European Banking Federation: Banking for the Future - Conference 2014

(Summary created by Novares Monitoring)

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Key Points

- **Structural reforms and financial regulation:** Although Christian Clausen (EBF President) noted that the EBF supported the financial regulation reforms which have been put in since the crisis, he questioned the need for structural reforms, saying that splitting up activities would add complexity for consumers and businesses as well as increase costs. This sentiment was echoed by other attendees. Attendees also suggested that it was time for a revision of the regulations that have been put in place over the past half a decade to assess them for their effectiveness, unintended consequences, and their usefulness in promoting economic growth.

- **Changing consumer behaviour:** The conference was focused on the future of banking, and a significant amount of the day discussed how the industry should react to the rise of digital businesses which are increasingly competing with mainstream banks. Changing behaviour means that consumers are more willing to embrace mobile digital platforms. Paul Willmott (McKinsey Digital) noted that people in a traditional sector are often unwilling to adapt to change because the old formulas still work until it is too late.

Summary

Wim Mijs (Chief Executive, European Banking Federation) opened the conference. He quoted former US President Calvin Coolidge, who said, "it takes a great man to be a good listener". They chose this theme of the conference because it is a hot political issue. The industry is adapting and listening to what society needs. The strategy of the EBF was approved by the board last Friday. He introduced the President of the EBF.

Keynote Speech: The Key Transforming Drivers of the Banking Industry

Christian Clausen (President, European Banking Federation) said that they have spent a lot of time discussing the past - now is the time to discuss the future of banking. Banking is important to everyone. It is important to growth, and the infrastructure of the economy. He quoted Churchill, "history will be kind to me because I intend to write it". He can't say the same for himself, but the industry itself is writing history.

Banks are going through the biggest transformation in its history.

He addressed the key transforming drivers that will shape the future of the banking industry. Balance sheet regulation has been ongoing for five years. It addresses structures and liquidity, among other things. Most of it has been done, and more is being done. The implementation of the Single Supervisory Mechanism (SSM) on time was an achievement. It will help ensure a level playing field.

However, what remains is the cost of all this new regulation. They will have to face the huge cost of running balance sheets of this magnitude. This will impact a lot of what they do.

The second driver addresses conduct, anti-money laundering and consumer protection. It means that banks will have to control transactions and monitor them against models such as terrorist financing. Transactions will have to be in the customers' best interests. However, he worries they are creating a monster - banks are not built for policing on a global level.

Another driver is the changing behaviour of customers. They are more mobile, and use digital transactions. There are now four times as many digital transactions as manual transactions. There is a huge opportunity, but also a new challenge of building a new machine room.

Every element of the bank is changing.

The next part of the challenge is that banks need to get a decent return on the capital. They need to build a business model for the future that meets the new drivers. They have come a long way, but they have a long way to go.

The EBF has supported the regulations introduced since 2009. However, when added all together, they now think it may have become too much. They must think if this is really what they wanted to do or if it has gone too far. It may impact lending to SMEs.

60 per cent of the European economy is in the SME sector. They have created financial regulation that has made it virtually impossible to lend. It is wrong to ask what it will take to get banks' lending - they want to lend, as they have the capital. The question is how to get regulation to allow them to do it.

Structural reform has not been well designed. The European economy has been driven by the universal banks. It was the lending side, not the trading side, that caused the crisis. He asks if they really want to separate trading with forex and interest rate swaps. It will be very complex for the customer. He does not see the logic. It will also dry out liquidity. Another consequence could be reducing activity in trading, which hampers the capital requirements. A leverage ratio is a damaging thing. From his point of view as a banker, it will also mean liquidity will dry up. Money for the real economy will not be there.

The European banking sector has 26 trillion euros in lending. The US has a much bigger capital markets. They welcome and support the building of a Capital Markets Union (CMU), but it is important to note that it is the market that built it. One cannot regulate one's way into a CMU.

It is time to recalibrate the leverage ratio. It has gone too far.

The EBF are supporting all the new regulation, apart from structural reform. But now is time to recalibrate.

In history, regulators will want to say that after the financial crisis they did everything right. But there are other possibilities - that history will say that they became so obsessed with this financial crisis, they over-regulated, and forgot to recalibrate.

