Q&A

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How to ensure smooth financing of the Green and Digital Recovery?

Even if the pandemic is not behind us, what are the key lessons for banks that you draw from this crisis?

First of all, even if the health crisis is not behind us, we can already say that the massive coordinated fiscal and monetary response to the pandemic has been very successful, to minimize the impacts on the economy, and to preserve jobs. This has helped businesses and households to weather the crisis, which has allowed a very robust rebound in 2021, compared to previous crisis.

Second, the crisis has brought to the forefront existing vulnerabilities, such as supply chains, and accelerated structural changes in behaviors, such as work from home, digital shopping, awareness to climate change.

In this context, banks have shown their resilience, and their pivotal role to continue to finance the economy in times of stress, also helped by targeted temporary regulatory adjustments. Banks across Europe deployed hundreds of billions of state guaranteed loans, provided moratoria, restructured debt, etc… while continuing to apply strict credit worthiness assessments. The NPL wall, expected by some, has not, and most likely will not, materialize.

At the same time, banks have accelerated the changes in their organizations and business models and ensured continuity of service while maintaining their operational resilience. Our teams can be proud of these achievements.

Now we enter in a new phase, where some restructurings will have to be implemented, while a large part of the economy is rebounding strongly, creating other issues such as inflation. Banks have demonstrated that they are best placed to engage with clients, and they are prepared to continue to do so. Whatever their business model, what matters is to ensure that they are not unduly penalized by the regulatory framework, as otherwise this would slow down the recovery. As is now better recognized, the EU economy cannot be competitive without a competitive EU financial sector.

What are the main challenges that the EU banking sector is facing (e.g. digitalisation, climate transition, macro-economic risks, demographic change…) and how are these expected to evolve in the future?

Dealing with multiple challenges is “business as usual” for banks, and most of them are well equipped to deal with them.

In particular, banks have taken major commitments to finance the transition toward a net zero economy, which will require massive work in the next few years, in close cooperation with their clients, which are on the front line to transform their industries to achieve the goals. Banks are best placed to work with clients on their transition and to monitor them. The regulatory and supervisory framework must support and encourage the banks, rather than being excessively prescriptive.

Financing the transition of our clients must be our main focus, on which human and capital resources should be allocated. We are all learning by doing together, at national, European and international levels.

Another issue is the need to improve profitability, which has been hit by low rates, reluctance to cut costs for social reasons, high competition due to overbanking, insufficient consolidation due to the still fragmented European market. Bank profitability is the first line of defense for financial stability. Over the next few years,banks’ earnings should not be captured by rising capital requirements, but rather used to finance growth, and the massive IT investments needed to develop the new generation of banking systems : instant payments, digital currencies, ESG reporting, cyber responsiveness, to name a few…

In order to win this battle, competitiveness is key. If European banks have to face competitors which are less affected by regulatory reforms, or not regulated at all, in the case of techs, they will not be able to generate the earnings needed to ensure their transformation.

After 15 years where the regulatory agenda was focused on banks and markets, it is essential to strengthen the regulatory and supervisory framework for the financial system as a whole, not only to ensure level playing field, but also to make sure that authorities have a holistic monitoring of financial flows, to capture new sources of vulnerabilities.

What are the priority actions required at national and EU levels to relaunch productive investment? How can the investment needs in relation to the green and digital transition be financed in the current macro-economic environment?

The implementation of Next Generation EU needs to be accelerated. In this very accommodative monetary policy, financing the investment needs is not an issue of liquidity, which is cheap and abundant, but of risk, which needs to be properly capitalized and remunerated.

As the EC says, net additional investments needed represents 650bn€ per year. As banks finance 80% of the EU economy, this would require an amount of prudential capital which is beyond EU banks' capacity to grow their capital base. Therefore, capital markets will have to play a bigger role, given banks will be unable to absorb this financing. At the same time, banks are better placed, notably in less liquid segments such as SMEs, to analyze the risks of their clients, based on their local expertise. The only way to get the best of both worlds is securitization: encourage banks to continue to finance their clients, while allowing them to transfer some risks to the market to reduce their capital charge. To unlock the EU securitization markets, solutions are well known, written in all recent reports. Let's move, now.

Does the monetary and regulatory banking framework allow the banking sector to actively contribute to the post Covid recovery in the EU? What additional measures or changes may be needed to support this role?

First, the banking sector should be prepared for a scenario of progressive normalization of monetary policy, and the US and UK have already engaged in this path. This will reduce the overall liquidity available and make it more expensive.

Second, the EU regulatory framework will continue to tighten. On the micro-prudential side banks will have to absorb higher RWA under CRR3, higher leverage requirements, as early as 2022, and binding MREL requirements. And on the macro-prudential side, contra-cyclical buffers are already on the rise, as well as various other more targeted measures, notably on the real estate market.

These two trends only reinforce the urgent need to make progress on the Capital Market Union, so that the tightening effect of monetary and regulatory policies does not slow down the rebound of the EU economy, and the financing of the Green and Digital transition.