DIVERSITY IN THE EU BANKING SYSTEM

GIUSEPPE SIANI

Director General for Financial Supervision and Regulation - Banca d'Italia

Diversity in the EU banking system: future challenges and way forward

Diversity in banks' business models is and will probably remain a distinctive feature of the EU banking system, reflecting also historical, economic and social evolution of the EU countries. It might increase the resilience of the system in case of turbulence, as there is the chance to compensate the failure of the most affected banks. EU GSIBs represent less than 40% of the Euro Area Total Assets (TA), while LSIs represent around 16% of TA, with spikes in some jurisdictions (e.g. 38% of TA and 45% of Total liabilities (TL) in Germany). Business models different from GSIB and 'Universal and investment banks' (26% of TA) still represent an important part of the system, accounting for 35% of the Euro Area TA.[1]

EU regulation properly considers the need to recognize the different business models by allowing simplified application of the Basel prudential requirements and reporting needs, so as to duly apply the proportionality principle based on ex-ante estimation of risk. Also supervisors apply proportionality by planning the so-called minimum level of engagement (MEL) and then evaluating the actual risk profile of the banks in the supervisory assessment (SREP).

Looking ahead, technological innovation might trigger potential reconsideration of the traditional classification of business models irrespective from the scale and main areas of activities; in particular, the banks' main strategic challenge is to seize the opportunities offered by technology and move towards the progressive digitalization of their business. Although the number of pure 'digital banks' is still limited, all major banking groups have adopted transformation strategies, fostering material changes in their relationships and reducing the close and direct geographical links between their customer base and their business.

To this end, small and medium-size firm too have increased their investments significantly to make the necessary progress (in particular in payment systems) both in their digital transformation and in the implementation of their strategic partnerships with third party providers (TPPs), thus reshaping their interaction with their customers.

In addition, the increased reliance on outsourcing exposes the banking and non-bank sectors to higher levels of interconnectedness, given also the concentration in the service providers' market. The gradual implementation of DORA will help mitigate risks related to TPPs, by requiring institutions to meet specific standards when outsourcing critical functions, and properly considering concentration risk, interdependencies, cybersecurity and data protection.

Drawing from the above, banks' business models can be impacted through three main channels.

Firstly, new business models have been implemented, for example 'banking as a platform', where platform banks incorporate business services offered by third parties, and 'banking as a service', where banks offer their own services to third parties which might not be licensed but provide them directly. Banks are thus experimenting structural changes in the profit-and-loss composition, as it mirrors the new – more fragmented - value chain of their business and reflects the actual sustainability level over time.

Secondly, smallest institutions too might overcome the limit of their size, traditionally a challenge for the sustainability in the medium-long period, thanks to services provided by TPPs and platforms. But increasing interconnection with non-financial parties could be at the cost of losing control on strategic decisions and of higher contagion risks due to the associated operational risks.

Thirdly, the growing competition of Big-Techs that provide financial and payment services have so far been mitigated by banks' strategic partnerships and material investments in fintech-related projects. The main advantage of Tech firms is operating with no legacy systems, thus allowing prompt and flexible responses to changing external conditions. Given that incumbents are confronted with stricter regulatory constraints, Tech companies can therefore exploit the information collected in their platforms by non-financial activities to design and offer new banking services. Banks are then called to review their digitalization strategies to face the ongoing competition.

Technological innovation might change the traditional classification of business models.

Supervisors should properly implement the new regulation that has widened the traditional regulatory scope by monitoring on the underlying risks rather than the legal form of transactions and/or of the firms involved so as to mitigate level playing field issues. The focus should be on the sustainability of the business model over time and the adequateness of the internal governance, in terms of strategic planning capability and availability of necessary skills, both in the staff and in the management bodies. This holds true whatever the organizational and technical solutions chosen by the banks.

1. *1 Diversified lenders, retail & consumer credit lenders, corporate & wholesale lenders and others residual business models.*

EDOUARD FERNANDEZ-BOLLO

Member of the Supervisory Board - European Central Bank (ECB)

Effective supervision to enhance the resilience of European bank business models

ECB Banking Supervision welcomes the diversity of banking business models in Europe. This diversity is a key strength that enables various financing needs to be met and facilitates the inclusion of different groups of economic operators in the financial system. As prudential supervisor, our primary role is to foster the resilience and sustainability of all healthy business models. To that end, we must strike a balance between making meaningful horizontal comparisons and paying adequate attention to the specific characteristics of each bank or group of banks. Horizontal comparisons are a crucial part of supervision as they help us to ensure a level playing field for banks and to identify peer institutions and the best practices for similar customers or markets.

