

EBI CONFERENCE

What is the future for small commercial banks in Europe?

Ljubljana, 19. 10. 2018

An event organised under the auspices of the
Faculty of Law at the University of Ljubljana
and The Bank of Slovenia

Centre for Legal and Economic Studies: CLES@pf.uni-lj.si



Pravna fakulteta
Univerza v Ljubljani

Keynote speaker

**Ms. Daniela Chikova, A.T.Kearney: The future of retail
banking**

Centre for Legal and Economic Studies: CLES@pf.uni-lj.si



**An event organised under the auspices of the Faculty of Law,
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What future for small commercial banks in Europe?

A.T. Kearney presentation
October 19, 2018

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Insights from the AT Kearney Retail Banking Radar

The A.T. Kearney Retail Banking Radar tracks 92 retail banks in 22 European markets

The 2018 Retail Banking Radar



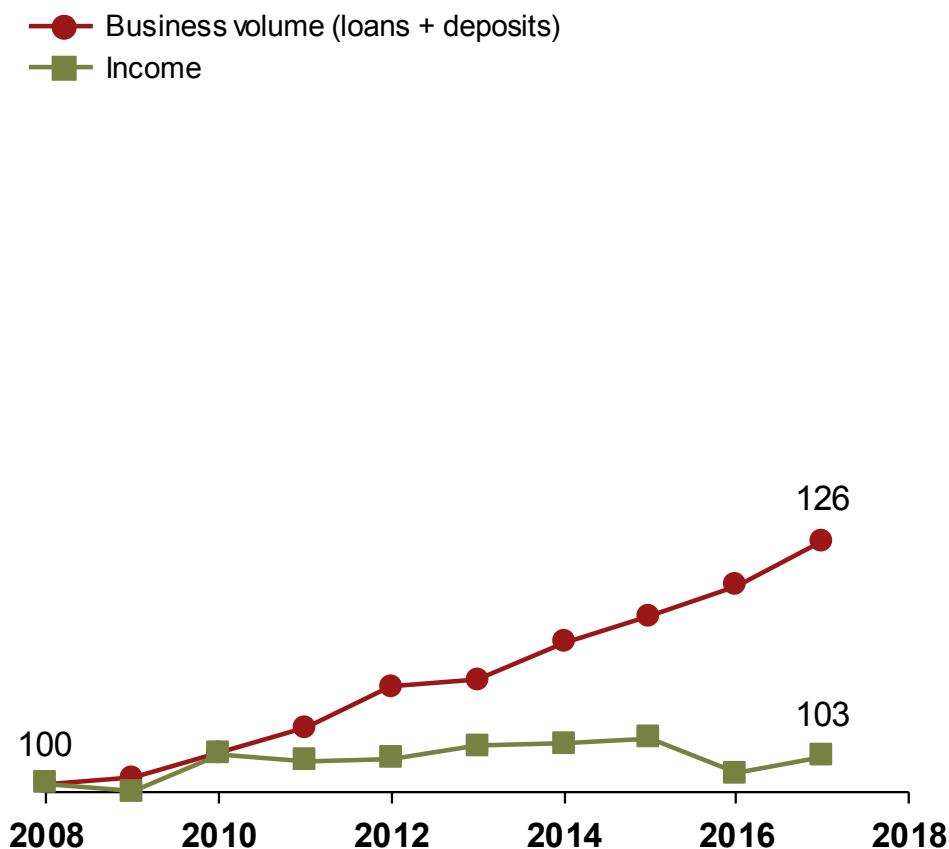
- 92 retail banks and retail banking divisions in 22 European markets: **50 banks in 13 Western European markets** and **42 banks in 9 Eastern European markets**
- These institutions account for anywhere between **60-90% of local retail banking markets**
- Around **630 million retail banking clients** served in more than **110,000 branches**
- Retail banking segment includes **individuals** with assets under management up to €1 million and **small businesses** with annual turnover of up to €5 million (varies from bank to bank)
- Several dimensions around **income strength, operational efficiency and risk management** analyzed
- Database built from official bank records from **January 2007 to December 2017**

European retail banking in a margin squeeze

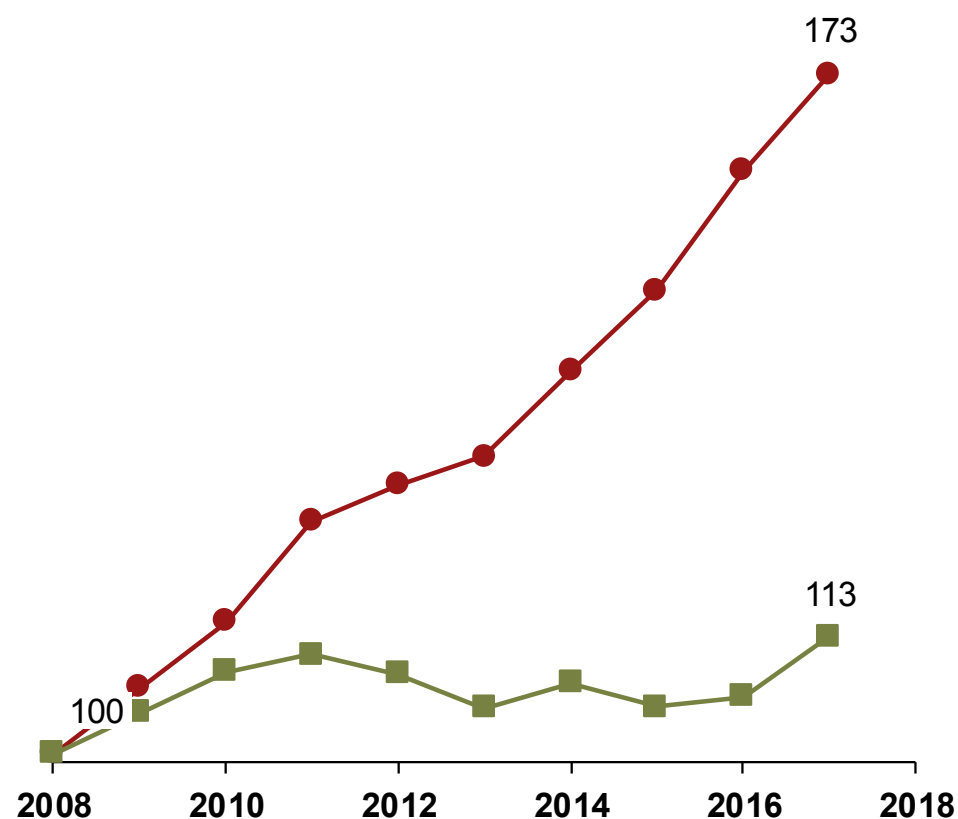
Retail Banking Performance – 2008-2017

(Index, 2008 = 100)

Western Europe

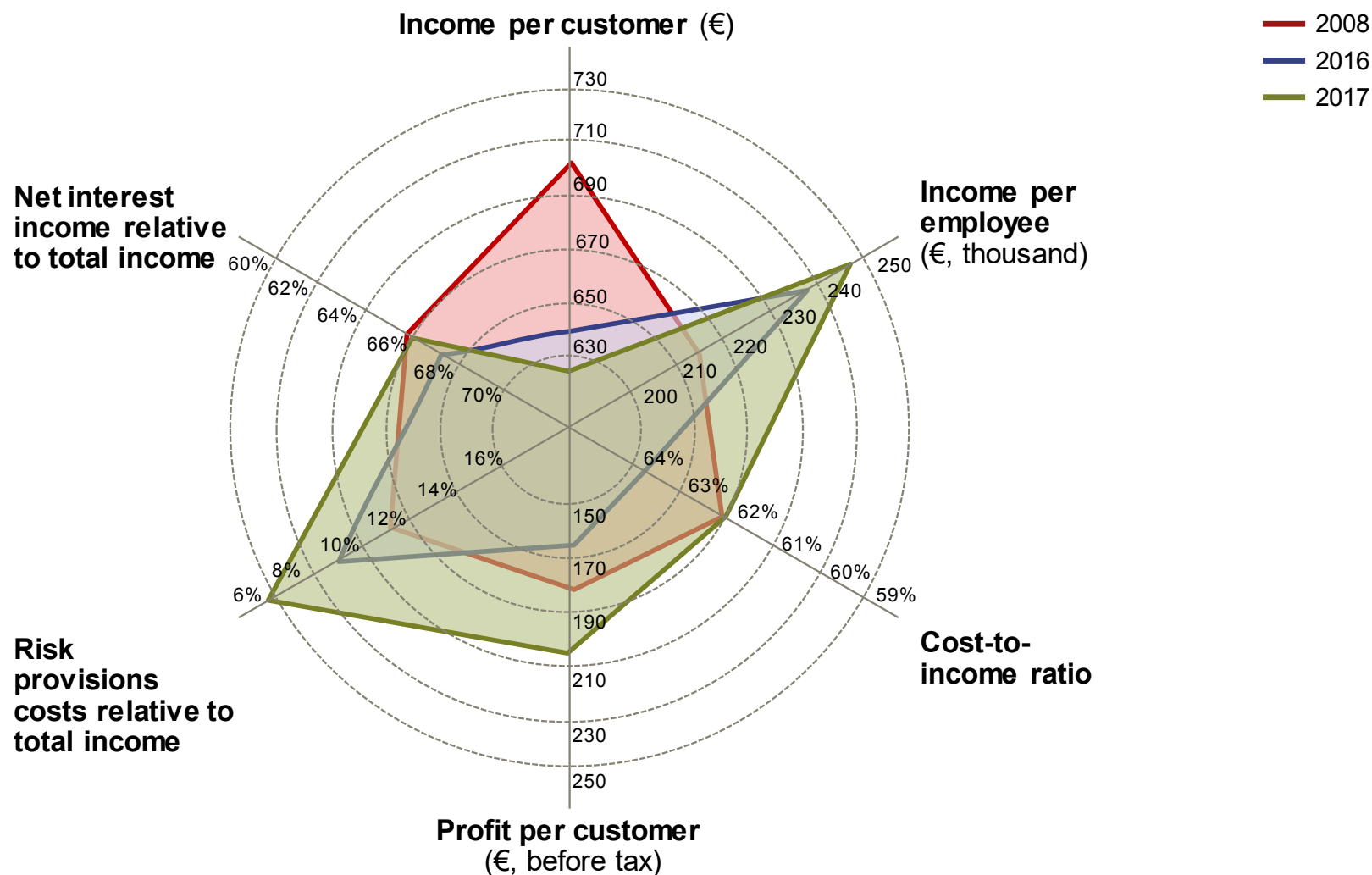


Eastern Europe



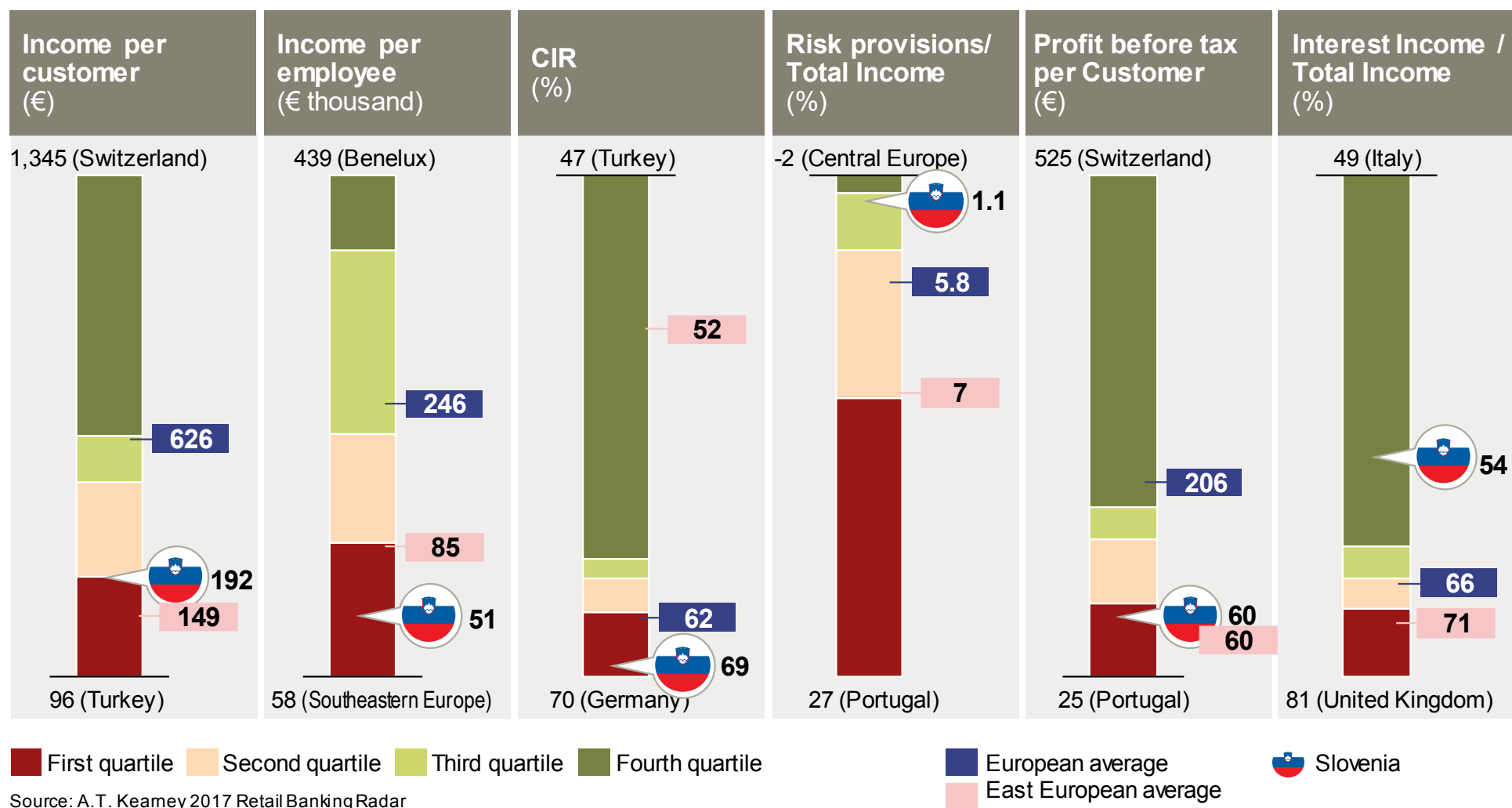
Two main performance levers – headcount decrease and better grip on risks