Panel I - The Changing Supervisory Landscape

Panellists

WAS NOT PRESENT
Olivier Guersent, Deputy Director-General, European Commission
Wilfred Nagel, Chief Risk Officer, Member of the Executive Board, ING Group

Jerome Brunel (Chair, SSM Strategy Group, EBF) introduced the panellists. He invited them to respond to criticisms of the stress tests.

Olivier Guersent (Deputy Director-General for Financial Services and Internal Market, EU Commission) said that it is important to show the European banking system is in good health. The stress tests are important because it is the end of the debate on how healthy the European banking sector is. This process clearly shows the health status. The banks were able to prepare for these tests because they knew they were coming. The self-disciplinary impact of the process is important. It does not mean that no bank will have problems in the future. There are always a number of unknowns. It is important that they now enlighten the path to the future.

Brunel asked if the ECB should launch this exercise again.

Guersent said that they should. The tests have been good for the markets. But the cost is such that it would not be reasonable to make it a recurring, annual event. They can now confidently say that there is no major health risk to the banking sector.

It does not add credibility to the tests if one takes extreme scenarios.

On the question of the German savings banks, they have the regulations they have. It is not exactly what the Commission proposed, but it is not reasonable that they are expected to regulate these 5,000 separate banks. They are a myriad of risks, some of which are extremely small. Frankly, they have to make a cost-benefit analysis. In Banking Union, the top banks have about 80 per cent of the market. The system would not be made better by separating those banks.

Wilfred Nagel (Chief Risk Officer, Member of the Executive Board, ING Group) said that the process was "interesting". This is an opportunity to create transparency. As an industry they should embrace the results of the exercise. What was new for them as a European bank was that they had to rebuild their machinery. The European banking system is used to regulation by analysis rather than data delivery.

It was important to combine the Asset Quality Review (AQR) and stress tests. The parallelisation of the two was a challenge, but they understand the time constraints. They spent a lot more time on AQR than the stress tests. However, the AQR had a much smaller impact than the stress tests.

There was criticism of the scenario. The wider public tend to think this is all about asset quality. However, this ignores the other aspect - the impact of the interest rate scenario. They have created a realistic total impact, but the interest rate scenario had a much larger negative impact for them.

They did informal calculations that showed that leverage would have barely moved in this scenario.

He turned to the criticism that there was the exclusion of systemic risk in this scenario. He would argue that it was tested. There were serious consequences of the scenarios.

Brunel asked if analysts are now more comfortable with the European banking system.

Nagel replied that analysts were generally comfortable with them even before the stress tests, but they welcome the extra transparency.

Brunel asked about the impact of the tests on the changing landscape. Will they change the way banking in Europe is done? What impact would they expect on banks headquartered outside of the eurozone?

Nagel said that it will have a major impact. Local regulators and governments have begun to ringfence even more. One would expect the SSM to remove these gradually overtime. This will make banks more efficient, and the European capital markets more effective. In his own bank, they have billions which they have to keep hold on. That could be made use of.

Brunel noted that Daniele Nouy has been adamant that she wanted to take away national discretions and harmonise regulations.

Guersent said that at the end of the transition period, nine years from now, they will have a functioning regulatory system. Already, the SSM has had a defragmenting impact on the system. There are a number of national discretions. Most of them are transitory in nature. The SSM can ignore the discretion for the stress tests, so it is clear what their impact is.

They need to be confident that they have the tools to handle the situation.

Panel II: Growth in Europe

Panellists

Mahmood Pradhan, (Deputy Director Europe, International Monetary Fund)
Arnaldo Abruzzini (Secretary-General, Eurochambres)
Jakob von Wiezsacker MEP (S&D, Member of the ECON Committee)

Mijs said that the CMU reminded him of the Financial Services Action Plan of 1999. President Juncker's 300bn euro investment plan, like President Roosevelt's New Deal, is supposed to be geared towards growth. He introduced the panellists.