Our supervisory activities are particularly useful in the current environment of heightened uncertainty and elevated geopolitical risks. One of our key aims at present is to gauge the impact of macroeconomic trends on different business models. We are analysing and challenging banks' financial projections in baseline and adverse scenarios to understand how banks are factoring the impact of the changing macroeconomic environment into their key financial and business decisions. We are also paying attention to structural changes, such as digitalisation and the green transition, and looking at how banks are seizing related business opportunities and managing the associated risks.

In parallel, we are focusing on the specific characteristics of individual business lines, banks or clusters of banks so that we can better address certain patterns or issues which require tailored supervisory actions. For example, we are currently examining the investment banking business line to better understand the risk-adjusted profitability measures applied and, in turn, adapt our supervisory approach. We are gathering information on the root causes and early warning signals of structural weaknesses in banks' business models with a view to devising an appropriate supervisory strategy to address them as early as possible. Such a strategy may envisage escalation and full use of our supervisory toolkit.

More generally, following up on last year's reviews of our supervisory practices by external experts, we are revising our approach, including how we carry out our supervisory review and evaluation process (SREP) and how the results feed into supervisory measures. We want to focus more on the most important issues while still maintaining sufficient checks to ensure that we do not overlook any areas of risk and that we deliver on our priorities. With this goal in mind, we are finetuning the processes established under the multi-year SREP approach so that our supervisors can better adjust the intensity and frequency of their analyses to individual banks' vulnerabilities and the broader supervisory priorities. This will go hand in hand with a focused increase in the use of our supervisory tools to ensure that priority issues are addressed. The exact changes to be made to the SREP methodology have not yet been decided, but the capacity to tackle major identified weaknesses will likely play an increased role, which should ensure that the specific characteristics of different business models are duly taken into account.

Our supervisory priorities for 2024-26 illustrate this new approach. In them, we emphasise the need for banks to enhance their internal governance and risk management practices. This includes traditional areas like credit risk and asset and liability management frameworks as well as emerging challenges such as climate-related and environmental risks and risks associated with the digital transformation. Banks should also have the capacity to assess the risk/reward balance across business lines and benchmark their performance against their peers. To do so, they need effective, well-functioning management bodies with strong steering and enhanced risk data aggregation and reporting capabilities. Certain banks, with very different business models, have not adequately addressed major shortcomings in these areas. This is despite ten years of supervisory engagement – the Basel Committee on Banking Supervision's Principles for effective data aggregation and risk reporting were published back in 2013. Some delays are understandable, as banks may need to make major changes to existing IT infrastructure to resolve the issues, but it is crucial that they have a clear action plan in place with verifiable milestones. In all cases, measures to address the underlying weaknesses need to be carefully tailored to the specific situation of each bank, taking into account its legal form, ownership and organisational structure. This is why the ECB is seeking to establish best practices that are tailored to these characteristics. But the banks themselves also need to prove that the nature of their business organisation allows for effective remediation. This requires the right data to be able to take the right decisions.

To reap the benefits of diverse business models, banks should build on best practices tailored to their specific characteristics.

We are therefore convinced that focusing on the effectiveness of internal governance for remediation will benefit all banks. It will provide more flexibility to tackle new and emerging risks in a rapidly changing macroeconomic environment, where swiftly identifying emerging issues is critical for the sustainability of all business models.

HARALD WAIGLEIN

Director General for Economic Policy, Financial Markets and Customs Duties - Federal Ministry of Finance, Austria

Financial market stability: the basement for broad supply of financial services

The Supervisory Review and Evaluation Process (SREP) is a supervisory tool used by regulators to assess the overall financial soundness and suitability of risk management practices of banks. The SREP review involves a comprehensive assessment of a bank's risk profile, capital adequacy, governance, risk management and its overall financial health. By the use of quantitative and qualitative factors the comparisons of banks with similar business models, sizes and risk appetite is pursued. Supervisors are brought in a position to effectively address inappropriate business behavior to prevents systemic threats on the basis of a well-founded, justifiable method.