Retail Banking Radar (Europe; 2008-2017)



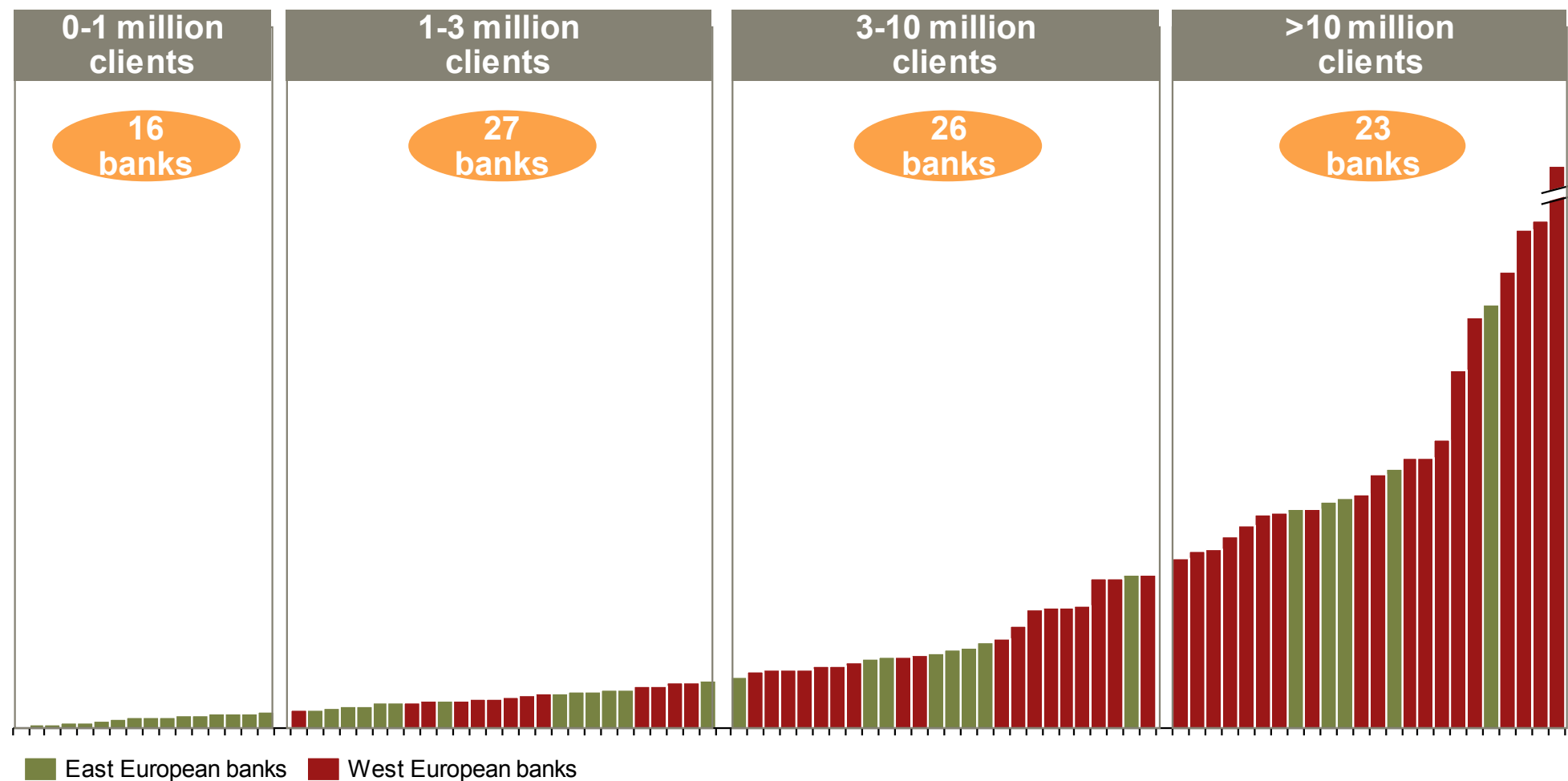
Country differences within the European retail banking industry remain sizable

Retail Banking Radar: Country view (2017)



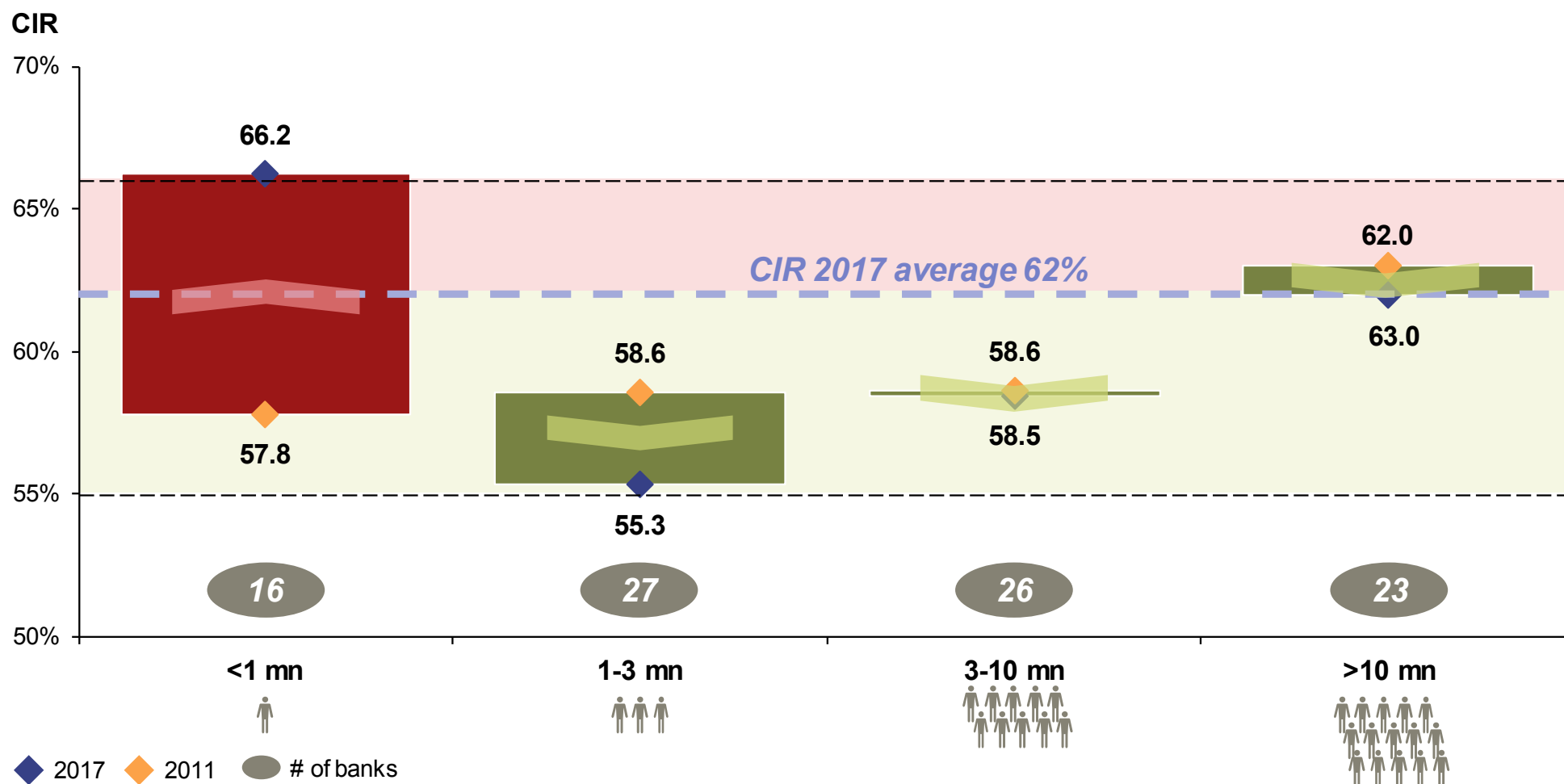
European banks vary significantly in size

European Retail Banks by Client Brackets



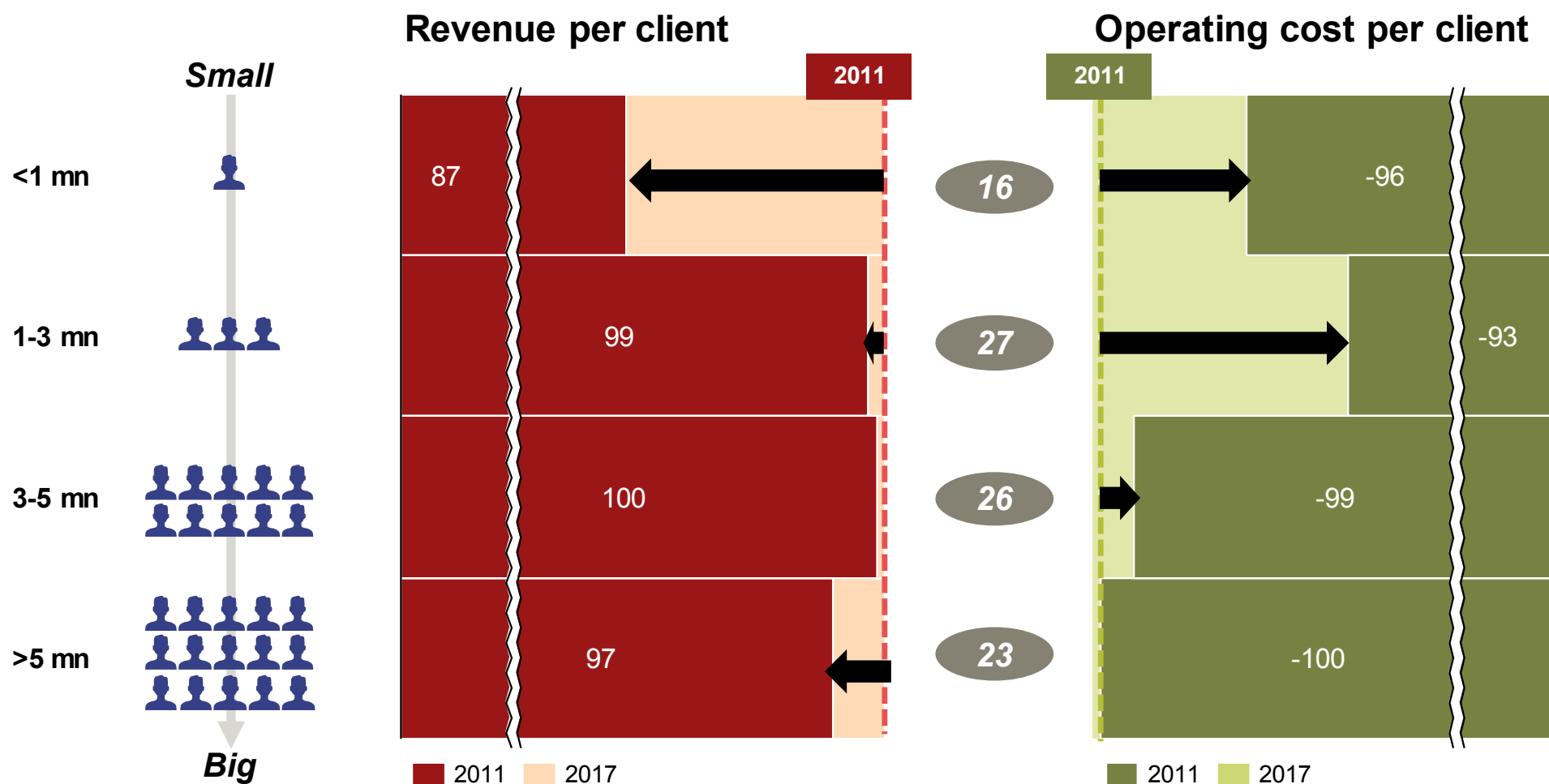
CIR of smallest banks has deteriorated most significantly

CIR Development (Europe, 2011 – 2017)