Mahmood Pradhan (Deputy Director Europe, IMF) said that the IMF's role is more than an outside observer. They have come a long way since the crisis. They are faced with a weak recovery. There is weak domestic demand across the eurozone. Investment is well below pre-crisis levels. If ones compares the eurozone to Japan or the US, investment in the EU is 18 per cent below pre-crisis levels while in the US and Japan it is above those levels. The IMF welcomes the positive news about the banking sector in the EU. They are faced with high unemployment levels throughout the eurozone, particularly youth unemployment. They have associated with this a very worrying inflation outlook. Europe actually fares well in sovereign debt compared to other regions. The debt burdens are still very high in a number of countries. Low inflation poses a very challenging adjustment. If one takes a country like Italy, where sovereign debt is over 130 per cent, in addition to low inflation and weak growth, it is difficult to see how to reduce that debt.

There is an issue of financial fragmentation across the eurozone. This has been addressed forcefully, and they are in a much better position than they were two years ago. However, they are still at the point where borrowing costs in Spain and Italy are about 200-300 basis points above Germany. There are only a small number of countries where inflation is above 1 per cent, a large number are significantly below that and there are five or six countries with negative inflation. If one looks at countries that are highly-indebted, real interest rates are significantly higher. This is the central problem.

The AQR and Comprehensive Assessment have done a lot. There has been progress and the SSM should help in this area. But one thing the stress tests have revealed is long exposures.

The market reaction to the stress tests has been positive. However, banks' prices have not performed so well. The 2009 US stress tests generally had a line going up. There are some areas where Europe needs a lot of work. They are very encouraged by what the EU is doing. Fiscal policy is no longer a major drag on demand. There is a need to be more ambitious on structural reforms. They are crucial.

A CMU would help to make the system more resilient. In terms of SME finance, there needs to be this initiative about more direct investment, which is more centralised for the eurozone.

Analdo Abruzzini (Secretary-General, Eurochambres) said that they try to remain optimistic. The study they will release in ten days makes several findings. One area where an impact is expected is investments. The expectation of the business community in the eurozone is that investment levels will continue to decrease. This is frightening.

There is no single measure that could change this. The micro-level is what interests him to address this. Much of what is discussed in SMEs is that banks will not lend them money - it does not matter if it is true or not true, it is a sentiment. The challenge is making business leaders and finance work together. How can they be part of the solution?

Entrepreneurs want to see a constructive, optimistic approach.

The 300 billion euros investment programme would be a drop in the ocean. The investment gap has been more than 1 trillion euros. The question is if banks can be part of the solution. It is not the right approach to regulate banks harshly. Many businesses do not consider banks to be a partner, but something to fight.

Jakob von Weizsacker (MEP, S&D) asked the audience to consider a scenario of 0.1-0.2 per cent growth in the eurozone. This is a scary thought but they need to think about it. They have heard it is not clear how it will change in the near future. There is the problem of public and private debt, and internal structural reforms, with social implications for this. Spain is held up as a model country for reform, but a party which did not exist nine months ago is now leading the polls. He would agree with the speech from ECB President Draghi that the idea that monetary policy alone can deal with this problem is naïve.

Juncker's investment package will be unveiled next week. He is not confident of getting all the reforms that they need.

One could argue that part of this could be used to subsidise banks more. He does not think this would be a wise strategy.

There are a number of big banks in Europe that have balance sheets with a ratio of 20 per cent or more.

Mijs questioned the need for structural reform. The IMF had a clear list of things that still need to be done, while Abruzzini gave a very worrying conclusion about businesses' attitude to banks.

Insights: Digital customers

Speakers

Mark Jamison (Director, Customer Experience and Business Intelligence, BBVA)
Paul Willmott (Leader of McKinsey Digital, McKinsey & Co)

Pia-Noora Kauppi (Chair, Executive Committee, European Banking Federation) welcomed the panel.

Mark Jamison (Director, Customer Experience and Business Intelligence, BBVA) said it would be easy to show some shocking statistics about the proliferation of digital banking. Retail banking is facing an existential crisis. He referred to Darwin's theory that the one who survives is the one most adaptable to change, comparing it to the economic theory of Joseph Schumpeter, who said that capitalism is an evolutionary process. The Fortune 500 was created in 1955, and the average company was over 90 years old, now the average is less than 20 years old. Less the 15 percent of the original members still exist. He compared the success of tech companies such as Apple and Google.