Effective supervision is a precondition for financial market stability and well-functioning markets. While the SREP process is valuable for ensuring the stability and resilience of banks, neither the inclusion of underserved populations nor the promotion of broader access to financial services is a focal point. Nevertheless, stable, effective markets are a precondition for the participation of businesses and individuals in financial activities.

Even in a highly competitive and overbanked market, exclusion of certain customers from financial services is still possible. While competition can lead to innovation and increased access to financial services for many, there are several factors that may contribute to exclusion, especially for specific customer segments. If this is the case, financial inclusion should be addressed by collaborative efforts, targeted initiatives and policies. Specific challenges or barriers faced by underserved populations may have to be addressed by policymakers, regulatory authorities, and financial institutions.

Customers who may suffer from a limited access to finance may include small and medium enterprises (SMEs), in particular when such SMEs are new businesses or entrepreneurs who struggle to secure the initial capital required to launch or expand their ventures. In such situation, limited access to finance can stifle innovation and hinder the development of new industries.

Mature SMEs may have to adapt to a challenging business environment or struggle with gaining suitable financial means potentially impeding their growth, hindering innovation, and restricting their ability to create jobs. Individuals and businesses in some rural or non-urban areas may find it challenging to access banking services and credit facilities which could lead to economic disparities between urban and non-urban regions. People with lower incomes may face difficulties in obtaining affordable credit, impacting their ability to make essential purchases, invest in education or cope with unexpected expenses. Local governments may struggle to secure financing for infrastructure projects, public services, and community development.

Effective supervision is a precondition for financial market stability and well-functioning markets.

Limited access to finance can also affect consumer spending and the retail sector. Consumers may face challenges in obtaining credit for major purchases, and retailers may struggle with working capital and expansion plans. Industries that heavily rely on research and development or technological advancements may suffer if access to finance is limited. Lack of funding can impede innovation and hinder the competitiveness of these industries on a global scale. A comprehensive approach involving collaboration between financial institutions, policymakers, and local communities is therefore needed.

Addressing these challenges and promoting financial inclusion is essential for fostering economic growth, reducing inequalities, and ensuring that a broad spectrum of customers can participate fully in economic activities. Policymakers, financial institutions, and other stakeholders play crucial roles in developing strategies to enhance access to finance for all customer segments. Initiatives that promote financial education, technological innovation, and targeted policies can help bridge the gap and ensure that small businesses, local governments, and individuals in non-urban areas gain better access to banking services. Digital financial services could reach a broader customer base, including those in non-urban areas.

Financial institutions could adopt inclusive practices, such as creating products tailored to the needs of underserved communities and engage with local communities to better understand their needs and being able to develop suitable financial solutions.

Targeted programs should enhance financial literacy to help individuals to make informed decisions about suitable financial products and services. By implementing a combination of such strategies, the access to bank financing for economic agents across all EU territories could be enhanced.

CSABA KANDRÁCS
Deputy Governor - The Central Bank of Hungary

World changes, but protecting vulnerable customers must remain a priority

In Hungary, the difficulties of the cooperative sector are to be traced back to several reasons, many of which can certainly be found in other Member States. Among these, operational problems need to be highlighted on one hand, as inadequate economies of scale and fragmented management systems. Technological development and the launch of various payment and transfer systems accelerated in the financial sector, and the increasingly diverse and largely disproportionate regulatory expectations and risk management technologies emerging in response to the economic crisis of 2008 induced capital-intensive banking investments (e.g. in IT). Due to their small size, cooperatives were not able to properly respond to these. On the other hand, it was a recurring difficulty to find qualified professionals at both expert and managerial levels.

The chronically low level of capital and emerging profitability problems were also due to the limited financial potential of clientele of cooperatives (typically lower-income clients with limited penetration of financial products). Weak ownership (membership) control contributed to the difficulties, since the members neither having been engaged for the brand, nor they were able to exercise control over the management. Various institutional protection funds have been created, however these failed to provide an adequate umbrella, which was highlighted by the insolvency of several cooperatives. In 2013, the Hungarian legislator ordered the consolidation of cooperative credit institutions into a new cooperative integration. As a result of consolidation, by 2019, the former cooperative sector continued to operate as a single commercial bank with adequately sized operation and with a more balanced mix of clientele.