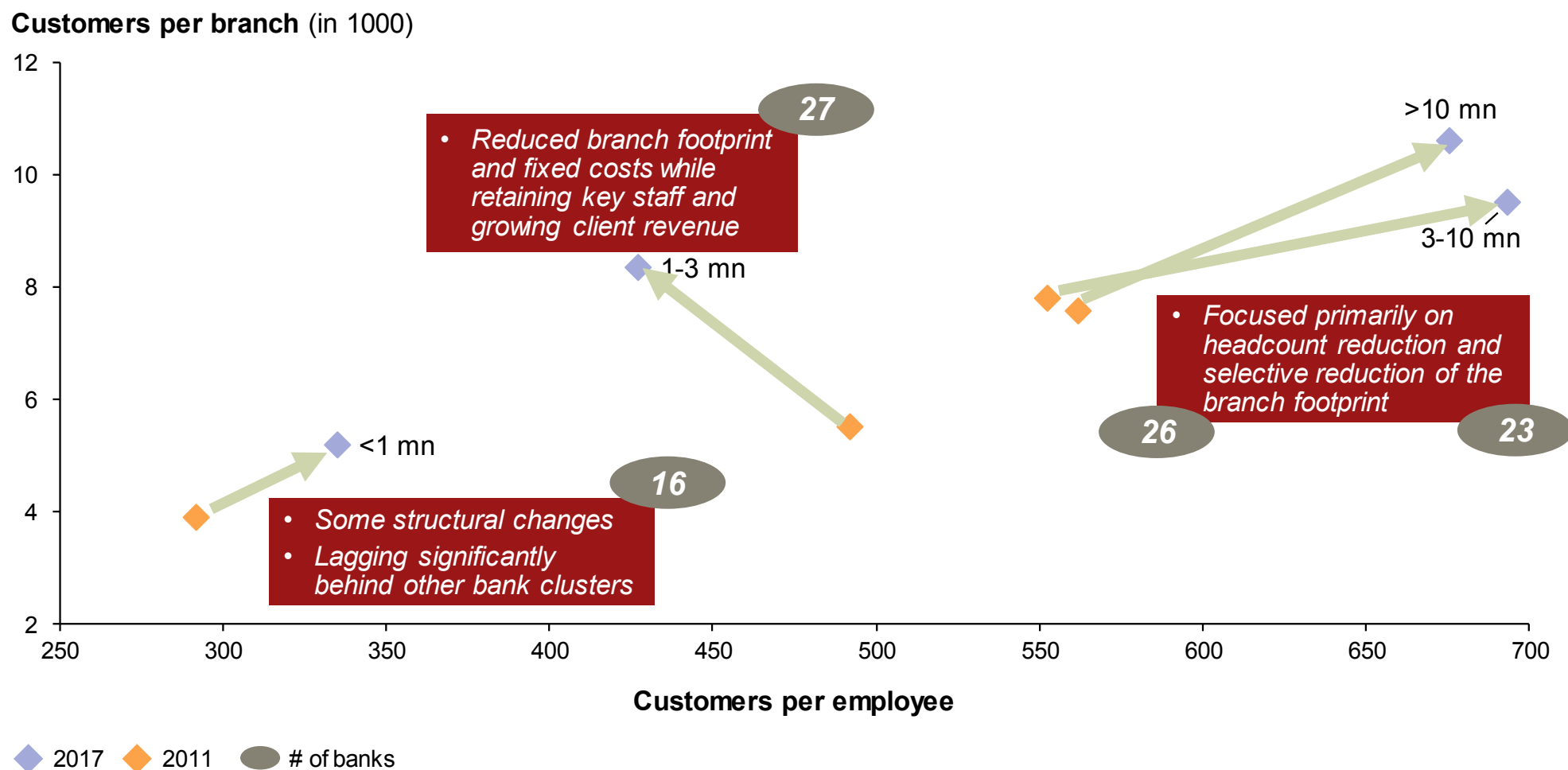
Loss in client income is not compensated by decline in costs

Client Franchise (Europe, indexed performance, 2011-2017)



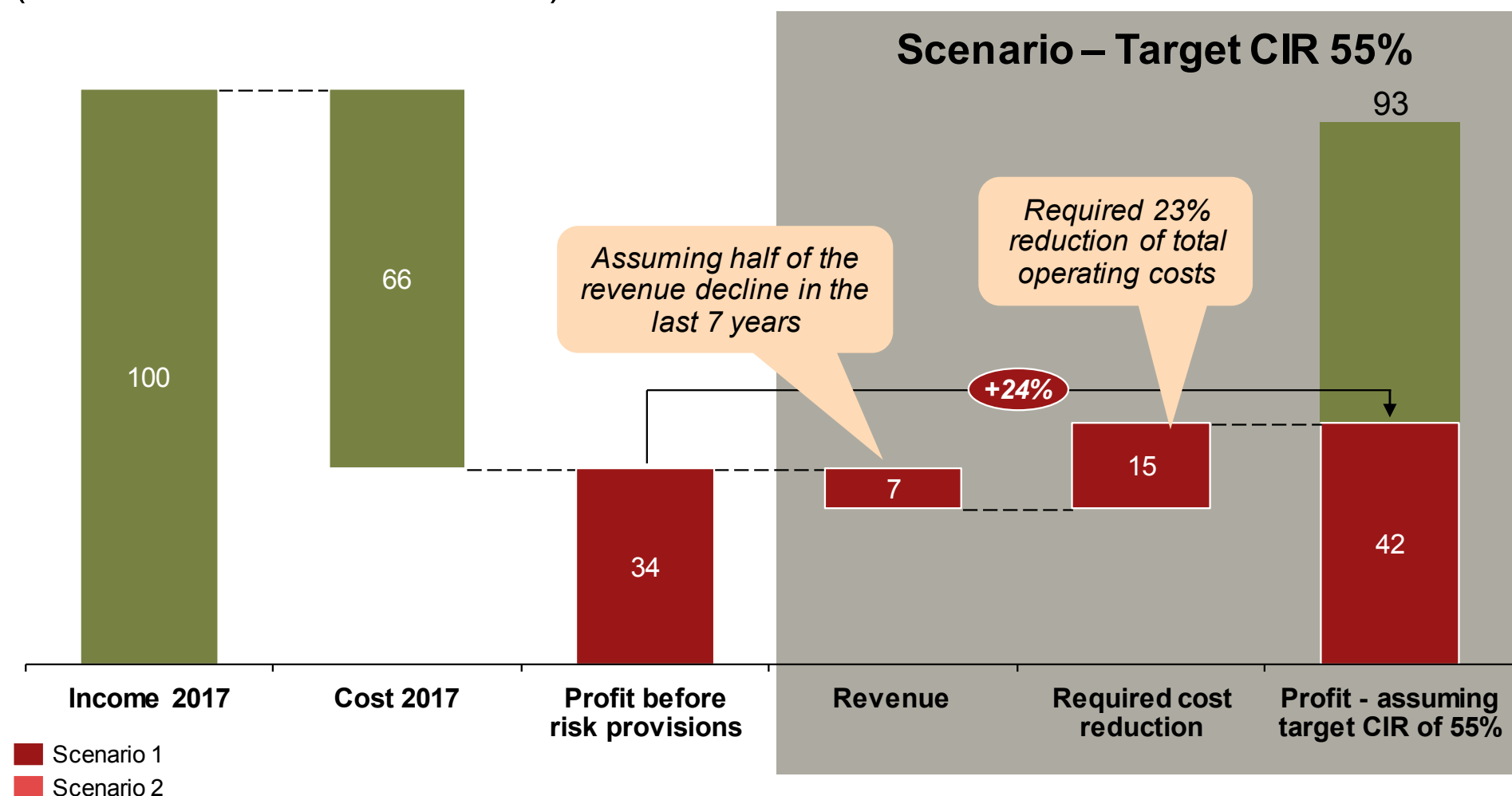
Structural improvements made only in small steps

Structural Changes (Europe, 2011 – 2017)



To get at par with the best competitor group, significant cost reduction is required

Required Cost Reduction for Target CIR of 55% (banks with <1 mn customers)



Looking Ahead

The banking industry is at an inflection point

Factors Shaping the Landscape



**Changing
client
expectations**



**Product
commoditi-
zation**



Digitization



**New
competition**



**Data
becoming the
new "oil"**



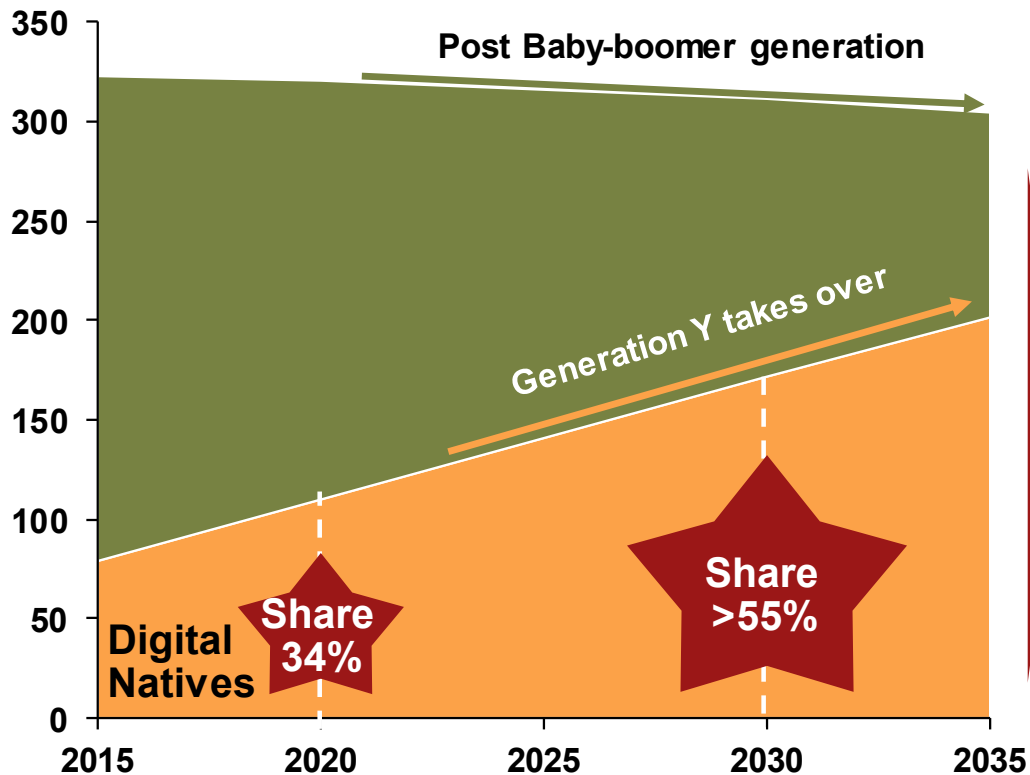
**New ways of
working**

Protracted low & negative interest rates

Wave of Regulation

Digital natives will account for 45% of addressable customers in the EU by 2025

Workforce in the EU-28 – 2015-2035 (in mn.)



Croatia



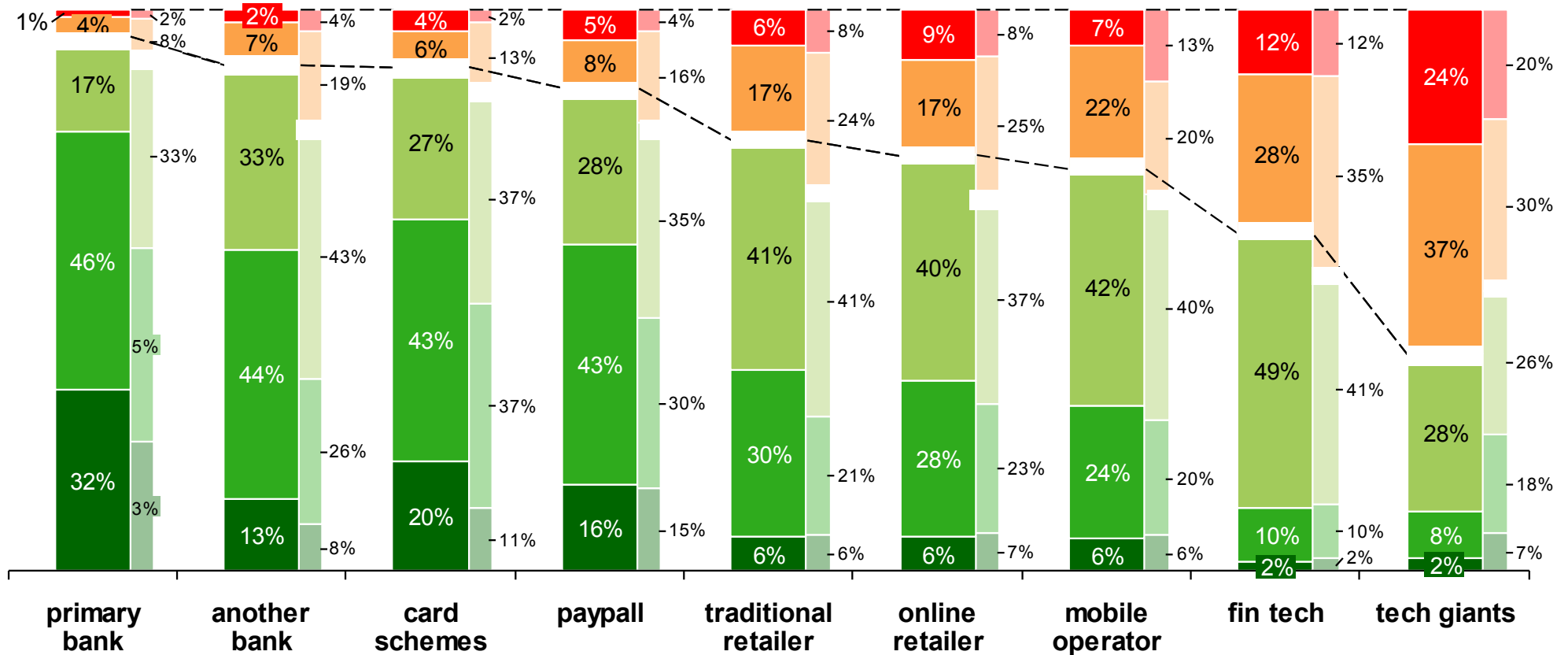
Trends in Customer Expectations

- Personalisation
- More for Less
- 24x7 access
- Social media feedback
- Multichannel access
- Simplicity
- Trust
- Transparency
- Convenience
- Emotion
- Empowerment

