable and uniform framework to deal with troubled banks and to facilitate market exits, we will continue to have an amalgam of smaller, more regional, more inefficient, and more politically connected banks.

Lastly, we must address the regulatory differences across countries that banks continue to face. These span areas as broad as insolvency frameworks and tax regimes. However, a clear area where decisive EU action is possible in the short term is anti-money laundering.

Today's framework leaves too much discretion to local regulators and supervisors. This creates divergences in how rules are applied and understood that are inefficient to comply with across borders and that seriously undermine joint efforts to eliminate any risks derived from financial crimes. There has been enough talk of "coordination" on this issue, it is time for common AML supervision and for a European Financial Intelligence Unit.

DR. STEFAN SIMON

Member of the Management Board, Chief Administrative Officer, Deutsche Bank AG

The next five years – Europe to outline its blueprint for future generations

Europe's plans for open strategic autonomy include several priorities designed to strengthen the financial sector. Central to this is promoting the euro and fostering its status as an international reference currency.

Legislative choices will greatly influence to what extent the European Commission (EC) will be successful in delivering strategic autonomy. The various legislation covers a digital euro, data protection/localisation, onshoring of euro related investment banking services, but also Basel implementation.

The right choices need to be made if European policymakers expect banks to play their part in financing the European economy. Especially against the background of the post-pandemic economic recovery and the fact that it will still need time to develop any meaningful European capital market to fall back on.

In September 2020, the EC set out its digital finance strategy, outlining how Europe can support the digital transformation of finance while regulating its risks. While this should provide opportunities for banks and their clients via better use of data, the

focus on crypto-assets and issuance of a digital euro, it also entails clear risks.

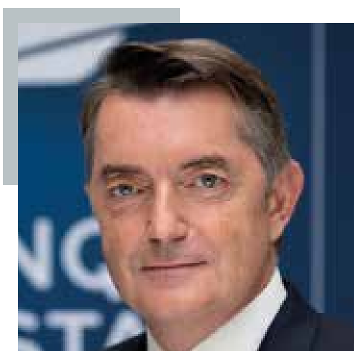
Crypto-assets as a means of payment and exchange of value will play an increasingly important role in the financing of the EU economy. As the digital agenda of the EU economy progresses, an increasing number of industry processes will be based on blockchain/DLT e.g. pay-by-use concepts and machine-to-machine payments. This creates a demand for compatible payment solutions and the financial industry is shaping its digital strategy accordingly.

A strong and robust EU regulatory regime for crypto-assets is essential to ensure that this technology supports a competitive, financial and economic ecosystem that protects consumers, investors and businesses. This should be based on the "same risk – same rules"- approach by relying on existing regulations, adapting these or, where necessary, introducing new rules that address the novel nature of crypto-assets while retaining financial stability.

The digital finance strategy includes many concepts which are new to policymakers and do not fit into the traditional financial regulatory architecture. This might lead to an overly conservative framework, especially for banks. Linked to the push on European sovereignty, a likely reaction is to close the European market for outside stakeholders and focus on data localisation. Closing markets has however never led to better client services.

For the financial industry, crypto-assets have the potential to feature many of the elements needed in a digital and globalized financial market place e.g. real-time finality of transactions or frictionless cross-border availability. But further institutionalization is needed: the establishment of a regulatory foundation followed by at-scale participation of key members of the regulated financial ecosystem.

While Europe should focus on embracing new technologies as part of its goal of strategic autonomy, it is clear to us that this should be paired with remaining open, as many of the new policy developments have cross-border impacts.



PHILIPPE HEIM

Chairman of the Board,
La Banque Postale

Supporting proportionate regulation and hastening sustainable finance policies

Retail banks have played a major role during the crisis (financing the economy, supporting State guaranteed loans, etc.) and will be key in facilitating the way out of the crisis, by financing recovery and investments.

However, banking models face severe challenges: persistently low or even negative market rates, new customer demands or reduction of the intermediation margin. The rapid growth of bigtechs/fintechs, which disintermediate major segments of the value chain, is also affecting their profitability. Furthermore, digitalization generates very significant costs, linked to the development of digital tools and self-care, and goes hand in hand with an efficient policy in terms of security (AML-CFT, cyber risk, fraud, etc.).

The weakened retail banking models must be less vulnerable to these risks: La Banque Postale has resolutely engaged in diversification since its creation in 2006, the most recent being the subsidiarising of CNP Assurances in March 2020.

This is why I consider the EU's political priorities to be the following:

- Slowing down of legislative measures,
- Reinforcing unified and fair European supervision
- Accelerating digitalization and sustainable finance policies

EU should take international leadership in building extra-financial reporting standards.

As European banks face a growing risk of paradoxical requirements and regulatory fatigue, unproportionate procedures should be limited and legislative initiatives need to be carefully assessed and selected. This is all the more true as prudential measures and the first steps of the Banking Union have been widely implemented in recent years. Reporting burdens, for example for non-performing loans or climate risk, should not be further increased nor duplicated between supervisory silos.

Likewise, taking into account European economic specificities in prudential regulation, ensuring a fair treatment between banking and non-banking actors for the same activities, and pursuing unified supervision at European level should be a concern of paramount importance as they are closely related to European sovereignty and sound international competition. This also means establishing a balance between market and banking finance through capital calibration and avoiding national gold plating or successive layers of supervision.

Finally, I see two major priorities in the years to come: digitalization and financing the energy transition.

Digitalization has been magnified by the pandemic and open finance responds to customer needs. But it should be clear that seamless user experience and widely connected tools be not detrimental to cybersecurity nor genuine control by the customer of its personal data.

The EU has rightly initiated a very active approach in the funding of energy transition. Such dynamic should lead to international leadership in building extra-financial reporting standards and fostering access to related data. This is a matter of sovereignty and reliability of information for end-users.