He compared the situation of banks to Jurassic Park, in that they were dinosaurs protected by a "regulatory moat", until someone "built a bridge across to it". They now have to adapt.

The iPhone is only seven years old, and yet industries are being "eaten" by apps, such as atlases, cameras, travel agents, weather TV channels, publishing companies, and recording companies.

The banking industry is a target for digital competitors, but not in all sectors of banking - competitors decide they want to be the best at particular niche sectors of it - for example, international transfers.

He concludes that they have an existential crisis and a "burning platform for change".

Paul Willmott (Leader of McKinsey Digital, McKinsey & Co) said that there are a section of industries in the "eye of the storm", which are going through rapid change - that includes banking and insurance.

There is a trend of price pressure. People can see the price of anything, anytime. The more digitally aware someone is, the more price pressure there is. The consumer will force industries into transparency.

There is also unexpected competition. Going digital reduces the barriers to entry. Big digital brands can stretch easily. He cites Amazon giving credit to its small business providers as an example. They are building expertise in credit risk.

Another advantage is that variable costs are very low.

He said that half of the jobs in the US are subject to being automated. Banking does not escape from that. 85 per cent of customer-facing banking activity could be automated. Banks will have too many people, but not enough of the people they need.

There is an issue of globalisation and centralisation. Consumers are increasingly willing to shop cross-border. This is driving a shift in the way global banks are structured.

The low barriers to entry, increased economies of scale and an accelerating diffusion of the market are leading to relentless reinvention. This has not come to banking yet - he is citing the music industry - but he expects that it will come to this industry.

Kauppi noted the quick growth of Alibaba in China.

Jamison said that Alibaba has a large market size. It also has a lot of services. It has a specific investment in doing payments in Fintech.

Willmott agreed. He has talked to a lot of banking executives who think they know all about digital, but actually they are behind the curve. Alibaba has taken 10 per cent of deposits in China. It is prepared to take very small margins. They are innovative in interacting with customers. It has an exciting interface. Their ambitions do not stop in Asia.

Kauppi asked what the main reason is that banks have not adapted. Is it regulation or the cost of legacy systems?

Willmott said he worked with the music industry in the nineties, and there are parallels. Executives are reluctant to adapt to change, because they do not want to change a model that is - presently - winning.

Jamison said that many banks have done a series of acquisitions, and adapted to digital in a very piecemeal way which is difficult to replace later. Digital companies do not have the problem of legacy systems. They can adapt their product without massive investment.

Kauppi said that banks often say the try and error system does not work for them because of regulation. Is that correct?

Jamison replied that is a hard issue that needs to be tackled. They could agree to a set of principles when launching new technology, whereby people understand they are taking part in a beta programme.

Question from the floor said that the news last night was that Google is stopping its wallet for some digital activities. Not all of these technologies are guaranteed to succeed. In this area, are established companies advantaged in this respect?

Willmott said that start-ups are jealous of banks because they have a lot of information about their customers. They probably know more than the government. People will engage more with a digital company. This gives more opportunity to build a relationship.

Jamison said that there is an incumbency advantage in that people trust banks more than Google, for example.

Kauppi said that banks survived the financial crisis, and now they must survive this storm. What would the panellists do if they were "banking god for the day".

Willmott said he would start by educating the top team of banks.

Jamison agreed.

CEO Roundtable: The Bank of the Future

Panellists

Douglas Flint (Group Chairman, HSBC Holdings)
Frédéric Oudea (CEO, Société Générale)
Johan Thijs (CEO, KBC Group)

Clausen opened the Roundtable.

Douglas Flint (Group Chairman, HSBC Holdings) said that the debate up to now has been about too big to fail and structural reforms. Total Loss Absorbing Capacity (TLAC) was a response. It forces stakeholders to face up to their bail-in responsibilities. The good thing about the reforms is that they set a good example for loss-absorbing capital. They put them in a good position on the trust issue. It can be aligned with the individual resolution strategy.

There are issues around subsidiaries in other countries.

He questions the changes that would be needed in the business model, and the effect on creating a level playing field. He asks who is going to provide liquidity if a bank cannot pay - do people understand what the risk is?