Banks are still most trusted; yet, millennials trust big tech brands as well

Europe

Consumer Trusting 3rd Parties with Their Data



All: Not well at all Somewhat well Well Very well Extremely well

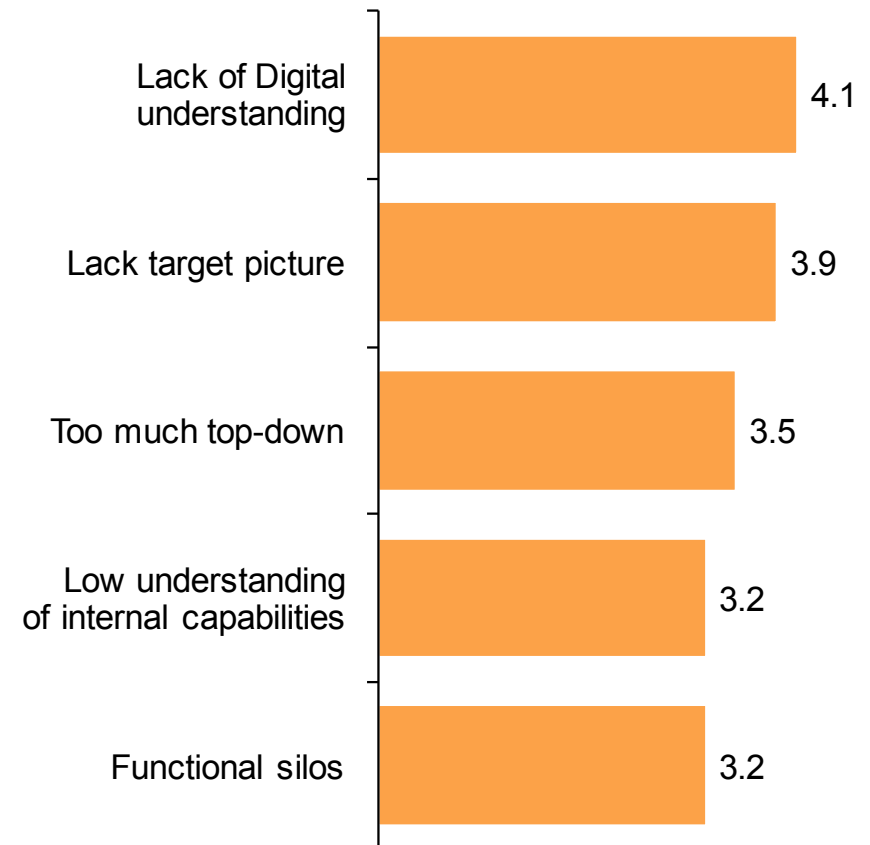
Millennials (18-24): Not well at all Somewhat well Well Very well Extremely well

Many bank digital initiatives do not focus on value and fail to deliver results

Impact and Focus of Digital initiatives

Focus \ Impact	Incremental Improvements	New Business Model
Top Line	26%	5%
Bottom Line	12%	0%
Enabler	57%	

Top reasons for failure



We believe there are still opportunities to “win”



Race Yourself to the Bottom

- Take aggressive action to ruthlessly automate, digitize and transform your cost structure



Embrace the “No Free Lunches” Concept

- Look for value for clients and aim to monetize on new services



Light a Fire

- Create a permanent sense of urgency



Unleash the Hounds

- Address the culture needed to enable the organization to compete in this disruptive climate



Find a Friend

- Develop understanding of the digital partner landscape



Open the Gates

- War-game how to respond to the opportunities and threats from open banking

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Europe	Amsterdam Berlin Brussels Bucharest	Copenhagen Düsseldorf Istanbul Lisbon	Ljubljana London Madrid Milan	Moscow Munich Oslo Paris	Prague Rome Stockholm Vienna	Warsaw Zurich	
Middle East and Africa	Abu Dhabi Doha	Dubai Johannesburg	Riyadh				



First session: Small credit institutions and proportionality: the perspective after the Risk Reduction Package

Chair: Dr. France Arhar

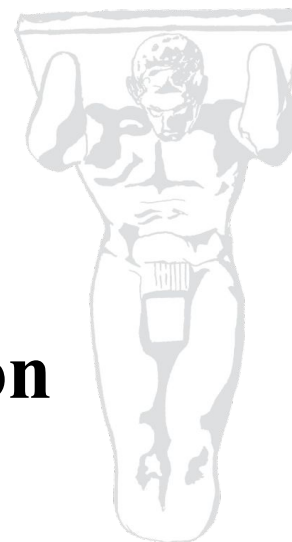
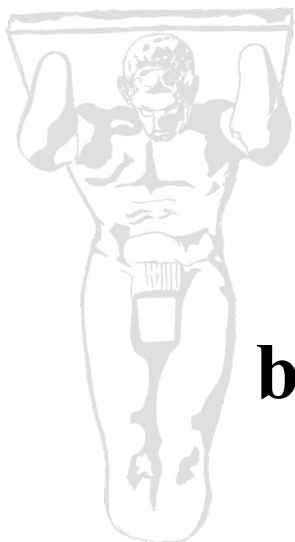
Panelists:

Prof. Dr. Christos Gortsos

Ms. Damjana Iglič

Mr. Michael Engelhard

Centre for Legal and Economic Studies: CLES@pf.uni-lj.si



Proportionality in banking regulation and supervision

What future for small commercial banks in Europe?

Damjana Iglič, Bank of Slovenia

Ljubljana, October 2018

The views of the author do not necessarily represent the views of the Bank of Slovenia

Agenda

- 1) Proportionality in theory**
- 2) Proportionality in existing regulation and supervision**
- 3) Proportionality in the proposal of EU banking reform (CRR / CRD IV revision)**
- 4) Conclusions**

Proportionality in banking regulation and supervision

REGULATION

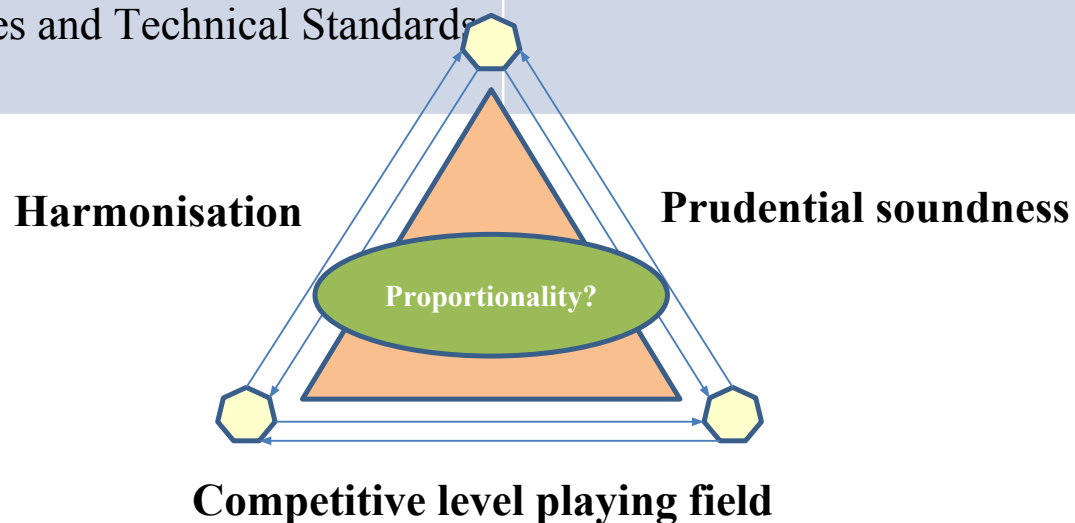
- The rules should reflect size, complexity and systemic relevance of institutions:
 - same rule for the same risk
 - stricter requirements in presence of higher risks to financial stability.
- Regulatory burden should be proportionate to the business model of the bank, and to the risks it poses to the financial sector and to the economy at large.

SUPERVISION

- The nature and intensity of supervision should be adapt to the specifics of the bank (size, risk profile, business model) and to the particular purpose being achieved ("case by case" approach).

Proportionality in banking regulation and supervision


REGULATION	SUPERVISION
<ul style="list-style-type: none"> ▪ Basel III ▪ CRDIV/CRR (and other EU Directives and Regulations applicable to banks) ▪ National legislation (laws and by-laws) ▪ SSM Regulation ▪ EBA Guidelines and Technical Standards (RTS, ITS) 	<ul style="list-style-type: none"> ▪ Application of regulation ▪ Supervisory manual ▪ Supervisory standards and policies ▪ Supervisory Practice



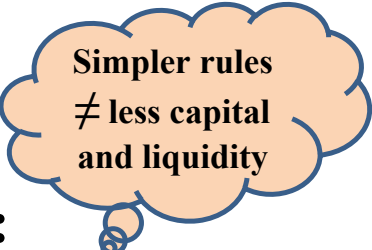
Proportionality in existing regulation

➤ Different approaches for calculating capital requirements for different risks:

- simpler vs. complex methods
- standardized vs. internal models



Costs vs.
benefits?



Simpler rules
≠ less capital
and liquidity

➤ Specific prudential requirements and waivers:

- treatment of small trading book positions like banking book
- limit for large exposures to institutions above 25% of capital
- less strict corporate governance rules (combination of risk and audit committee, less restrictions on number of directorships, simplified remuneration approaches)
- supervisory reporting (exemptions, reductions, simplifications)
- omission of some disclosure
- simplified recovery planning
- G-SIIs and O-SIIs capital buffer....

Proportionality in supervision

Quantitative and
qualitative criteria to
determine big/small,
significant...!

➤ On-going supervision

- scope and frequency of information requests depends on the nature of the banks' business
- intensity of supervisory action is based on banks' risk profile and potential impact on domestic economy
- supervisory measures, including Pillar 2 requirements, are tailored to the individual risk profile and characteristics of the bank in question
- the size of supervisory teams is linked to the size and complexity of the bank
- level of cooperation between ECB and NCAs and fees are influenced by banks' size and significance

➤ Stress testing

- use of simplified approaches

"Too many to
fail"
problem??

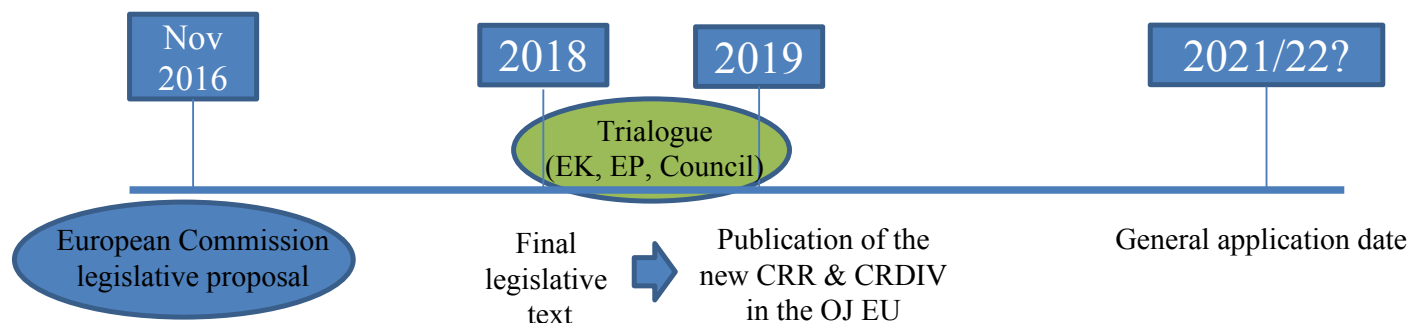
Current work in international and EU fora

➤ Basel Committee on Banking Supervision (BCBS)

- Several simpler approaches for calculating capital requirements (e.g. credit risk, operational risk, CVA risk) are being or have been revised;
- BCBS meeting in December 2017: agreement on possible initiatives related to proportionality

➤ EU

- Review of CRDIV&CRR currently ongoing
- Timetable (tentative)



Post-crisis banking reform (CRR / CRD IV revision)

Regulatory framework should address **any outstanding challenges to financial stability**, while ensuring that banks can continue to **support real economy**.

Main goals:

- to make financial system more stable and resilient, to further reduce risks in the financial sector, to reinforce banks' ability to withstand potential shocks, to increase market confidence
- to make regulatory framework more growth-friendly and **proportionate** to banks' complexity, size and business profile
- to support SMEs and investment in infrastructure

CRR & CRDIV: Definition of a small and non-complex bank

NOT FINAL –
possibly subject to
further changes!

- it is **not a large bank** (!all O-SII banks are large)
- it meets **all of the following conditions**:
 - the total value of its assets is on average equal to or less than the threshold of EUR 5 billion (!discretion of CA to lower this threshold)
 - it is subject to no obligations or simplified obligations in relations to recovery and resolution planning
 - its trading book business is classified as small
 - the total value of its derivative positions (held with trading intent) is less than or equal to 2% of its total on- and off-balance sheet assets
 - it does not use internal models for calculating its own funds requirements (except subsidiaries using models at group level)
 - it has not communicated to the CA the objection to being classified as small
 - the CA has not decided that the bank is not to be considered small and non-complex based on an analysis of its size, risk profile....