The above difficulties incentivised also commercial banks to improve their economies of scale. Substantial consolidation has also taken place in the Hungarian banking sector in the past 15 years following the 2008 crisis, the number of banks has decreased significantly. Most challenges for the cooperative sector are typical for small banks as well, the sustainable viability of small institutions needs in addition to organic growth, targeted acquisitions, or a clear strategy of specialised/niche-banking.

Even though most of us can handle their finances quickly and simply through mobile apps, access to finances has not ceased to be a challenge in the modern age. The harsh reality is that 1.4 billion people in the world (in Hungary around 12% of the adult population) continue to be unbanked. Disadvantaged people (e.g. unemployed, chronically ill, visually impaired) or those who live in rural areas often do not have adequate access to financial services, while many people do not feel comfortable using digital channels (e.g. older generations).

The global wave of digitalization and closing of branches might even worsen the situation of some and deepen digital financial exclusion, which makes this case a priority for policy makers, including central banks for ensuring that no one is left behind in the digital financial ecosystem.

The Central Bank of Hungary (MNB) has launched several initiatives that make the digital transition smoother and prepare citizens and SMEs for the related challenges. The Money Compass Foundation operates with the aim of launching financial awareness development programs for schools in cooperation with market players. The MNB's Financial Navigator program, which also includes a physical financial advisory office network across the country, provides important information chargeless for retail users about everyday finances, consumer protection topics and even a platform to compare available bank account conditions. The MNB has a dedicated recommendation for credit institutions to support digital transformation, which encourages financial institutions to provide fully remote account opening and closing and to support less digitally confident retail and SME customers with educational practices and initiatives.

Our central bank has launched several initiatives making the digital and green transition smoother.

The transition risks caused by digitalization are managed also by the revised ATM regulation, which ensures that cash is easily accessible to citizens throughout the country. Finally, mitigating cybersecurity risks is a key area in digital financial inclusion. Involving all relevant authorities and market participants, the CyberShield project informs and educates people about the security risks regarding their digital financial activities.

Sustainability is a global megatrend that is a priority for the world as well. Central banks can be active players here too. The MNB is backing the green transition in Hungary with several tools. We believe that without compromising its original mandate, there are many steps a central bank can take to promote green initiatives.

PERRINE KALTWASSER

General Manager of Risk, Compliance and General Counsel, of the Conglomerate & Member of the Management Board - La Banque Postale

A more individualized supervision to cater for each kind of banking model

"Diversity in the banking system" is not a question of highlighting one type of governance or another, or of advocating the merits of less regulation or supervision for the benefit of one institution or another. Rather, the aim is to outline the diversity of the business models and to assess the conditions under which this diversity, if it does not prove problematic in terms of concentration (e.g. 2023 US failures), can add to financial stability and contribute to the financing of growth and Europe's green transition.

Banks reflect the richness of culture, history and human needs, hence their diversity. They have to adapt their risk appetite to the upcoming huge funding and social challenges, and supervisors should help them keep the transformation momentum by adapting their own approach and tools.

Diversity of banking business patterns is necessary, beneficial and should be encouraged

Diversity surely contributes to the resilience of the EU banking system and limits procyclicality under economic stress. It also ensures competitiveness (as long as the implementation of Basel standards is subject to a level playing field) and tailored services to various customers without discrimination, from local and small businesses to blue chips, vulnerable clients to high-net-worth individuals, local investments to State debt. Diversity is even more needed to ensure just transition for most affected clients and territories; with planned investments around €30 billion (according to the European Commission), the European Just Transition Fund will be far from sufficient.

Many regulatory provisions take account of this multi-faceted economic and social role of banks: climate stress testing and transition plans, green and transition ratios, the basic payment account, allowing financial advice for all,...

Diversity should be preserved as an asset for EU stability.

La Banque Postale proves specific in many regards (Stated-owned, postal network, large retail customer base, operator of a service of general economic interest...), but it intends to both capitalize on differentiation and follow a path of "normalization" and maturity, being "a credit institution like others, but a different bank".

