BANK MODEL DIVERSITY IN THE BANKING UNION CONTEXT

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No credit crunch within sight

Financial markets should be dominated by different business banking models to enable a competitive and effective supply of financial services. Undoubtedly, diversification in the sense of size, complexity, market and consumer focus is fundamental to ensure economic prosperity and to establish and maintain sustainable and viable business models.

This serves the needs of customers and investors, be it in a more traditional or digitalized way. In this respect, the EU banking sector is in a good position to overcome present and future challenges.

Scientific evidence underlines that access to bank loans is closely related with the risk, capital and liquidity position of a bank. A well-capitalized bank with a robust risk management will grant credits if the assumed risk is acceptable and manageable.

In this respect, the financial reforms of the last decades have been proven to be accurate. So far, EU-banks have shown resistance to the negative economic effects of the pandemic, a contagion to the Financial Sector did not happen. Undoubtedly, the fast and targeted responses of banks, Member States and regulators were of high relevance. However, the improved capital base and liquidity position of banks, the more robust and resilient deposit insurance system, the newly established recovery and resolution framework and the comprehensive tool-box for supervisory and resolution authorities helped.

In that vein, the 2021-EBA-stress exercise with its severe adverse scenario, thus also considering the impact of the pandemic, identified room for improvements in the banking sector. According to this exercise, some banks would be considerably more affected than others and some Member States seem to be more vulnerable. However, it also confirms the significantly improved resistance of the EU-banking system as a whole. The information gathered will be used in the SREP as a basis for discussions between regulators and banks. I expect necessary activities to follow which will contribute to solid and stable financial markets thus ensuring that banks remain able to perform their duties.

The EU banking sector is in a good position to overcome present and future challenges.

The ECB's Euro area bank lending survey of Q2 2021 underlines that Euro area banks expect a slight net tightening of credit standards for loans to firms of 2% for Q3 2021 which can be explained by market developments. Besides, a small net tightening impact of the risk perceptions and a net easing impact on banks' overall terms and conditions was noted on balance. The bank lending survey also referred to a moderate increase in firms' demand for loans or credit lines in the second quarter of 2021 while the share of rejected applications for loans to firms remained unchanged.

Overall, the developments of the leading indicator properties used in this survey do not signal a sharp reduction in lending to firms in the coming quarters. This all in all positive outlook for the third and fourth quarter of 2021 is encouraging. The importance of banks for the financing of companies within the EU is undisputed. However, the strengthening of companies with equity and hybrid capital is also of high importance.

I am therefore thoroughly following the Capital Market Unions' progress. In my view, we have to contribute to more financial educated people, should support a better visibility of companies and enforce more effective and efficient Capital Markets.

Legislators, regulators and banks need to closely work together to enable the recovery of the EU-economy by preserving a high and future-proof level of Financial Market stability. We have to closely monitor developments in the real economy as well as the Capital and Financial markets to set the right and appropriate measures if needed in an appropriate and targeted manner. However, in general the EU-banking sector is robust enough to constantly ensure credit supply.

It's diversified structure and the high level of market integration within the EU is of importance and should be preserved.

EDOUARD FERNANDEZ-BOLLO

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The diversity of banking business models in Europe

A business model can be seen as the total of systems, mechanisms and methods through which a bank generates earnings and satisfies its owners, clients and other stakeholders in a way that ensures it continues its business. In these terms, European banks are characterised by their different degrees of reliance on lending income (which is by far the most important income type) and range from institutions essentially dependent on lending to banks relying heavily on fee-based activities, such as asset management or investment banking. However, a mixed business model (sometimes called "universal") is also a European characteristic. In addition, there are important differences due to the funding mix (with various degrees of reliance on deposits, which entail different cost patterns), size, and channel of distribution: from small local entities, to very large retail banks present in different national markets, to some purely digital cross-border entities. There can also be very specific specialised entities, like public development banks.