CRR & CRDIV: Proportionality - reporting

1. **Purpose:** reducing costs from the perspective of reporting and strengthening proportionality with regard to the size and complexity of the institution
2. **Content:**
 - a. definition of small institution: quantitative + qualitative criteria
 - b. reduce granularity of reporting for small institutions
 - c. EBA mandate with regard to assessment of costs and benefits of regulatory reporting
 - d. clarification of duplication of reporting (potential waivers)
 - e. development of IT tools for compliance by EBA
3. **Expected impact:**
 - reduction in reporting burden and costs
 - maintenance of sufficient bases for banking supervision

CRR & CRDIV: Proportionality - disclosures

-
1. **Purpose:** strengthening of proportionality with regard to the size and complexity of the institution, compliance with international standards and adjustment to changes in legislation
 2. **Content:**
 - a. classification of institutions into three categories: large, small and other, with further distinction between listed and non-listed institutions
 - b. scope of disclosures with regard to categorisation (sliding scale), with differentiation in the substance and frequency of disclosures
 - c. key prudential metrics table:
 - minimum standards for all banks
 - own funds, RWA, P2R, CBR, LR, LCR, NSFR, MREL
 3. **Expected impact:**
 - reduction in administrative burden and costs
 - comparability of disclosures at global level

CRR & CRDIV: Proportionality - remuneration

1. **Purpose:** elimination of disproportionality of certain existing rules for the smallest, less-complex institutions, and for staff with low variable remuneration
2. **Content:**
 - a. derogations from the rules on deferral for the variable remuneration can be exercised for:
 - ~ small, less-complex banks: total asset value \leq EUR 5 billion
 - ~ staff with variable remuneration \leq EUR 50.000
 - b. listed institutions may provide variable remuneration in the form of share-linked instruments
3. **Expected impact:**
 - reduction in administrative burden

To conclude...

Small banks are generally less risky than larger ones, so a proportionate approach to regulating and supervising small banks is usually appropriate.

For small banks, the costs of implementing complex prudential rules are higher and benefits smaller than for big banks.

Consistent supervision does not mean "one-size-fits-all" supervision.

BUT

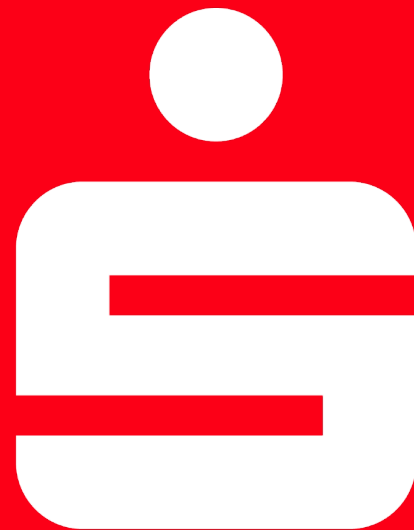
Proportionality does not mean that the rules should be generally less strict, or that banks can hold less capital or liquidity.

With simpler rules we should not create "too many to fail" problem.

Application of proportionality vs. change in business model/orientation?

Small credit institutions and proportionality: the perspective after the Risk Reduction Package (Small and Simple Banking Box)

Ljubljana, 18 October 2018



The regulatory environment 10 years after the Global Financial Crisis...

**European
Regulators have
been particularly
productive so far**

**Output of all 3 European Supervisory
Authorities (ESAs) since 2011**

180+ Guidelines

300+ Technical Standards

3,000+ Q&As

1,861 page count of EBA Technical Standard
on Supervisory Reporting

(Record holder for longest publication in the EU Official Journal)



Banking regulation today is highly detrimental for smaller banks.

- Ongoing regulatory initiatives are increasingly asymmetric in their impact on the banking landscape.
- The extent of regulation is penalizing to smaller institutions because its implementation mostly requires fixed costs.
- Even a small bank with comfortable capital levels and a simple, low-risk business model will not be spared from increasingly complex, uniformly applied regulation.
- Banking regulation since the crisis has a strong tendency towards increasing the rift between too-big-to-fail banks on the one side and too-small-to-survive banks on the other.

But isn't Europe “overbanked”?

United States

- population: 326mn
- ~11,000 (5,500 community banks + 5,800 credit unions)

*“Treasury (...) recommends that the overall regulatory burden be significantly adjusted. This is appropriate in light of the minor complexity and **lack of systemic risk of such financial institutions**”*

A Financial System that creates Economic Opportunities, Banks and Credit Unions,
U.S. Department of the Treasury, June 2017

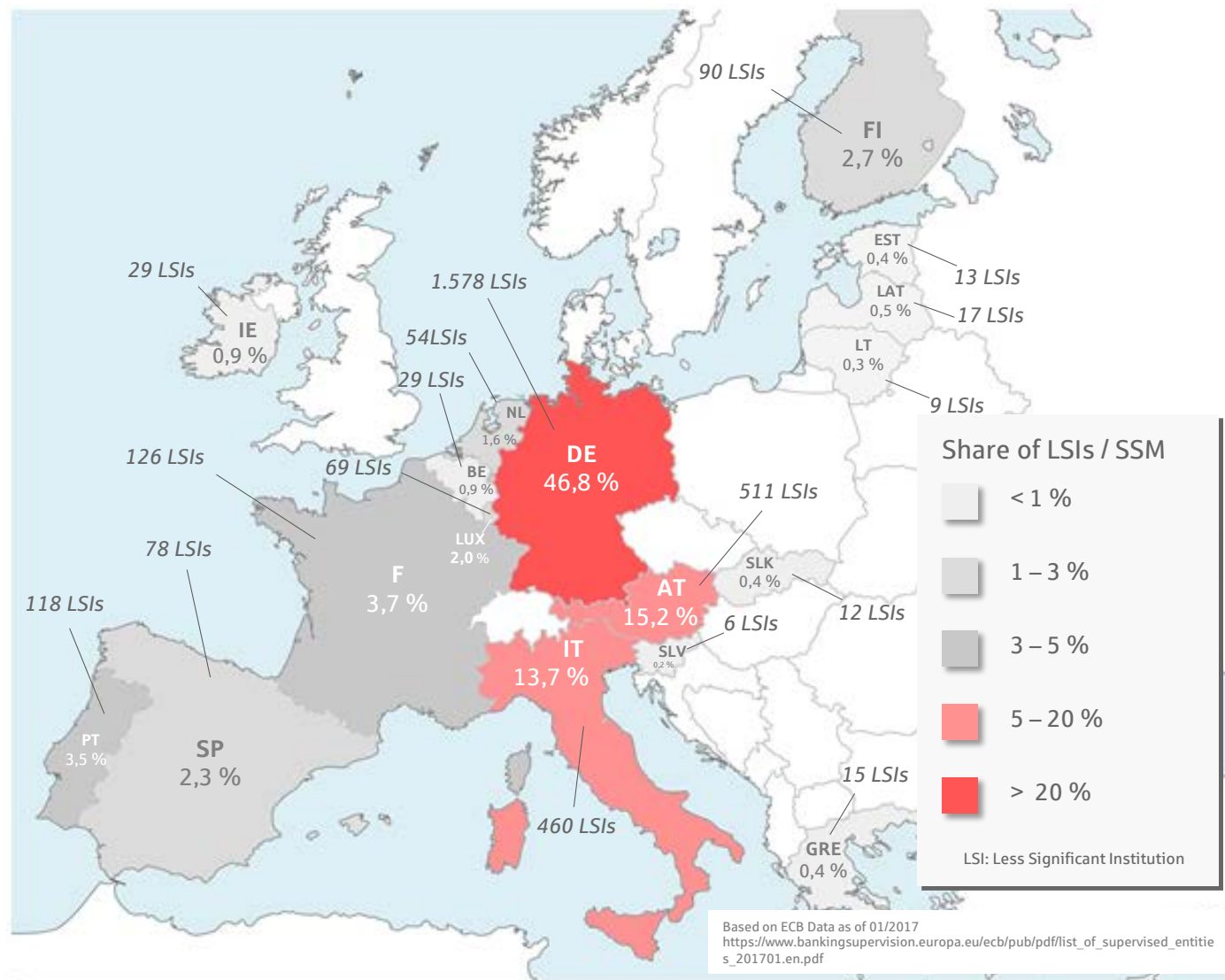
Euro Area

- population: 340mn
- ~3,200 less significant (smaller) institutions

*“...In the event of a failure, all these small banks taken together could pose a big risk to the financial system. This is known as the **“too many to fail”** problem.”*

Statement by the Vice-Chair of the Supervisory Board of the ECB, at an IMF seminar,
Washington D.C., 14 October 2017

Distribution of smaller banks across the Euro Area



Diversity and its benefits to financial stability

- Smaller, regional banks are better suited to provide SMEs with funding and individual solutions.
- Research shows how central decisions about capital and liquidity allocation are detrimental to peripheral regions.
(Alessandrini, Pietro, 2006: Banks, Distances and Financing Constraints for Firms)
- A granular banking system reduces too-big-to-fail.
- The European Parliament seems to agree: “(...) pluralistic structure is a European asset that promotes financial stability and the endogenous potential of regions”.
(Own summary of ECON reports by Karas (2016, 2008), Pitella (2008) and Muscat (2006))

How do regulatory approaches compare against each other?

US: Regulatory Approach

- Vast array of thresholds to cater for different types of institutions
- Clear distinction between Wall Street and Main Street banks
- “Proportionality by exemption”
- Willingness of supervisors and regulators to engage with small banks and to alleviate regulatory burden (e.g. Community bank summaries of relevant regulations)
- International standards (Basel!) are only implemented for larger banks

EU: Single Rulebook

- Mantra of the ubiquitous „level playing field“ (often from a big bank perspective)
- Harmonization, cohesion, consistency
- „Same rules for everyone“ (Single Rulebook)
- „There must be no cutting turns“
- Proportionality as the supposed alleviation
- International Standards (Basel I to IV) are implemented for all banks, large and small

Proportionality in Europe: A flawed discussion.

The mantra of the „level playing field“ is highly flawed:

- The argument assumes equal costs (in relation to balance sheet) for large and small banks.
- In fact, small banks have much higher fixed costs for complying with regulation than larger banks.
- So, from a small bank perspective, more proportionality will actually promote a level playing field, not damage it.

But everyone is talking about proportionality!

- Proportionality may be the biggest buzzword in banking regulation and politics.
- However, it is widely understood in a minimum-threshold manner, i.e. there is always a minimum extent to which rules have to be applied.

How can Europe realize proportionality in banking regulation?

The SSBB: A case for more proportionality in European banking regulation

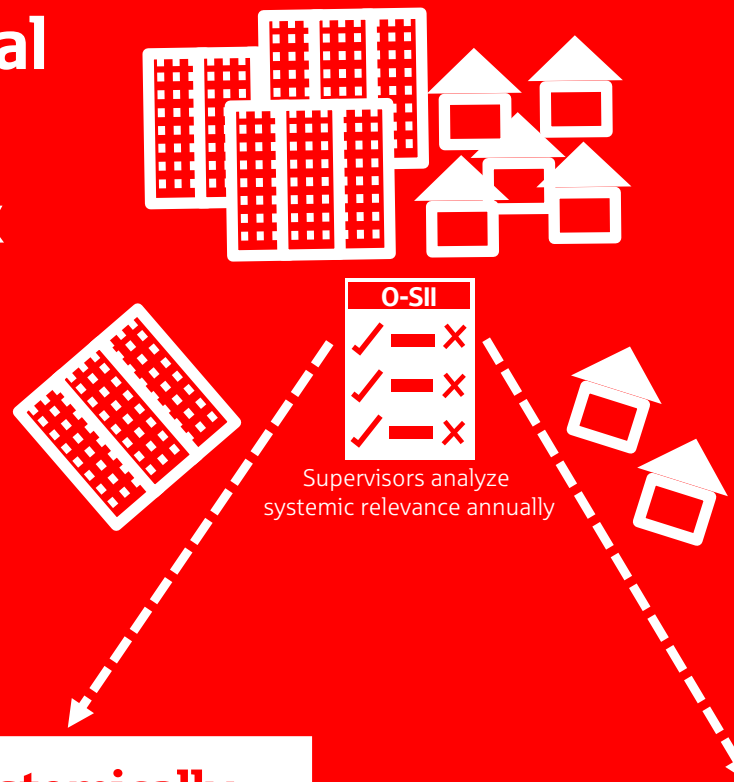
Preclaimer:

- The proposal is not about lower capital ratios and less stringent liquidity requirements
- Focus is purely on relief in reporting, disclosure and other administrative or compliance-related issues

Small and Simple Banking Box (SSBB):

- DSGVO has been a longtime proponent of more proportionality.
- Concept of a Small and Simple Banking Box was first developed and proposed to regulators and legislators in mid-2016.

Our original proposal for a Small and Simple Banking Box



Implications (Examples):

- ✓ Application of Basel IV („Basel 3.5“)
- ✓ Full reporting
- ✓ Full disclosure

Implications (Examples):

- ✓ No application of large bank regime standards (no Basel 3.5 ff.)
- ✓ Reduced reporting extent and frequencies
- ✓ No disclosure

So, are we there yet?

A lot of progress has been made, but...