Diversity does not prevent from common regulation and financial solidity to reconcile with sustainability

Profitability standards can vary according to bank specificities (shareholding structure, mission-led company, public service mission...) but sufficient profitability, solvency and liquidity are required to at least cover the generation of capital and cost of risk. Adequate risk monitoring tools and governance also ensure robust decision making.

Profitability, solvency and access to liquidity over the long term are also essential to finance banks' transformation needs, above all digitalization and the green transition.

Just as important, financial solidity is essential to support new needs of all European economic players (retail and corporate) in terms of both ecological transition and digitalization. This is all the more true in a context where over 70% of European corporate financing comes from banks (versus 20% in the US), reaching 90% for individuals (versus 27% in the US)[1].

Beyond the issue of financial robustness, there is the issue of regulation. Whatever the diversity of business models, we fully subscribe to the original European choice to apply the adage "*same activity, same risks, same rules*". In this respect, the middle-size US banks setback in 2023 is an obvious example of the importance of this choice, which should be constantly reaffirmed in future regulatory developments (e.g. CMDI package).

In the same vein, prudential regulation must remain homogeneous, with proportionality only applying to reduce administrative and reporting burden.

Diversity of business models needs a certain level of tailored supervision

Due to the diversity of bank business models, supervision should navigate between two pitfalls: one size fits all and bespoke supervision, the right balance being "smart supervision", which involves anticipation, adaptability and consistency.

A "strong and intrusive supervision", as noted by Franck Elderson in December 2023, is acceptable if it remains risk-based, without interference in business choices. To evaluate whether proportionality should be applied, size is not per se an indicator of risk and supervision could take inspiration from the G-SIB methodology, using criteria of interconnectedness, complexity and cross-border activity.

Furthermore, if benchmarking seems inevitable, it should not be rigid but carefully interpreted according to each individual context: constant dialogue and explanations are necessary to ensure a mutual understanding and a proper implementation of supervisors' requests.

We therefore very much welcome the 2023 SSM initiative to "*embed agility and risk-focused approach that would translate into the introduction of new supervisory risk tolerance framework*" that should enable supervisors to better adjust their tools to bank specific business models.

1. *Source: Eurostat*

DANIEL QUINTEN

Member of the Management Board - National Association of German Cooperative Banks (BVR)

Diversity in the EU banking system: contribution to financing needs, future challenges and way forward

What are the challenges and consequences that innovation and digital transformation might pose to the diversity of banking business models?

Technical innovation and digital transformation foster diversity as they bring new enterprises with new business models as challengers in the market. At the same time, more diversity and complexity of business models makes it increasingly difficult for legislators and authorities to establish a balanced regulatory framework and to ensure fair competition. In this context „less could be more" especially if one considers competitiveness of Europe.

Are there examples or problems of a level playing field between banks, fintechs and the Gafams, particularly when it comes to technological choices and the implementation of new models for developing digital financial services (platforms, open banking, etc.)?

The dynamics between traditional banks, fintech's (financial technology companies) and GAFA in the financial services sector have indeed raised concerns about a level playing field. The aim must be to have the same or equivalent standards regarding competition, data protection and data-sharing, conduct of business, operational resilience and financial stability.

Big techs offer a diverse range of services and thus, their activities fall under several different regulatory authorities, such as central banks, financial regulators, but also competition and data protection authorities. As such, it can be challenging to coordinate policy for big techs, especially in a cross-border context. Big techs are headquartered in only a few countries but provide services across many different economies, within the same region or around the world. Host authorities may have very little traction against large foreign players for whom the respective market is very small compared to the overall business.

It is therefore very encouraging that the European Commission has taken measures to ensure access of market participants to mobile wallets for payments or other technologies. It must be avoided that digitalization and innovation lead to a concentration of economic power with a handful of actors.

Moreover, traditional banks are subject to very complex regulatory frameworks that may not always apply directly to fintechs or GAFA companies. This creates an uneven regulatory landscape. For example, fintech startups might operate in regulatory sandboxes, allowing them more flexibility to experiment with innovative solutions without immediately facing the full regulatory burden.

The access, control and ownership of customer data are crucial in the digital financial services space. The EU's open banking initiative is promoting standardized APIs (Application Programming Interfaces) that enable data sharing between financial institutions and third-party providers. However, the sharing only goes one way. FIDA will give BigTech companies access to financial data held by banks, but the latter will not have access to data collected by BigTechs. This threatens to further concentrate power and increase strategic dependence on GAFAs.