From the point of view of prudential supervision, it should be stressed that, in principle, diversity is most welcome: it not only serves to satisfy different stakeholder needs, but also ensures a degree of resilience that entirely uniform banking structures could not reach. But there is an overarching imperative applying to all, which is the raison d'être of prudential supervision: all banks, whatever their business model, should be managed in a sound and prudent way that ensures their capacity to absorb the potential shocks without negative spillovers to the rest of the economy. This means that all banks have to put aside a margin of income (whether they call it profit or building up of cooperative reserves) over current costs in order to be able to absorb – in a sustainable way – future costs, in particular costs linked to the materialisation of risks.

Here is the main challenge for European banks: net interest income – the euro area banks' main source of income, which accounts for roughly 60% of aggregate income – is under pressure due to margin compression, which persists even when global profitability recovers, as it did in Q1 2021. This presents a challenge to business model sustainability. Even though in Europe the cost of risk is subdued, both for structural reasons and particularly thanks to recent government support, the current levels of interest income would not be able to absorb a marked increase in these costs over the medium term without impairing the global profitability and thus sustainability of a number of European banks.

This is particularly the case for traditional lenders, relying heavily on this margin between interest earned and paid, but it also affects – to different degrees – most of the universal banks and even specialised lenders, as they are also price-takers in a very competitive credit risk market. This heavy reliance on lending sets the European banking system apart from its counterpart in the United States, where capital markets play a larger role in financing, and banks provide more ancillary, fee-generating services. This divergence shows no signs of reversing: we continue to observe a trend of European banks retreating from trading activities in the aftermath of the great financial crisis. Their portfolios also feature less consumer finance than those of their US counterparts – a trend that is not yet abating either.

Another difference is the more diverse nature of the national markets in Europe, which is due to different attitudes toward credit, and legal differences, for instance regarding insolvency or the seizing of collateral; all of that shapes lending and products along internal borders. As a result, even within the euro area, banks have fewer cross-regional credit exposures than US banks.

Action is therefore needed to strengthen business model sustainability of the different banking models in Europe. Banks need to earn a sufficient return on their capital to be sustainable and most banks under European banking supervision currently fail to do so.

Part of the solution could be to reap the benefits of digitalisation. It is not only an opportunity to cut costs or improve the effectiveness of internal processes. More fundamentally, when its risks are properly managed, digitalisation gives banks the opportunity to reshape their processes and services offered to customers, generating new revenue streams.

Digitalisation offers many opportunities to gain a better knowledge of the customer, and it may allow banks to better satisfy the needs of their customers by increasing responsiveness to their particular situation.

Diversity should also be part of the solution: the essence of banking lies in assessing, balancing and managing risks and benefits; since different types of the risk/reward equilibrium are needed to satisfy different types of customer needs, there is place for different types of banks. There is a trade-off between complexity and diversification – banks with leaner business models, specialising more in a specific region or customer group may be able to better align their product offer and operating model to serve that specific purpose; on the other hand, they are less shielded from idiosyncratic developments of that specific activity or market.

Size can yield economies of scale and scope, which can be particularly relevant when rolling out digital platforms, and it can facilitate geographic diversification. At the same time, expansion into new markets and business activities should be accompanied by the acquisition of adequate skills and expertise in the bank's management and appropriate control function and risk management practices. Increased complexity can pose a challenge to management as cost structures, IT infrastructure, etc. become less tractable.

The choice of the specific strategic actions is in the hands of the banks' management.

Our role, which we are determined to play actively, is to ensure that this diversity of busines models develops in a safe and sound way, without being constrained by artificial barriers within the Single Market, including the presence of institutions without a sustainable strategy that are kept afloat in the market at all cost.

KARL-PETER SCHACKMANN-FALLIS

Executive Member of the Board, Deutscher Sparkassen- und Giroverband (DSGV)

Finding a proper regulatory environment for the EU's diversified banking sector

In the EU, there are about 4,300 credit institutions, 9% of which are large, 29% mid-sized, and 62% small and non-complex. Together, they form a banking sector whose diversity increases financial stability and allows meeting the demand of the real economies of the EU Member States. To maintain these benefits, policymakers have to have the entirety of the banking sector in mind when working on any regulation.

Within the EU, the German banking market in particular is marked by a variety of business models, legal forms and the complementarity of large and small institutions. This setup leads to high competition and diversification, benefitting the customer and society as a whole.