Almost by definition, this will divert money away from the real economy towards the banking system. This is curious, as it goes against the growth agenda. The regulation agenda means that the institutions will be even bigger, and even more important. The deposit flows will be more concentrated.

His final point is about protecting the taxpayer. People say that the resolution mechanism protects the taxpayer, but that misses out that losses are hard-wired into the pensions system.

Frederic Oudea (CEO, Société Générale) said that this Conference has focused on the challenges of all banks. The eurozone economy has a more challenging task because they have just entered Banking Union. He thinks this is a success. It was very challenging for the regulator, but it provides a good base. There is a good regulator with the energy and determination to build something which works.

Beyond what they have been talking about, beyond complying with global regulation, he feels they are entering a challenging period in the eurozone. There will be a harmonisation in the implementation of the legislation. There will also be attempts to see the effects of all this new regulation. A condition of good growth is to have good credit growth.

On one hand, he believes there will be further consolidation in the retail market. He cannot see how a small retail bank can compete. Consolidation is being seen already in many countries. There are large banks, which can compete on a global basis, but they will have to be more compact.

Banks will have to select their core competencies, and where they want to compete. There will be a refinement of business models over the next five years. The first year of the Banking Union has been a success.

Johan Thijs (CEO, KBC Group) referred to the 'Jurassic Park' analogy of an earlier panellist. The model worked well for banks for a long time. They built it, and they built trust in the system. This was shaken in 2008. The digitalisation of the industry is happening. That has changed their environment fundamentally.

On the question of whether they will survive, he thinks this is still a strong probability. Banks are still trusted with people's money.

Customer centricity is something that everyone talks about, but what is it? It is about, among other things, responsiveness. The propensity in the digital market for one company to dominate is also a challenge for banks.

Clausen said that a powerful argument on considering the balance sheet is considering the customer need. Half of the balance sheet is about facilitating the corporates to do hedging and derivative lines. He questions, referring to his speech earlier in the Conference, why they would want to split that.

If there is anything left to resolve, they need to be more specific about the issue and regulate where needed. However, structural reform is a big hammer, and clearly wrong.

Q&A

Question from the floor asked about the consolidation of the market.

Oudea said that the costs and challenges are present. Banks are looking at ways to consolidate costs, but beyond the traditional consolidation, there might be limited options. There could be changes to help banks compete with companies like Amazon and Google.

Question from the floor asked about the unintended consequences of regulation. Are they confident that regulators have the tools to evolve that regulation?

Flint said that he has sympathy with regulators because the mandate they are being given is very one-direction - stability, protection, "never again". He senses that prioritisation will now shift towards an emphasis on growth, so people will consider the impact of regulation on growth, such as concerning the cost of capital. They need to say to the regulators, keep doing what they are doing, but ask themselves the question, "does this enhance growth?"

Clausen said the hope is that they get to a stage where lawmakers start to review whether regulation has gone too far. When he meets the supervisors, it is clear what their view is. Finance Ministers want to talk about growth all the time. This is the time when they can talk about recalibration and unintended consequences.

Question from the floor asked about concerns on shadow banking. A report claimed that the total shadow banking assets are more than twice as much as banking assets. Is this also an opportunity for banking in the future?

Oudea said that capital markets should be focused on. The willingness of the regulators means that there will be more clearing platforms, and more clear products. There are risks, and more work needs to be done to ensure sound practises. Having more assets outside the banking sector is a direct consequence of regulation in the banking sector.

Thijs asked how the regulators will react to entity-focused products which grow suddenly outside the banking sector - should regulation shift horizontally?

Flint asked what the system would look like when all the jigsaw pieces are in place. No one has that complete picture of where they are really going.

Clausen said that if further lines are crossed, it might be an issue for regulators. He welcomes the sector, but he does not believe regulators will allow them to enter market without similar regulations.

Question from Finance Watch noted it would be good for this panel to have represented all models of banking. They asked about diversity in the banking system. The main issue for too big to fail, apart from the size of the institution, is the interconnectedness. A problem for one bank is a problem for the whole system.

Flint said that they will see a lot of new entrants into the marketplace. Many industries, like supermarkets, would be able to enter the payments industry - the question is whether they want to. For example, the Marks and Spencers Bank in the United Kingdom has their branding, but the backend of it is HSBC.