How can we ensure that prudential supervision is as neutral as possible when it comes to technological choices and encourage the development of innovation, even when the initiatives come from traditional banking players?

Regulatory frameworks need to be technology-agnostic, focusing on outcomes rather than specific technologies. This allows traditional banks to adopt innovative solutions without facing unnecessary regulatory hurdles.

For banks, as it is currently the case for fintechs, there should be regulatory sandboxes that provide a controlled environment for testing new technologies and business models. This would allow banks to experiment with innovative ideas without the full burden of regulatory compliance.

Moreover, digitalization and innovation are part of doing business; therefore, supervisors should handle digitalization and innovation as integrated in business and not as separate aspects.

Regulators must actively engage with industry stakeholders, including traditional banks, to understand their technological challenges and aspirations. This collaborative approach helps regulators stay abreast of industry developments and ensures that regulations are responsive to evolving needs.

Lastly, since the financial crisis lots of regulation and new authorities had been developed, leading to a good level of financial stability. It is time for a pause now to allow banks to concentrate resources in technical innovation (and not oblige to allocate them to continuously implement regulation). Regulators and supervisors should leave sufficient room and steadily encourage and support banks to adapt to technological changes and promote innovation.

CHRISTIAN EDELMANN
Managing Partner Europe - Oliver Wyman (UK)

It's time for banking supervisors and investors to focus on business models

The post-global-financial-crisis efforts to create a safer and more stable banking system were put to the test last year as Credit Suisse, Silicon Value Bank, Signature Bank, and First Republic all failed within the span of a few months.

Much has been written about the interlinkage of interest rate risk, bank funding, and capital in these failures. Whilst there are important lessons to be drawn in terms of deposit characterization, fund transfer pricing, and IRRBB, arguably the primary cause of these failures was the lack of a convincing business model — or management's inability to execute on that model.

Business model analysis is a critical component within the European Banking Authority; Pillar 2 capital add-on requirements are based on "a detailed analysis of the viability and sustainability of banks".

Yet for a long time a simple approach to categorizing business models has been missing. As recently as 2018 the EBA authored a paper on "a novel approach to classifying banks in the EU regulatory framework".

Business model categorization is important for two main reasons. First, it provides authorities with a benchmark for classifying institutions and supports the application of the proportionality principle to adapt capital and governance requirements to individual business models. Second, it provides shareholders with a differentiated "investment thesis" when they assess the risk/reward profile of each institution and each business model.

On the regulatory and supervisory side, more can be done to take business models into account. Different types of banks, such as local or international universal institutions, are materially different from, say, cooperative or mutual institutions. In terms of governance and organization structure, many cooperative banks put forward the principle of proportionality, since the cost of regulatory compliance can be relatively high for such institutions. Also, many have governance systems that allow clients to be elected in the governing bodies, which can make it difficult to comply with associated regulatory requirements.

In terms of capital requirements, asset mix, and shareholder structure, cooperative banks serve predominantly small- and medium-sized enterprises, and risk-weighted asset mechanisms to calculate capital requirements will result in higher capital for these institutions. In case of a deviation from minimum regulatory targets, cooperative banks might have to reduce financing capacity if direct member contributions are not forthcoming in sufficient capacity.

For a long time a simple approach to categorizing business models has been missing.

From an investor standpoint, the European banking sector remains challenged in terms of valuations. Despite a recent recovery, European banks trade at 60% of book value, with the spread among leaders and laggards remaining largely the same since 2021. Recognition of various business models by investors is not differentiated enough, and many banks resort to share buybacks and dividends as primary valuation-support levers.

Given the increasing correlation between the price/book ratio of a bank and its perceived strength, business model recognition is becoming increasingly important. Investors will trust bank management more to redirect capital towards business model strengthening when the models are clear and recognized by regulators.

At the same time, banking regulation and supervision need adapt to the ever-growing importance of the non-banking financial sector and its interconnectedness with the banking system.

Despite the explosion of debt in the system, European Bank Balance sheets have remained stable over the past decade at 27 trillion Euros and have shifted towards mortgages and liquid assets. Return on assets has dropped as a result, impacting profitability.