The German savings banks provide a good example of how different institutions take on specific economic and social tasks. Their regional focus and decentralised responsibility, covering the entirety of Germany, allow for quick decision-making and close customer proximity that minimizes asymmetric information. This made them a natural partner for Germany's SMEs and helped to create a close relation with private households.

To diversify potential risks, there is an interbank cooperation via the Savings Banks Finance Group bolstering the stability of its autonomous members while enabling them to realize economies of scale, for example regarding shared IT systems and back-office services. This cooperation is best reflected in their joint institutional protection scheme (IPS). During the Global Financial Crisis, these and other regional banks in Germany and Europe provided stable lending to SMEs and self-employed businesses. Again, over the course of the last year marked by the COVID-19 pandemic, they proved to be a reliable partner providing the needed liquidity, advisory services, and forbearances in addition to distributing record volumes of promotional loans.

A diversified banking sector is beneficial for the real economy and enhances financial stability.

There are good reasons to strive for a well-functioning EU single market for financial services, but it should be ensured that this is not done at the expense of a diversified banking sector. Particularly when considering that the resulting concentration would be counterproductive by introducing herd behaviour and placing crucial financial services in the hands of a few at the expense of the European customer.

Considering the challenges ahead, it will be vital that all institutions can make optimal use of their equity to finance the recovery of the real economy and the necessary transitions to come. SMEs will be confronted with the necessity of transforming their business activities in a digital and sustainable fashion, which will require innovation and investment. Given their decentralized setup, the German Savings Banks are well suited to accompany this process. Based on their local presence, they can facilitate an appropriate allocation of credit, including the rural areas. Furthermore, they can provide the tailored financial advice and services necessary, fostering sustainable investments and ecological business models.

Thus, decision-makers should have the entirety of the EU banking sector in mind when shaping the future policy framework. Amongst others, improvements are possible when transposing international capital standards. While these are designed for large, globally active institutions, the EU still largely follows a one-size-fits-all approach in its implementation (Single Rulebook). The resulting fixed costs and complexity affect small or medium-sized banks disproportionately. Due to increased awareness, the principle of proportionality already played an important role in the banking package from 2019. Now, the EU should build on these first achievements when developing its financial markets. Regarding efforts to improve the Banking Union, we see a similar picture. Instead of seeking feasible solutions, specificities of a large share of the banking sector are ignored, particularly regarding questions of deposit insurance, but also considering supervision and crisis management. The interests of small or medium-sized, regionally focussed credit institutions and the special characteristics of their network organisations must not be disregarded.

For all the above, it should be in the EU's interest to have a more holistic view on the desirable way forward for its banking sector. This is not about a preference of certain banks' business models or about lowering prudential requirements. The actual objective should be nothing less than the creation of a real level playing field by introducing measured, proportional approaches allowing for the entire EU banking sector to strive.

PHILIPPE HEIM
Chairman of the Executive Board, La Banque Postale

Diversity of banking models is an asset for the financing of the EU economy

The banking industry has a long history in Europe where various types of banks have emerged over time, shaped by history, culture, public policies and consumer needs. More than others, it has constantly evolved, not only driven by disruptive technologies and regulatory changes but also in a bid to meet growing expectations from all stakeholders, notably in terms of positive impact finance.

Diversity means robustness under economic stress

First, banking models' diversity is key to limit procyclicality, as well as to preserve European financial stability.

As the crisis taught us, European banking models' diversity has allowed economic actors to deal with the sanitary crisis while preserving the robustness of the financial system and limiting any contagion risk. To this end, banks have played a crucial role in supplying more credit state guaranteed to all who needed it.

Yet, it is critical that such diversity does not translate into a burdensome complexity: as evidenced during past episodes, being "too-big-to-manage" often comes with adverse profitability developments. Hence, the debate is on how to strike the right balance between sufficient diversification and profitability.

Diversity means adaptability and innovation

The diversity of banking models also reflects the adaptability of financial services to a fast-changing environment and to customer's needs. Individuals expect ever more simplicity, instant digital interactions while still getting the possibility of tailored human financial advice in local branches. When it comes to savings, customers also expect to benefit from a wide range of services with a growing attention geared towards the social and environmental impacts of their investments.

