CEPS IDEAS LAB

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Reconstructing the Union

Conference Report

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Finance

Will banks survive the age of digitalisation?

Discussion Leaders: Alvaro Martin, Head Economist, Digital Regulation, BBVA Research; **Michael Stephan,** COO & Founder, Raisin; **Olivier de Groote,** Managing Partner Financial Services Industry, Deloitte, Belgium

Moderator: Sylvain Bouyon, Research Fellow, CEPS

While banks have had difficult years since the crisis, with poor financial results and significant deterioration in consumer trust, restructuring and regulatory intervention have helped them to recover. One of the current challenges for banks is the low interest rate environment. By contributing to cut operational costs, digitalisation has been seen as a potential response to this particular challenge. Nevertheless, in coping with the difficulties in their digital transformation, banks need to question many aspects of their business models: ICT systems, tax systems, internal human organisation, etc. In this respect, there are some serious legacy issues that need to be overcome. In order to be competitive and improve customer services by increasing speed and accuracy, many systems need to be radically reshaped. This transformation requires new skills that banks generally do not have themselves and which are fairly difficult to acquire.

Conversely, new entrants such as Fintech startups have no legacy issues, resulting in short lines and high flexibility in their decision-making process. Banks know how to spot the FinTech startups they need to acquire or collaborate with in order to support their digital transformation, but often prove unsuccessful in integrating them efficiently. Potential new entrants such as GAFA (Google, Apple, Facebook and Amazon) have some advantages and might be able to target some attractive niche markets; however, if they decide to deploy significant resources to enter the banking market, they will have to address the issues related to the multiplicity of banking rules.

Against that background, it is still not clear if policies will end up protecting banks in their digital transformation rather than favouring new market players. Overall, whereas policymakers need to continuously address specific risks related to consumer protection and financial stability, they also need to ensure that providers have sufficient room to innovate constantly. In that respect, the use of regulatory frameworks such as sandboxes can help supervisors better monitor the innovation dynamics in financial services, especially by being informed of new products much more in advance. To conclude, although the real future impact of technologies such as blockchain seems to be difficult to predict, questions can be raised about how such technology could lessen the compliance burden.

Implementing the new regime: bail-in and systemic risk

Discussion Leaders: Nadège Jassaud, Head of Unit for Resolution Strategy and Cooperation, Single Resolution Board; **José María Roldán,** Chairman and CEO, Spanish Banking Association and Vice President, European Banking Federation; **Philippe Lamberts,** MEP, and member of the ECON Committee

Moderator: Willem Pieter de Groen, Research Fellow, CEPS

This Lab session assessed the challenges for the resolution regime, which is the main novelty in the post-crisis regulatory and supervisory financial architecture in the EU. The resolution framework must ensure that banks and supervisors are, on the one hand, better prepared for resolution. On the other hand, that the losses will be wound down on the bank creditors through a bail-in rather than on taxpayers, as was the case during the crisis.

Philippe Lamberts, Nadège Jassaud, Willem Pieter De Groen

The resolution mechanism is still a work in progress on various fronts. Although the mechanism is already operational, the resolution authorities are still working on drafting the resolution plans and the banks are still in a transition phase to close the €100 billion gap in minimum required bail-inable liabilities (MREL). There are, however, some more structural issues that still need to be addressed to make also the resolution of mid-sized and large banks credible. Currently there are no provisions establishing who may hold bail-inable liabilities, which may mean that some creditors who are supposed to be bail-inable prove not to be so after all (e.g. some retail clients, other banks). There is also no back-up facility if the resolution fund proves insufficient. Moreover, the required liquidity provisioning is only implicitly arranged through the existing Emergency Liquidity Assistance (ELA) facility of the central banks, which is officially only available for solvent institutions with a liquidity shortage.

Several policy and supervisory measures were proposed to improve the functioning of the resolution mechanism and enhance the credibility of the resolution mechanism. The sales of bail-inable liabilities might, for instance, be restricted to 'sophisticated' investors that are able to assess and diversify the risks (e.g. pension funds, insurers). In order to improve the ability of those investors to determine the riskiness of the bail-inable liabilities, the resolution authorities and/or the banks should consider disclosing at least part of the resolution plans. The European Stability Mechanism could function as a backstop for the resolution fund. Finally, the liquidity issues could be addressed with a special ELA facility established exclusively for the banks that are being resolved.

Strategic Investments and Development Banks

Discussion Leaders: Benjamin Angel, Director, Treasury and Financial Operations, European Commission and member of the Steering Board, European Fund for Strategic Investments; **Iliyana Tsanova,** Deputy Managing Director, European Fund for Strategic Investments, European Investment Bank; **Debora Revoltella,** Director, SG Economics Department, European Investment Bank

Moderator: Karel Lannoo, Chief Executive Officer, CEPS

This session focused on three issues: i) the overall performance of the European Fund for Strategic Investment (EFSI) since its creation two and a half years ago, ii) the interaction of EFSI with the private sector and the banking sector, and how this can be improved and iii) the macroeconomic impact of EFSI, particularly on investment in the EU.

Since summer 2015, when EFSI was officially launched, more than 400 projects have been approved in 28 member states, leveraging 54% of the full €315 billion envisaged. Due to this significant performance, investment in the EU is picking up and recovering, as a recent survey by the EIB reveals. This is happening in a very uneven way among countries, asset classes and firm size, however, for a number of reasons. The distribution of funds is mainly concentrated towards old member states and only 8% is being channelled towards new member states. There is a general lack of transparency and understanding about how EFSI works. More focus should be placed on climate change (green finance and sustainable investments) and SMEs, while the cooperation between EFSI (EC and EIB) and the local financing institutions, and the local development banks, needs to be improved. Nevertheless, financial instruments will not change the market overnight. The right balance between traditional activities (i.e. infrastructure and climate) and new financial instruments is crucial. What matters is the quality rather than the quantity of capital and how to motivate technological shifts and innovation.

There were several important recommendations to further improve and strengthen investment within the EU. For example, to incorporate more private investors, one recommendation was to slice projects into senior (triple- or double-A rating) and junior tranches, to allow development banks to invest in the former, while private investors could invest in the latter. The development of public-private partnerships could also be a way forward, but public opinion does not always support these initiatives (i.e. the state selling its assets), while investors don't want to own the assets, only to invest in them. Better education of the general public on PPPs and their effect on Europe's economy could also be helpful. Finally, more work is needed to finance SMEs, especially on the maturity of lending and on collateral requirements.

Recommended reading from CEPS research:

The Future of Retail Financial Services: What policy mix for a balanced digital transformation?, **February 2017**

Sylvain Bouyon

European Bank Resolution: Making it work!, **January 2016**

Thomas Huertas

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