Non-bank financial institutions (NBFI) have assumed a more important role as financers, gaining market share in lending from banks, often holding the riskier—and more profitable—part of the assets.

On the retail side, open banking has facilitated client information flow from financial services providers to other financial services providers but also a much broader set of institutions, including fintechs and large global tech companies. While the benefits for customers are evident, open banking could create an unlevel playing field as traditional banking players are ultimately strengthening the large tech companies' already dominant customer data position. Thus, Banking regulation and supervision should capture the services provided (such as mortgage financing, deposit taking, and advisory services), irrespective of the type of provider.

This is not an easy task—but it's essential to support a robust, flourishing, and diversified European banking sector.

BENOÎT DE LA CHAPELLE BIZOT

Head of Public Affairs and Advisor to the Chief Executive Officer – BPCE Group

Moving towards a SREP that heeds cooperative banking

Policymaking is all about cycles, and 2024 is one those pivotal years. The policy cycle which started after the financial crisis 2008 is hopefully coming to an end with the implementation of Basel III reforms in Europe. Those reforms have been successful: European banks are now much more solid, with significant improvements in capital, liquidity, and asset quality. Moreover, a crisis management framework now protects both depositors and the overall financial stability.

But does that mean that our work is over? Certainly not. The next policy cycle should be all about tailoring our current regulatory framework and, more importantly, supervisory practices. After more than a decade of uniformization, our next battle should be to adapt our regulatory and supervisory framework to the diversity of the banking sector. The specificities and characteristics of cooperative banks should be fully recognized, as they are central when it comes to ensuring that our customers, SMEs, and local communities have access to adequate financing and financial products. All stakeholders need to be enrolled if we want to overcome the challenges linked to the environmental, digital, and societal transitions.

The SREP review in 2024 is, therefore, a great opportunity for European policymakers and supervisors to make a difference in the real economy. Reviewing how the SSM assesses a bank's profitability and sustainability of each business model, designs its benchmarks, and puts forward its recommendations will be key to ensure that cooperative banks will have the capacity to accompany all local stakeholders. In short, supervisory tools and indicators should better heed cooperative banks.

On profitability, we stand with our view that a better indicator for supervisors could be the residual income after distribution, and the actual capacity to endogenously create CET1, since dividends reduce the profit channeled to CET1 for commercial banks.

Furthermore, the SSM's supervision is largely based on benchmarking and comply or explain processes. We believe that supervisors should recognize in practice the specificity of banking models in Europe, especially those who proved to be sustainable over time, and supervisors need to adapt samples according to the different business models.

In our view, JSTs should not be guided only by standardized benchmarking for banks' profitability, cost and risk management, and governance. Cooperative performance and community impact metrics which reflect our business model should be included in the benchmarks.

Adapting our regulatory and supervisory framework to the diversity of the banking sector is key.

For instance, new metrics could highlight the diversity of our clients (i.e. underserved communities, associations, SMEs), the geographical repartition of our branches and the diversity of our activities, which include an important share of social and fair financing.

Furthermore, new benchmarks could involve comparisons within the European cooperative banking sector. This would also allow cooperatives to learn from each others' successes and challenges.

With these new metrics included in benchmarks, the SSM could assess the impact of JST recommendations on the cooperative business model: this would be the basis for a "business model adequacy test". Symmetrically, a bank should be able to raise an issue regarding the integrity of its business model to JSTs (impact of a recommendation), who would then have to assess the issue. The process should be further defined within the SREP review by the SSM and with a dedicated action plan.

I believe that the European cooperative banks can work hand in hand with the SSM and regulators to leverage our central role for Europeans and SMEs to be fully active and involved in the environmental, digital, and societal transition in all territories. We are hopeful that the new chair of the SSM will be sensitive to these issues.

I look forward to this new policy cycle, and I'm hopeful that it will lead to significant advancements in the recognition of the cooperative business model in Europe. For BPCE, it is essential to preserve the DNA of our Group, which supports 35 million customers - individuals, professionals, associations, corporates, or local authorities - over the long term and at every stage of their lives, by financing their future projects but also by accompanying them in difficult times. BPCE, among other commitments, is the leading private funder of the hospital and social housing in France. We are also the first bank for the social economy and for protected adults, with 640,000 vulnerable customers, including 142,000 equipped with a specific offer for vulnerable customers.