Consistently, these European ambitions should be shared by private and public actors in terms of green and transition projects. In dedicating €1.5 billion for green projects in 2020, targeting €3 billion in 2023 and supporting citizen responsible consumption, La Banque Postale aims to be a major actor of a fair transition for all, including containment of social inequalities.

JOSÉ MANUEL CAMPA

Chairperson, European Banking Authority (EBA)

Regulatory completion and effective implementation

Covid-19 has sent shock waves around the world and caused significant personal and economic loss. It has evoked memories of 2008 when, following the collapse of Lehman Brothers, the financial world was shaken to its foundations. The financial sector was then at the centre of the turbulence and that event started a decade long process of regulatory reform that fundamentally reshaped the framework for financial institutions. The Banking Union was the flagship reform in the EU. However, those reforms have not been completed.

On the positive side, the regulatory framework and status of banks today is unrecognisable from a decade ago. Capital requirements increased substantially and liquidity/funding restored to its role at the heart of banking regulation. The Bank Recovery and Resolution Directive came into force and gave us a modern framework for dealing with failing or failed banks. These reforms have certainly helped banks bringing their core support to the real economy in the current context.

However, the worst economic effects of the crisis are still ahead of us for the banking sector. Banks will continue lending to the economy but those that entered the crisis with lower capital levels, poor business models and riskier exposures will face challenges. So, what are the regulatory priorities in this period of relative calm?

First, it is imperative that the third pillar of the Banking Union, a common deposit insurance framework, is established. Nine years after the measure was announced it remains elusive, notwithstanding the improvements we have seen in risk metrics across the EU.

Next is the absence of a harmonised insolvency regime for banks. National insolvency regimes are not bank specific and generally not aligned with the provisions of the BRRD. As a result, the requirements deeming a bank as failed or likely to fail are inconsistent with the domestic regime for determining insolvency.

At the micro-prudential level, there are a range of issues that have the potential to act as impediments to the effective use of the single market. Cross-border banking activity needs to be fostered through increased competition, elimination of undue burdens and the increase introduction of technology that enhance cross-border activity.

Beyond enhancing the regulatory framework, banks need to continue to enhance their strategies to ensure the sustainability of their business model. The challenges from low profitability, excess capacity and digitalization have accelerated during the COVID-19 pandemic. Cost adjustment, restructuring (including exit) and enhancement of the value-added propositions towards customers should be at the core of their restructuring.

ANTÓNIO SIMÕES

Regional Head of Europe, Group Santander

Now is the time to be pan-European

Covid-19 has accelerated the challenges European banks are facing, but also creates opportunities, especially if authorities and the private sector can share a vision and work together. Working closely with banks, European governments, the Commission and monetary authorities acted swiftly and convincingly to protect people and business s the pandemic severely disrupted reduced economies last year.

European leaders seized the opportunity to design a multi-year plan not just for recovery, but for digitalization and the greening of the economy. The biggest opportunity lies in building on this renewed unity of purpose.

The biggest opportunity is to create a true single market for financial services. Banks in Europe today operate in a fragmented market with an incomplete banking union. To do cross border business, we face barriers in everything from how deposits can be deployed to different customer protection and bankruptcy rules. We cannot freely move capital or liquidity.

It is crucial to advance more quickly in aligning policies and removing barriers, developing a clear single rulebook and completing the banking union with a deposit insurance scheme.

Because of this fragmentation, European capital markets remain woefully underdeveloped, unable to provide the scale or financing options available in competing geographies. A true single market for financial services in Europe would provide the foundation for banks to achieve the scale, efficiency, and resilience needed to finance more growth and jobs.

A second opportunity lies in the digitalization of the economy. FinTechs and BigTechs have entered financial services, providing a new source of competition to banks. However, the tech companies that provide financial services are not subject to the same regulations as banks. Rules governing innovation, access to data and platforms, and well as taxation, should be brought up to date to ensure a level playing field for incumbents and new

entrants. Banks are not seeking any favours, simply not to have to compete with one hand tied behind our back.

Thirdly, while regulatory and supervisory responses to the pandemic have been prompt and quick, certain measures did not work. Specifically, banks did not use the flexibility provided to draw down their countercyclical capital buffers, which could have supported more lending. We should use this opportunity consider how to develop truly countercyclical regulation, as well as take into account the challenges to the sector from green transition and digitalization.

Last is the challenge of declining profitability, especially in Europe. There are four main factors behind low returns. First, low interest rates are pressuring margins despite higher public and private indebtedness. Second, non-bank competition, especially from new digital entrants. Third, the costs of regulatory compliance and maintaining higher capital and liquidity ratios as a result of post-financial crisis reforms. Finally, the expected increase in business-related NPLs as a result of the pandemic, especially among small and medium-sized enterprises and the most-affected sectors.
We must seize the opportunity to mitigate this last factor by maintaining measures to support firms until the recovery is well under way. This would help viable firms remain solvent, and thus avoid the drag on the economy and the banking system that their failure would entail.

Europe's biggest opportunity is to create a true single market for financial services.

In Santander, with the One Europe project I am leading, our goal is to build a better and simpler bank that puts the customer at the heart of everything we do. One Europe will exploit synergies across our businesses in Spain, Portugal, Poland and the United Kingdom to take a truly regional approach.

We expect to grow by serving our customers better, simplifying and transforming our mass market business and accelerating our digital offer through a common omnichannel strategy. We expect this will enable us to realize significant efficiency savings in the next two years, even as we improve our products and services.

Doing this is the best way we can contribute to a strong and rapid recovery in Europe.

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THE EUROFI FINANCIAL FORUM 2022
7, 8 & 9 SEPTEMBER 2022
PRAGUE – CZECH REPUBLIC