- Under EP proposal, **MREL reporting waiver** would be conditional on a Leverage Ratio of 10% for banks that are subject to regular insolvency proceedings, although these banks do not have additional MREL requirements. 80%(!) of Sparkassen would have to report and disclose MREL.
- **(Absolute) threshold of €5bn total assets** will be prone to inflation over time (relative threshold would be „timeless“).
- **Simplified remuneration regime** could be applied to banks with more than €8bn in total assets.
- Current proposals focus too much on balance sheet size and too little on overall systemic relevance: Why not **apply O-SII methodology**, which has been designed for the very purpose of identifying systemic relevance?

However: legitimate criticism should not deter from remarkable progress that has been achieved so far.

Thank you.

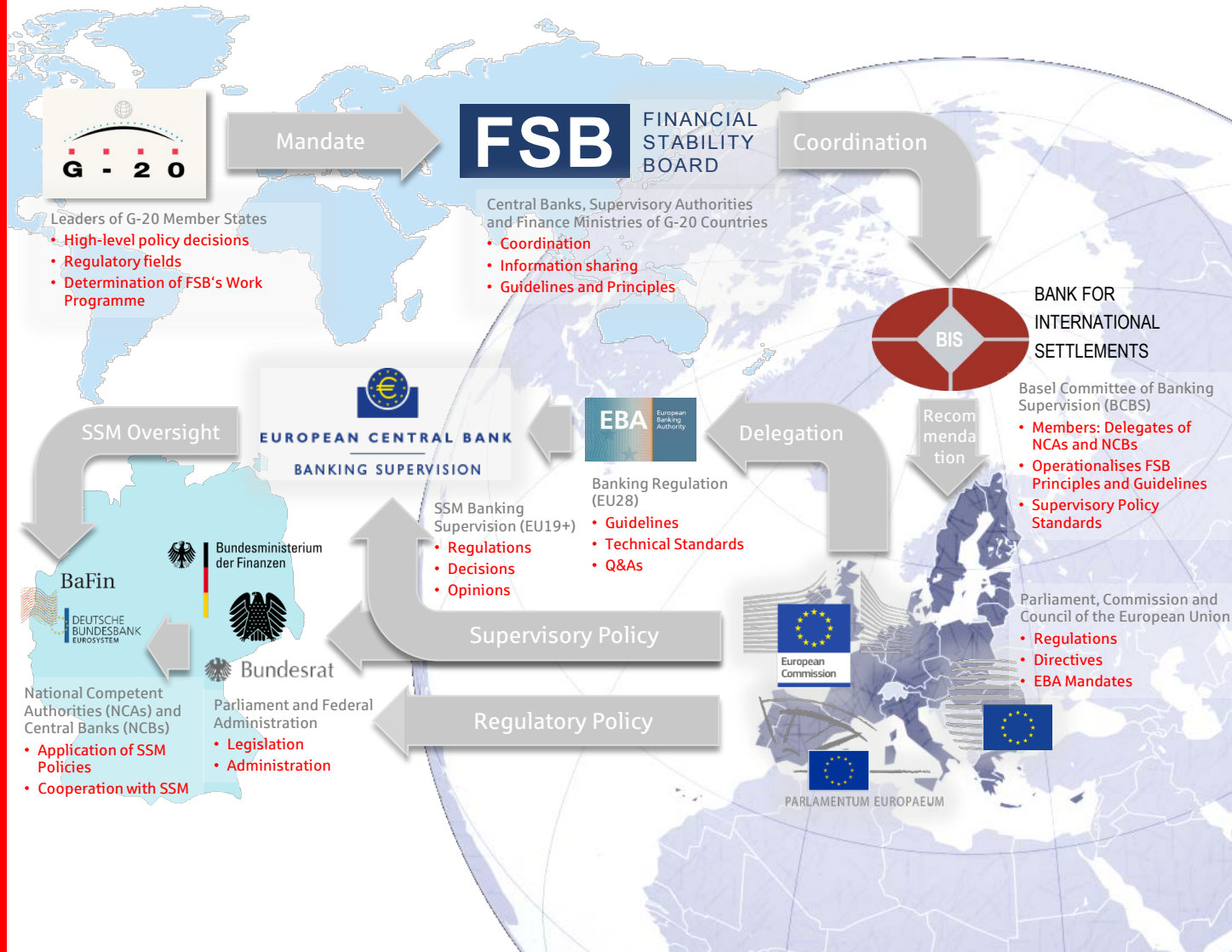
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International and EU Banking Regulation



How has Europe reacted to increasing calls for proportionality?

Proportionality has gained traction with legislators

*The **European Parliament** [...] is concerned that the **disproportionality of requirements might endanger the business model of small- and medium-sized banks** and therefore have unintended consequences for the structure of the financial industry; ...*

European Parliament, January 2016, 2015/2106(INI)

*The main problem remains the proper application of the proportionality principle in the new banking rules [...] This means that the **strictest requirements should apply to global banks**, stringent requirements should apply to pan-European banks (of a systemic nature in Europe) and **more flexible requirements should apply to national and local banks** (guaranteeing a proper level of consumer protection).*

European Economic and Social Committee (EESC), Own-Initiative Opinion: Proposals for an Adapted Financial Regulation Framework

Definition:

EU Commission Proposal (late-2016)

- 'small' banks: up to €1.5bn in total assets (~141 Sparkassen, 37%)

Definition:

European Parliament & Council

- 'small and non-complex' banks: up to €5bn in total assets (~333 Sparkassen, 90%)
- threshold can be lowered under discretion of national supervisors (EP proposal) or Member States (Council proposal)
- no internal models
- small trading book (Art. 94 CRR)
- small derivatives portfolio
- regular insolvency proceedings (= simplified BRRD requirements)

Implications: **EU Commission Proposal** (late-2016)

- very limited regulatory relief in areas of reporting and disclosure

Implications: **European Parliament & Council**

- EBA will be mandated to identify significant potential to reduce reporting relief (ideally 20%, but ,at least 10%‘)
- reduced disclosure requirements
- remuneration: application of basic requirements for banks with up to €8bn total assets
- simplified Net Stable Funding Ratio, sNSFR (EP proposal only)
- ALMM* waiver (EP proposal only)

* Additional Liquidity Monitoring Metrics

Second session: Small credit institutions and commercial banking for SMEs and natural persons

Chair: Dr. France Arhar

Panelists:

Prof. Dr. Franjo Štiblar

Dr. Christian Otto

Ms. Martina Küster

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THE SERVICES OF SMALL BANKS FOR CONSUMERS

Contents

- I. The book
- II. What went wrong and how it should be repaired and improved?
- III. A.T.Kearney's strategic view on retail banking
- IV. Experience in the USA and the EU
- V. The issues of regulation
- VI. Conclusion

The legislation of financial services for consumers is targeted more towards banks (oligopoly in supply) than towards the protection of consumers (polipson in demand), where banks predominate consumers, who are the weaker partner in the transaction.

I. THE BOOK: Good banking

The detachment of bad banks from real life is one of the reason for the crisis. The detachment has even escalated in the last decade.

Large banks are TBTB, TBTF, TBTM and less responsive to the needs of businesses, the population and the environment.

Relationship lending is disappearing on behalf of digital virtual relations.

Good banking should predominantly service the real sector: enterprises and consumers.

The focus of the presentation is on the relationship: small banks - consumers

II. WHAT WENT WRONG AND HOW SHOULD IT BE IMPROVED ?

We need financial health and financial justice for people.

To achieve that:

- increase the income of the poor and middle class, less income inequality,
- better financial education of the population,
- the services to consumers should be extended from financial to non-financial.

The relation of small banks to shadow banking institutions, advantages of the latter, but...

- the role of technological progress in finance: could be positive or negative,
- no capital, liquidity and corporate governance requirements for fin-techs, funds, enterprises.

The expansion of bank services for consumers: „back to the humans”

- additional financial services: bankers as financial doctors for consumers and their families,
- advice for tourism, health,
- beauty salons,
- children's playgrounds,
- car repairs.

This means the opposite of the invasion of the real sector entities into banking services.

III. A.T.KEARNEY'S STRATEGIC VIEW ON RETAIL BANKING

A new business model for retail banking: digitalization, cost cutting, outsourcing, closing branches.

*Critical remarks regarding this „anglo-saxon business model”:

- One model is suggested for all people, all the time - different countries – not good;
- The micro optimum for an individual bank is not at the same time the macro optimum for the whole society,
- Leap-frogging in technical development could sometimes create damage,

*Alternative „continental Europe business model”:

- The lower prices for provision of services will increase their amount and thus banks in the European business model could end-up with a higher income,
- Replacing closed big bank branches with branches of small banks with relationship banking could be advantageous for both, the small banks and the society.
- Nurturing personal relationship with clients improves the welfare of the society.
- Introducing elements of banking with purpose (ecological, social) could bring additional value to the society.
- Higher level of risk aversion in small banks could delay the emergence of a new financial crisis.

IV. EXPERIENCE IN THE USA AND THE EU

*The USA: Lisa Servon: Unbanking and underbanking (2018)

- financial distress of consumers,
- creation of bank deserts,
- but: the creation of the Consumers Financial protection Bureau under the Dodd-Frank act,
- nowadays it is difficult to establish new banks in the USA.

The EU

- restructuring banks by closing branches and leaving bankers as a burden to society is easy to execute; it can increase the bank's profit, but has negative externalities for society,
- a consumer financial protection agency should be established,
- bank deserts are starting to appear by following the new business model: the priority of maximising individual profit over society's welfare optimisation
- The approach of small banks with relationship banking (a deal with the local authorities) to consumers could easily replace the withdrawn bank branches and ATMs in outer regions.

V. THE ISSUES OF REGULATION

- a) More, less regulation or deregulation? Equal regulation for banks and non-banks ?!
- b) According to the EU regulation (article 89-91, EU regulation 648/2012) the non-financial services of banks can be established in separate SPVs with the bank's investment of up to 15% for an individual entity, and 60% of the total bank investment in non-financial entities.
- c) Non-financial services of banks are not allowed according to Slovenian banking law, so special legal entities should be established for non-financial services (type of SPV) and then consolidated into a banking group.
- d) A consumer financial protection agency should be established in the EU member states to replace the present insufficient partial solutions for consumers.
- e) The ex-post application of proportionality is too late if we want to preserve small banks (the economy of scale issue), which could expand new services (economy of scope issue).
- f) The newly prepared revision of the EU regulation (CRR, CRD4) in the field of proportionality enables the introduction of changes, which will be friendly to consumers.
- g) Big banks oppose the affirmation of the principle of proportionality with the argument that it would put them on un-equal footing with regard to small banks, but in fact it would only eliminate the advantages larger banks have due to the economy of scale.

VI. CONCLUSION

We need an industry that keeps people's money safe, provides high quality, affordable products and services, aligns with democratic values and truly serves people, in the best sense of the word (Servon, 2018, XIX).

It is necessary to support the protection of the financial rights of consumers, including the creation of a new consumer financial protection agency in the EU, which would moderate the financial instability and stress. Such an institution already exists in the USA, although its tasks have recently been diminished.

The financial field is becoming highly sophisticated so that a certain nudge of consumers in the right direction is needed for financially un-educated people at large.

The asymmetry regarding financial knowledge and financial information between banks and consumers is too large to be left un-corrected due to ethical criteria. In this, the financial and other services of small banks for consumers should be safe, attainable, fair and transparent. What is needed is financial justice.



Less significant institutions in Germany

Current state and future challenges from a supervisory perspective

Christian Otto, Head of Division "Coordination of National and International Off-Site Supervision"

| Agenda

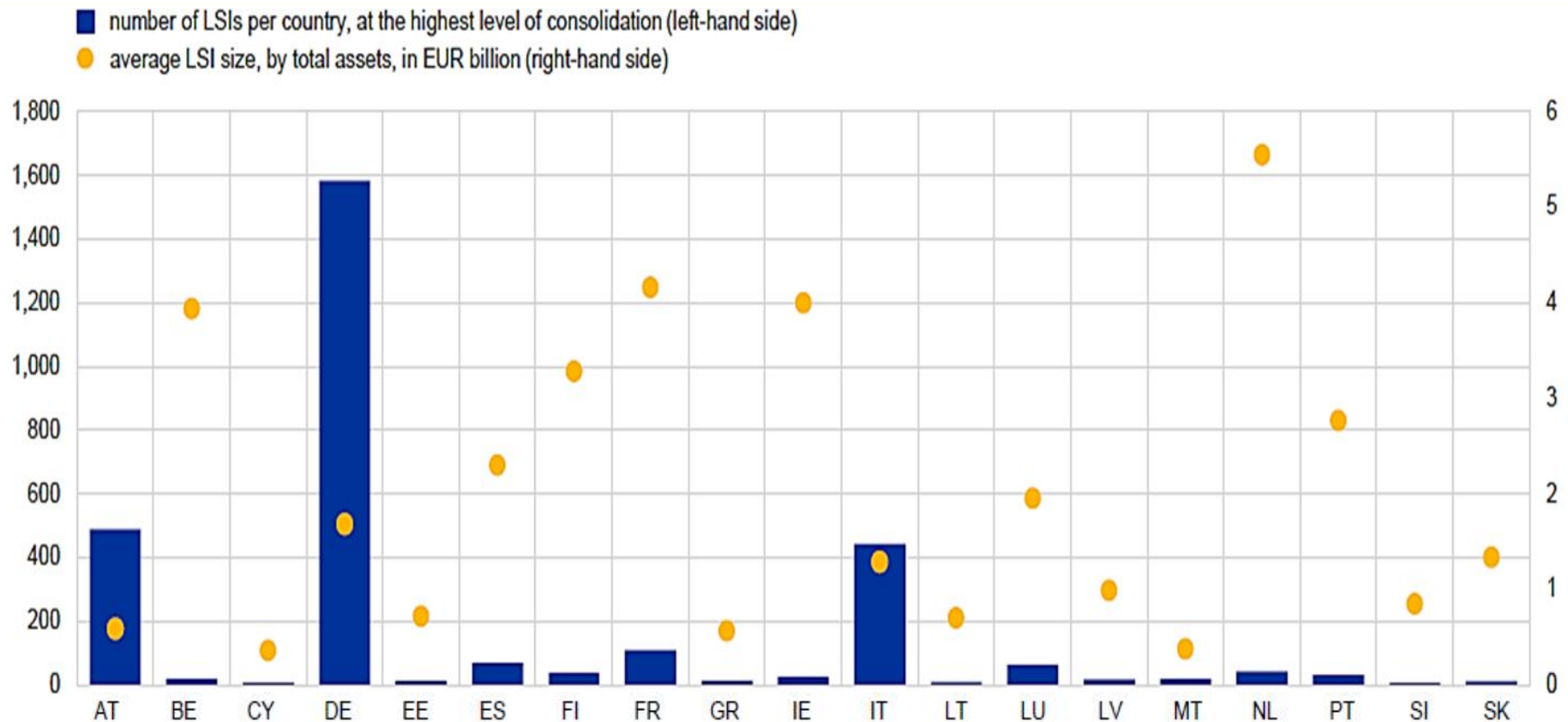
- 1. Overview**
- 2. Current business environment**
- 3. Performance of German LSIs**
- 4. The supervisory perspective**
- 5. Outlook**