HSBC has survived and done well through many crises because of diversification.

On too big to fail, the solution is not the number of buckets, but instead mending the hole in the roof. Sovereign debt and housing finance are the only things too big to fail. The interesting thing is that very few banks have seen significant customer attrition. That means they either think all banks are as bad as each other, or they think they are heading in the right direction.

Oudea said that they have to live in a world where there will be more diversified products in the marketplace. He cannot help comparing the US and EU banking sector. He thinks that is how regulators want the EU banking sector to evolve. A lot of the ratio has been established by liquidity. The most important thing for him is to ensure that customers are happy to stay with the bank.

Question from the floor about the opportunity to buy stressed bank assets. Governor Mark Carney made a speech in Singapore about regulating fixed pay. What was their reaction to that?

Oudea said that they saw in the crisis the difficulties of consolidation. In the UK and France there is already consolidation of the market.

On salary, a lot has already has been done, and he is not sure that more needs to be done.

Thijs said that it is too soon to say on stressed assets, but banks will have to be accountable to their shareholders. Banks will have to assess whether they will contribute to their profitability.

On remuneration, he did not hear the speech, but this is an ongoing issue. The question is what constitutes excessive salary. He compares it to the salary of a football player - does the relative value make his salary excessive?

Clausen said that he thinks no one can accept excesses, but regulation in this area always goes wrong. The more that is added, the worse it gets.

Flint said that the IMF has shown that the assets in Europe do not cover the cost of capital. That requires a response - whether that is the industry has to consolidate, the price of banking goes up, or investors accept lower returns. Yet, the regulation has not had an impact in seven years on the return for investors. So the question is, if the regulation has made the system safer, why is this not reflected in the investors' returns?

Question from the floor asked about consolidation in the banking sector. Are banks getting too complex to manage?

Thijs said that complexity was initially a barrier to entry, but now it works against them.

Oudea said he expects banks to become more compact, and reduce complexity. All the regulation is designed to have higher costs.

Flint said that he thinks the banking sector has evolved to make them more complex. All the risk management comes through products. The question arises how to absorb and redistribute risks. Risks outside the financial system are unhedged. The industry will continue to be complicated; the issue is keeping it transparent.

Clausen said that themes of efficiency, complexity and profitability are common. He thanked the panellists.

Keynote speech

Frederic Oudea (Incoming President, European Banking Federation) paid tribute to Christian Clausen. The previous President took over in 2011, which was a difficult time for the industry. Not only has he succeeded, but he has improved the profile of the EBF.

Oudea takes over as President from 2015. They must restore trust in the sector.

Their first priority is looking at how they can ensure the financing of the economy, and better anticipate the Single Market. The regulation of the past few years was rightfully designed to make the system more resilient. There is a lot to be done here. The EBF wants to be involved in how the regulatory framework can support the right financing of the economy.

The European Commission has set the CMU as a top priority. This is very important. They have seen fragmentation in this area. They have to ensure the flow of saving goes to the economy to create jobs. They have to convince the regulator that Europe cannot have growth without not only a resilient but competitive banking industry. The EBF will be engaged, and show with concrete examples what is taking place on the ground.

The second priority is supervision and the SSM. The EBF wants to be an engaged partner. The EBF is the right institutional channel to have dialogue with the new regulator. Given the importance of the UK in the financial sector, there needs to be a way to ensure regulators in the eurozone and the UK look at the same issues. There should be common views on issues such as securitisation. They need to underline cooperation with regulators outside the eurozone, and the UK regulator as well.

The capacity within the EBF to propose best practice and take the initiative should be part of their agenda.

The EBF also prioritises digital banking. This is not just about the challenge of adaptation. It is also about the regulatory environment and the legal issues. They should remain humble in this area. There is more investment to be done on issues such as data protection. Cyber security is becoming one of the most important topics.

The EBF needs to bring positive energy. He is proud to be a banker. The EBF will be important in meeting the challenges going forward.

Mijs said that this Conference has been positive because everyone has been open on the opportunities and challenges. This Conference is not a one-off, but part of an ongoing dialogue. He thanked the attendees, speakers and sponsors, and closed the Conference.