Diversity of banking models surely does not mean the persistence of archaic banking institutions. Since 2008 in Europe, the total number of credit institutions has decreased by 30% due to the rapid transformation of the banking industry, which has demonstrated its ability to evolve through mergers, investment in new technologies or new partnerships with fintechs.

In this respect, La Banque Postale has been able to build a leading social finance platform gathering leading actors such as KKBB (crowdfunding), Goodeed (fundraising through advertising), Lendopolis (crowdlending) and Microdon (fundraising through micro-donations). In 2019, La Banque Postale also successfully launched Ma French Bank, a fully digital bank, which accounts for more than 350 000 clients to date, while still fulfilling its public service mission of banking inclusion dedicated to more than 1 million clients through the local branches of La Poste.

In that respect, La Banque Postale enjoys a unique and original position on the French market and is now successfully evolving into a large group offering a wide range of financial services including insurance products alongside CNP Assurances.

Diversity also means differentiation

Responsible by design and in line with its imperative of ensuring a "just transition", La Banque Postale will consolidate its international ESG leadership by launching new and differentiating initiatives such as its Global Impact Weighting Factor ("2iG") for financing and investment decision or the rollout of our positive-impact consumer loan offer. Finally, after the unveiling of its company purpose, La Banque Postale will consolidate these long-term commitments by becoming a mission-led company, which is unprecedented at the European level.

Comparability and transparency are necessary

Importantly, preserving banking model diversity goes hand in hand with ensuring comparability and transparency. In the spirit of the single rulebook, common standards are necessary to ensure a consistent and fair supervision, thereby giving true meaning to what a genuine European Banking Union should be.

Striking the right balance between sufficient diversification and profitability is key.

Indeed, the demand for comparability is strongly expressed by consumers and civil society. In Europe, most banks have committed to long term social and sustainable objectives and in the wake of the pandemic the world's long term investors are reexamining their purpose or "raison d'être". In that respect, common standards, labels and measurable impacts are praised by investors and customers to better guide their investment choices.

As a wrap-up, the diversity of banking models is a source of competitiveness and innovation directly benefitting to European customers. As a public domestic bank providing a large physical network, a performing online offer while expanding its international activities, La Banque Postale's competitive edge builds on a differentiating and scalable banking model.

GILLES BRIATTA
Group General Secretary,
Société Générale

Shaping a competitive Banking Union

The French universal banking model has been a source of resilience through the cycle. However, as highlighted by the High-Level Expert Group chaired by E.Liikanen in 2012, rather than their business model, it is the level of risks taken by banks which matters.

In this respect, over the last decade, G-SIBs have made substantial improvements, propelled by regulatory reforms of the single rulebook and the establishment of the Single Supervisory Mechanism and the Single Resolution Mechanism.

Large European banks now operate with reinforced capital and liquidity, while enhanced supervisory measures and new resolution regimes are in place. Consequently, banks entered the COVID-19 crisis in a better position, which enabled them to play a pivotal role in supporting the economy.

Ten years into the development of the Banking Union, and despite the progress made on risk-reduction, progress toward completion of the Banking Union is held back by national interests, which could lead to fragmentation and be detrimental to pan-European banks.

Although completing the Banking Union is a commonly agreed goal, there are divergent approaches on what steps should be taken and in what order. Medium and small banks should be incorporated into the framework in order to avoid loopholes in the crisis management framework, which distort competition and hamper efforts at consolidation.

Within the euro area, cross-border banking has not meaningfully progressed since the launch of the Banking Union (as evidenced by M&A figures and cross-border assets in subsidiaries and branches). This is partly because the Banking Union does not fully recognize the EU as a domestic market.

While it is true that large banks have greater operational capacity to implement some measures, the principle must remain "same business, same risks, same rules". Any dilution of the common rules on MREL and the 8% minimum bail-in should be avoided, given that these provisions should be purely risk-based and increase market discipline. The proportionality principle should apply, not only with regards to the size of institutions but also considering the probability to use the schemes: contributions by the French banking industry to the Single Resolution Fund (close to 32%) have become disproportionate. Exemptions and carve-outs limit the predictability of the framework and create different interpretations which are detrimental to cross-border flows and businesses. The Banking Union framework should ensure the market exit of non-viable banks, as is the case in other jurisdictions.