1. Overview

Number and average size of LSIs

Number of LSIs per country and average size – end of 2016

Source: ECB, LSI supervision within the SSM, 2017



➤ Total number of LSIs: Around 3.000 institutions in 19 SSM Member States (at solo level).

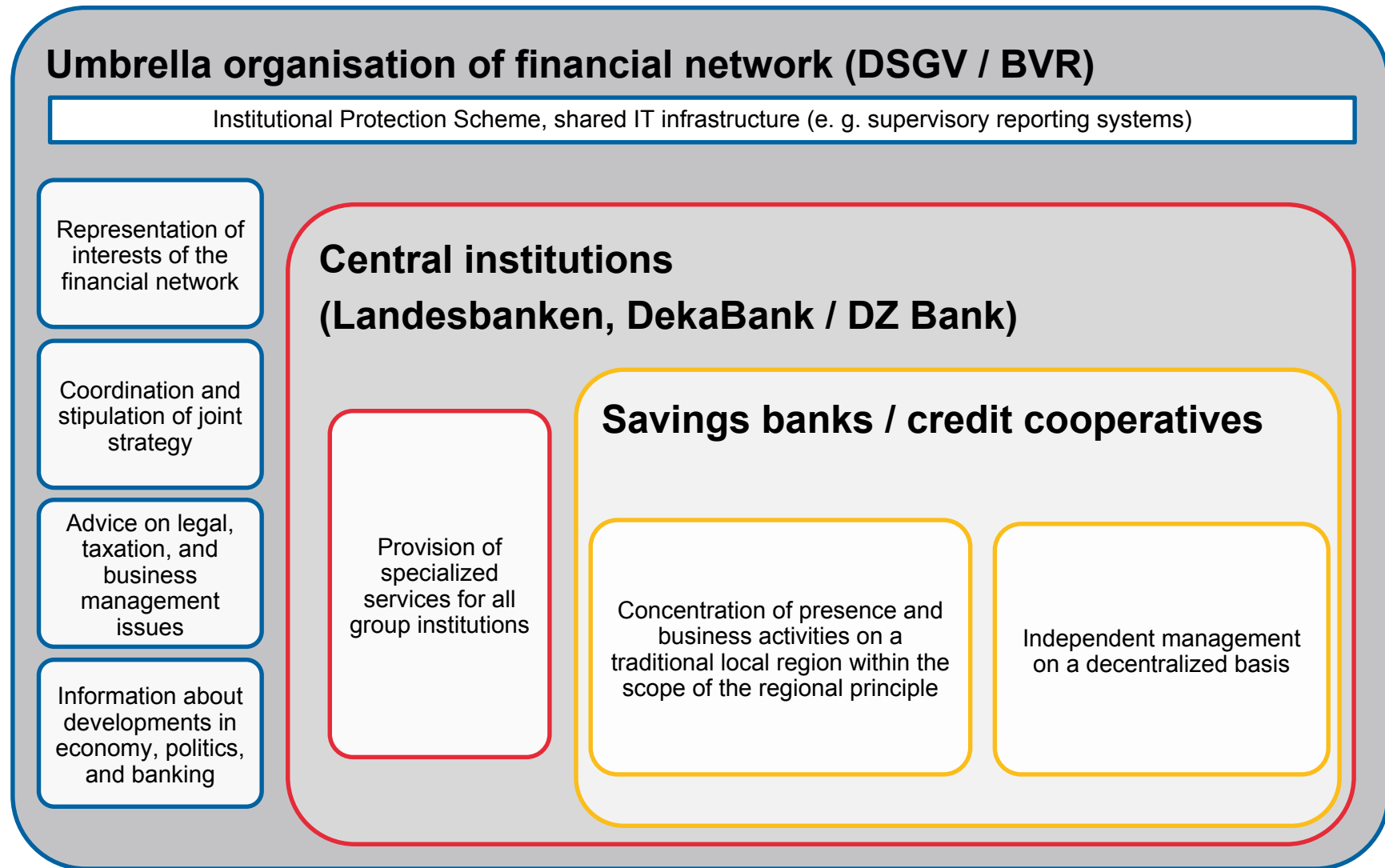
1. Overview

Structure of the German LSI sector – Three pillar system

Commercial Banks	Cooperative Banks	Savings Banks
<ul style="list-style-type: none">▪ 133 LSIs▪ Primary target: Maximisation of profits▪ Committed to the interests of the owners / shareholders▪ Regional focus: In general no specific regional focus <div><u>53 Specialized banks</u></div>	<ul style="list-style-type: none">▪ 916 LSIs▪ Primary target: To serve the interests of the members▪ Mission: To support the propensity to save among the population and to satisfy the regional demand for loans▪ Committed to their stakeholders, e.g. members, clients and the regional society▪ Regional principle	<ul style="list-style-type: none">▪ 388 LSIs▪ Primary target: To serve the common public interest and to support the propensity to save among the population▪ Mission: To support the propensity to save among regional society and to satisfy the regional demand for credit▪ Committed to the regional society▪ Regional principle

1. Overview

Cooperative and savings banks financial networks



2. Current business environment

Sound economic conditions in Germany

- In general, the economic boom in Germany is still ongoing.
 - The average GDP growth rate stood at 2.2% in 2017 and is expected to reach 2.0% in 2018.
 - Private consumption continued its ascent in spring 2018.
 - Negotiated wages rose sharply, reflecting recent wage settlements which were higher than in the last pay round.
- The domestic private sector's demand for loans accelerated.
 - The annual rate of growth of these loans to the non-financial corporate sector rose to 5.9% at end-June, its highest mark since 2008.
 - Loans to households picked up significantly (particularly high demand for housing loans).

2. Current business environment

Current challenges for LSIs in Germany

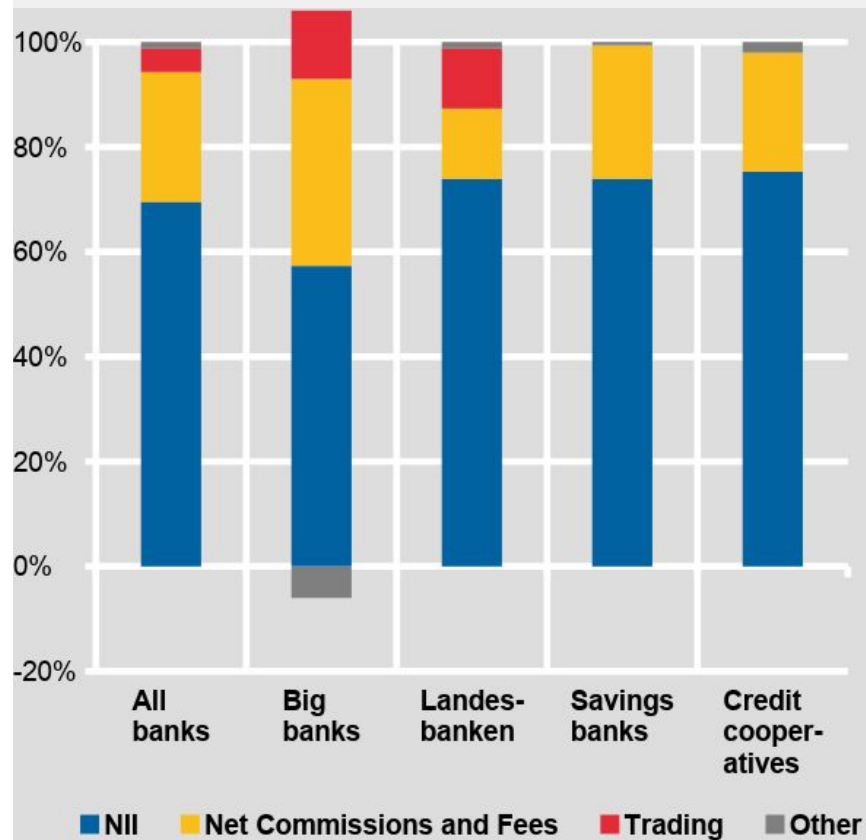
- Sustained low interest rate environment.
- High costs (e. g. due to local branch network, investments in IT infrastructure, digitalisation, rising wages).
- High competition in the German banking sector (including online banks with leaner cost structures).
- New competitors/digitalisation.

3. Performance of German LSIs

Sources of income (1)

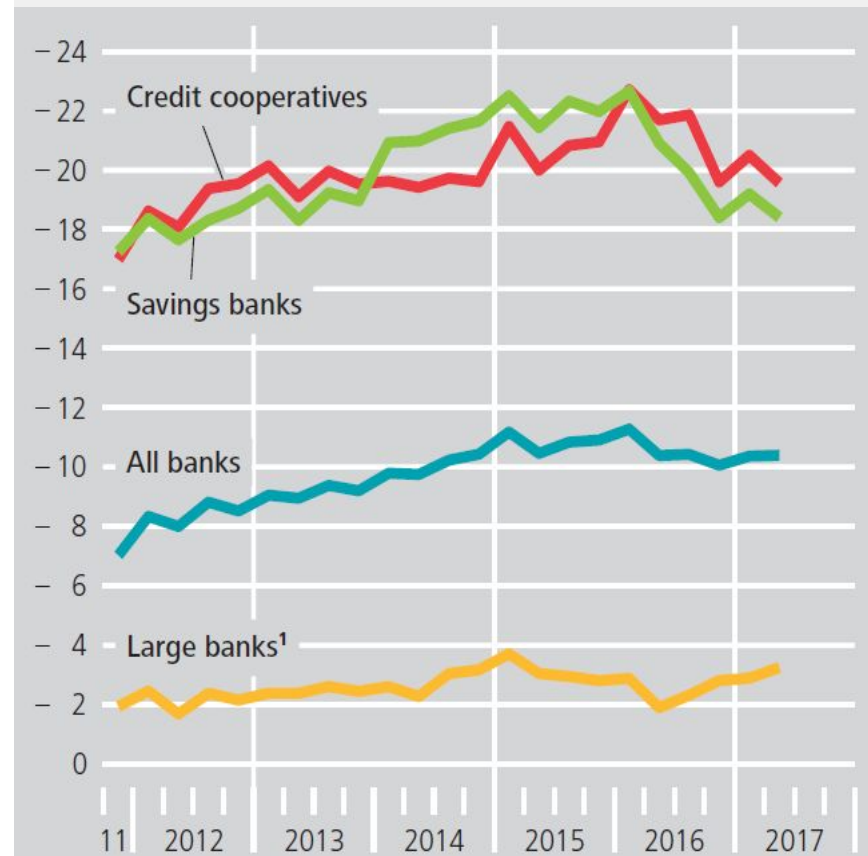
Sources of income by banking group

Aggregate, in % of operating income (as of 31.12.2017)



Source: Deutsche Bundesbank Monthly Report September 2018, "The performance of German credit institutions in 2017".