The Banking Union should ensure convergence, competitiveness, and autonomy of the European economy.

The Banking Union is a step towards a Single European Market. It should support recovery and growth with the aim of convergence, especially when national economies and sectors are diversely hit by the crisis.

The objective of the Banking Union should also be to bring efficiency to the banking sector, and not simply increase costs without the potential to generate savings.

Contributions to the second pillar of the Banking Union are significant. As of July 2021, the SRF is pre-funded to the tune of approximately €52 billion. Attention should therefore be paid to the evolution of contributions and their side effects :

a. they should reflect the probability of institutions being covered either by a resolution procedure or by an insolvency procedure, and not create 'zombie' banks ;

b. the impact of COVID-19 State-guaranteed loans should be adjusted to avoid penalizing support of public-sector recovery programs ;

c. the evolution trend of contributions after 2023 should be clarified. At the same time, an incomplete Banking Union weighs on the ability of cross-border banks to make savings and economies of scale, because of ring-fencing when applying certain prudential requirements (solvency, leverage, liquidity, large exposures). The Banking Union framework should enable efficiency gains on these aspects.

Finally, the market share of EU investment banks has been falling over the last 15 years, both globally and in the EU. An EU focused on strategic autonomy should aim to reverse this trend, and this should be a common yardstick for banking union, capital markets union, and the coming reviews of MIFID and CRR.

Strong transnational European banks not only increase the resilience of the system and provide the necessary private investment and jobs but ensure that Europe is sovereign in its choice of economic growth model.

European banks are needed to finance the digital and environmental transitions, by developing European companies (75% of corporate European debt is still dependent on lending, especially SMEs), and by transforming short-term savings into long-term stable financing.

JACQUES BEYSSADE
Secretary General,
Groupe BPCE

Preserving banking model diversity in the Banking Union context: benefits and challenges

The EU wants to chart its own course on the global stage, shape its own standards through leadership while preserving its interests and values. It can only do so from a position of economic strength. One of its key strengths is the diversity of its banking sector, notably because different business models increase the overall resilience of the financial system.

BPCE, a non-listed G-SIB with its DNA as a savings and cooperative bank, combines scale and knowledge of local economies, while embracing digitalisation and sustainability. It is ideally placed to illustrate why diversity matters in banking and why European policy and supervision should focus more on sustaining different ownership structures and different banking models.

The closeness of our individual cooperative banks to their local communities provides a long-term perspective and relationships of trust, while keeping us at the pulse of the French economy. As a result we can take a more long-term view on profitability and business orientation. Networks like ours underpin local prosperity beyond the economic and demographic centres. This diversity also particularly fits with the European Renewed Sustainable Strategy as all Europe and not only major hubs should transition.

Yet one challenge we share is that our different models are not well enough understood and taken into account in EU policy-making and even in Euro area supervision. This has important repercussions. For example:

- In EU legislation projects, the diversity of banking models has not been appropriately reflected even in areas where the underlying international standards had actually been neutral. Notably, transposition of Basel IV agreement puts at stake the decentralised model of cooperative banks with a central body;

- This is aggravated by Supervision practice: the ECB as Single Supervisor has benchmarked all banks on the profitability of global listed institutions while robustness, rather than profitability is the main objective of mutual banks. Its horizontal Directorates tend to create a one-size-fits-all approach which undermines models and diversity;

- On governance, there is a fit and proper issue were the technical competence of managers is favoured at the expense of knowledge of local businesses.

Overall, this is counterproductive. First, as a cooperative we do not need to satisfy shareholders looking for pay out ratios (strictly limited by regulations) or share price appreciation (as they are not tradable). Second, many non-listed banks provide highly valued services that correspond to long-term clients' needs and public missions such as financial inclusion, while ensuring trusted relationship with local or regional municipalities and public bodies such as hospitals.

Our different business models are not sufficiently taken into account by EU policymakers and supervisors.

This one-dimensioned "one size first all" approach jeopardises the overarching objective of a sustainable "Economy that works for people".

From a banking perspective, this means that all clients – and not only the most profitable ones – deserve adequate services.

It is now time to let the European diversity in banking finance a bright future for Europe.