Changes in present value given interest rate rise* As a percentage of regulatory own funds



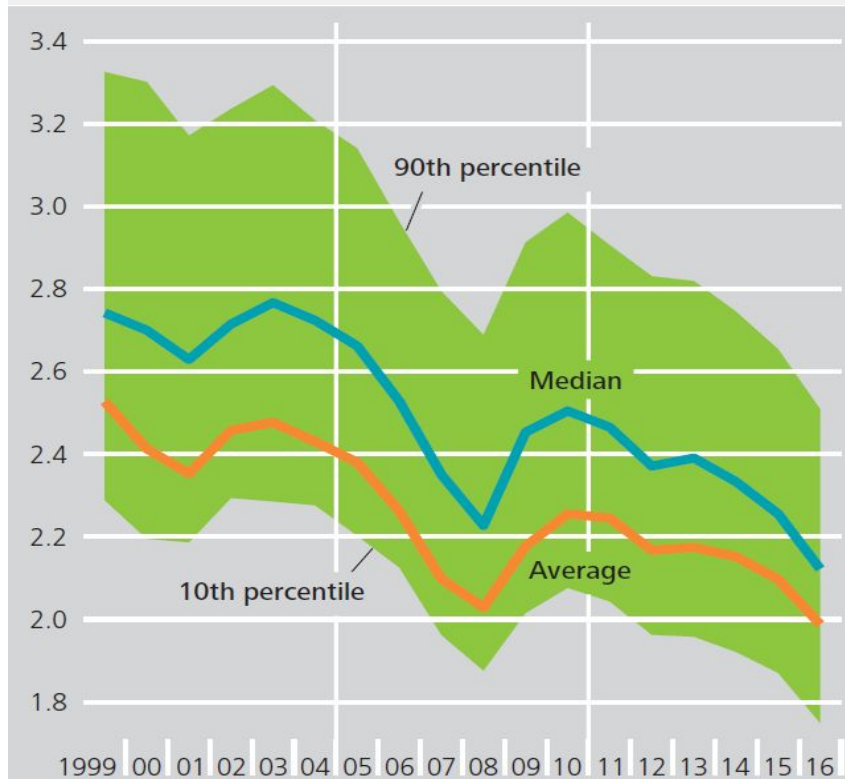
* Changes in present value of positions in the banking book subject to interest rate risk caused by an abrupt interest rate rise of 200 basis points across all maturities. The analyses are based on reports from institutions for the Basel interest rate coefficient. 1 12 major German banks with an international focus which did not outsource positions to resolution agencies in the observation period.

Source: Deutsche Bundesbank, Financial Stability Review 2017.

3. Performance of German LSIs

Sources of income (2)

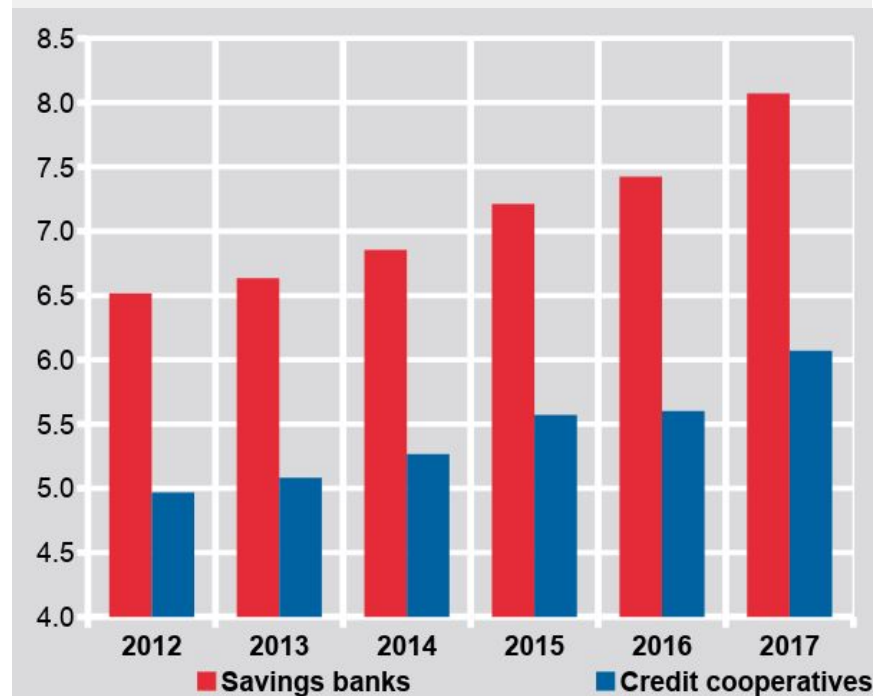
Net interest income of savings banks and credit cooperatives in % of average total assets¹



¹ Accounting-related rise in aggregate total assets in 2011 due to the Accounting Law Modernisation Act (Bilanzrechtsmodernisierungsgesetz).

Source: Deutsche Bundesbank, Financial Stability Review 2017.

Commission & fee income of savings banks and credit cooperatives aggregate, in € bn



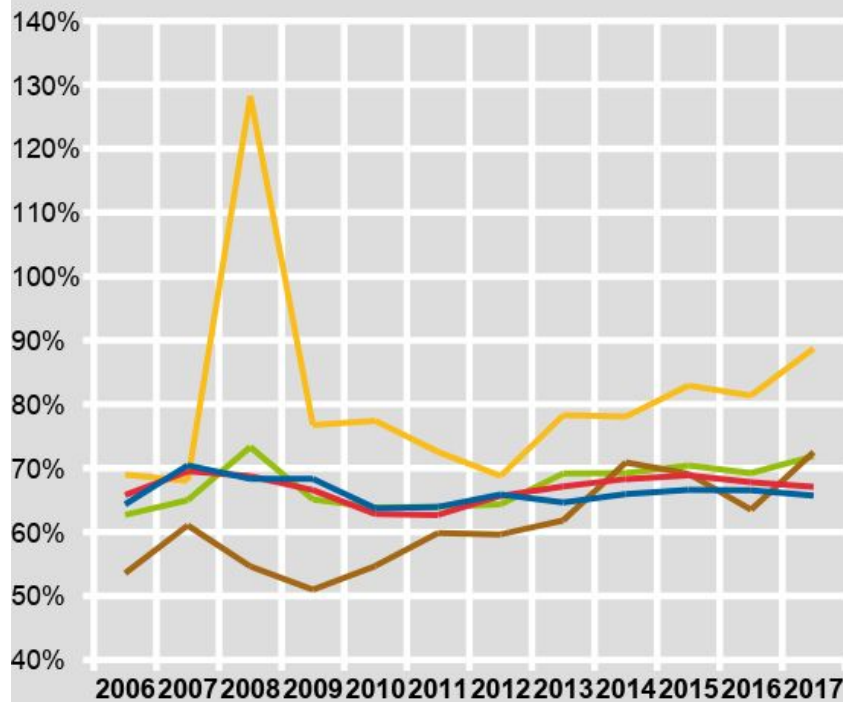
Source: Deutsche Bundesbank Monthly Report September 2018, "The performance of German credit institutions in 2017".

3. Performance of German LSIs

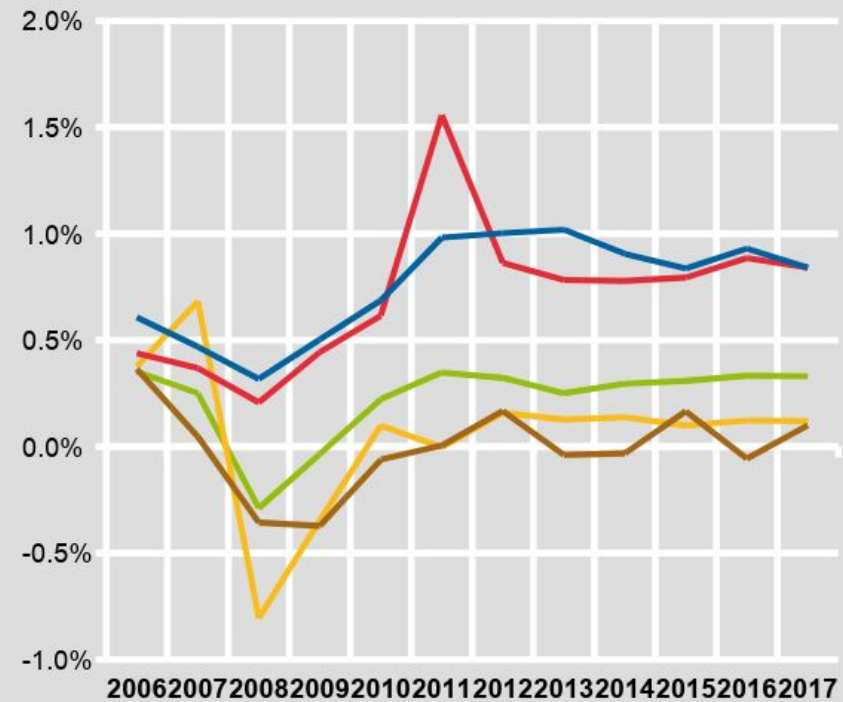
Profitability

Cost-income ratio and return on assets by banking group

Aggregate, profit pre-taxes in % of total assets



— All banks
— Big banks



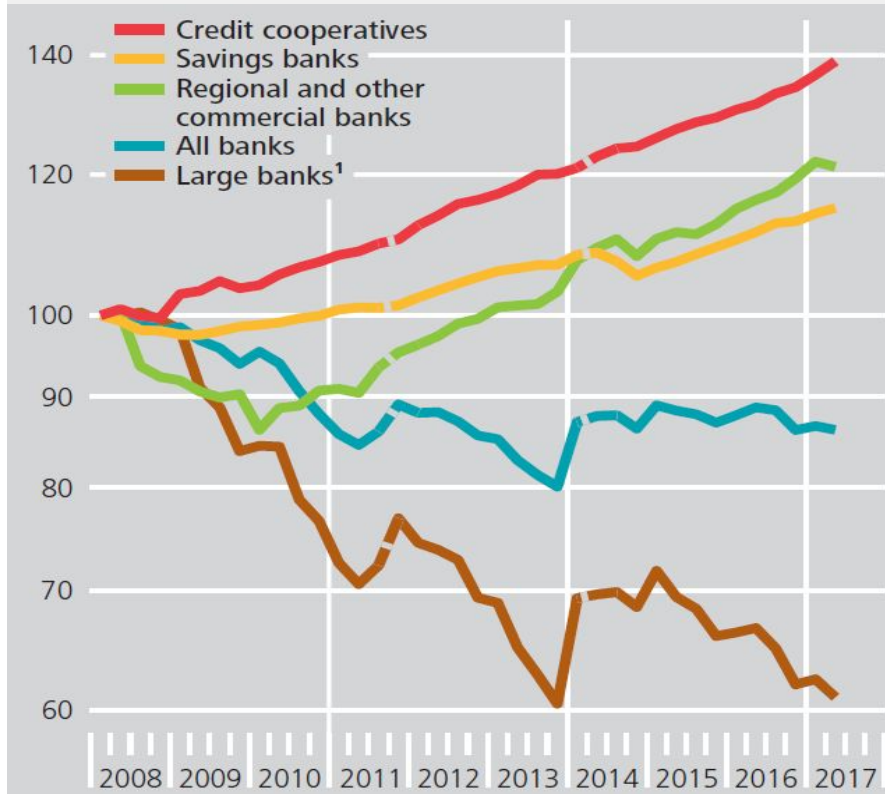
— All banks
— Big banks

Source: Deutsche Bundesbank Monthly Report September 2018, "The performance of German credit institutions in 2017".

3. Performance of German LSIs

RWAs and capital position

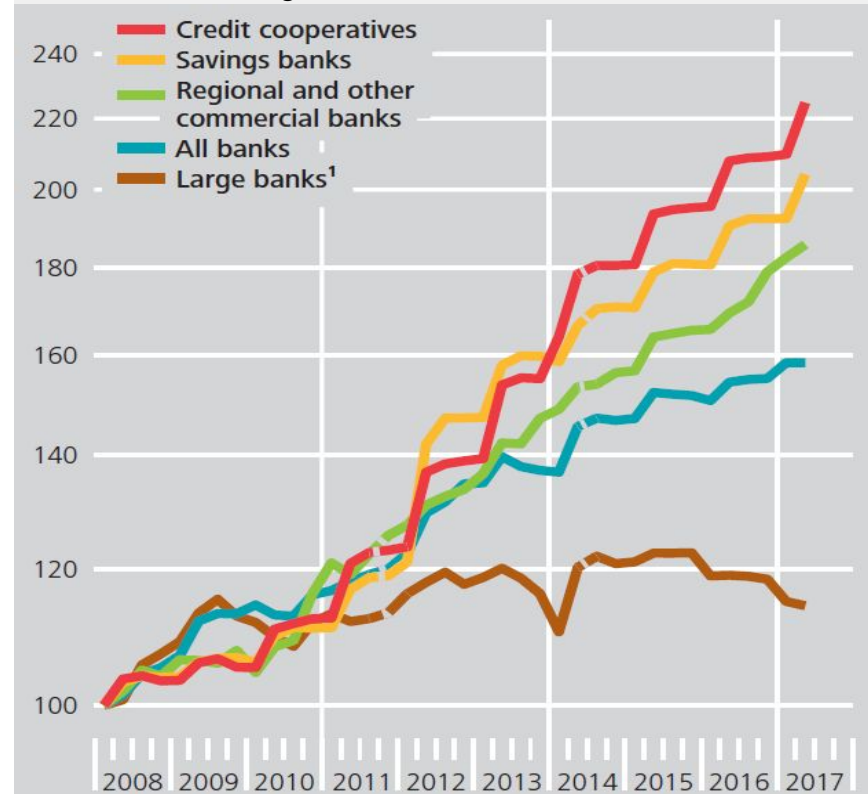
Risk-weighted assets by categories of banks*
2008 Q1 = 100, log scale



* Change in valuation in 2011 and 2014 as a result of Capital Requirements Directives CRD III and CRD IV. ¹ 12 major German banks with an international focus which did not outsource positions to resolution agencies in the observation period.

Source: Deutsche Bundesbank, Financial Stability Review 2017.

Tier 1 capital by categories of banks*
2008 Q1 = 100, log scale



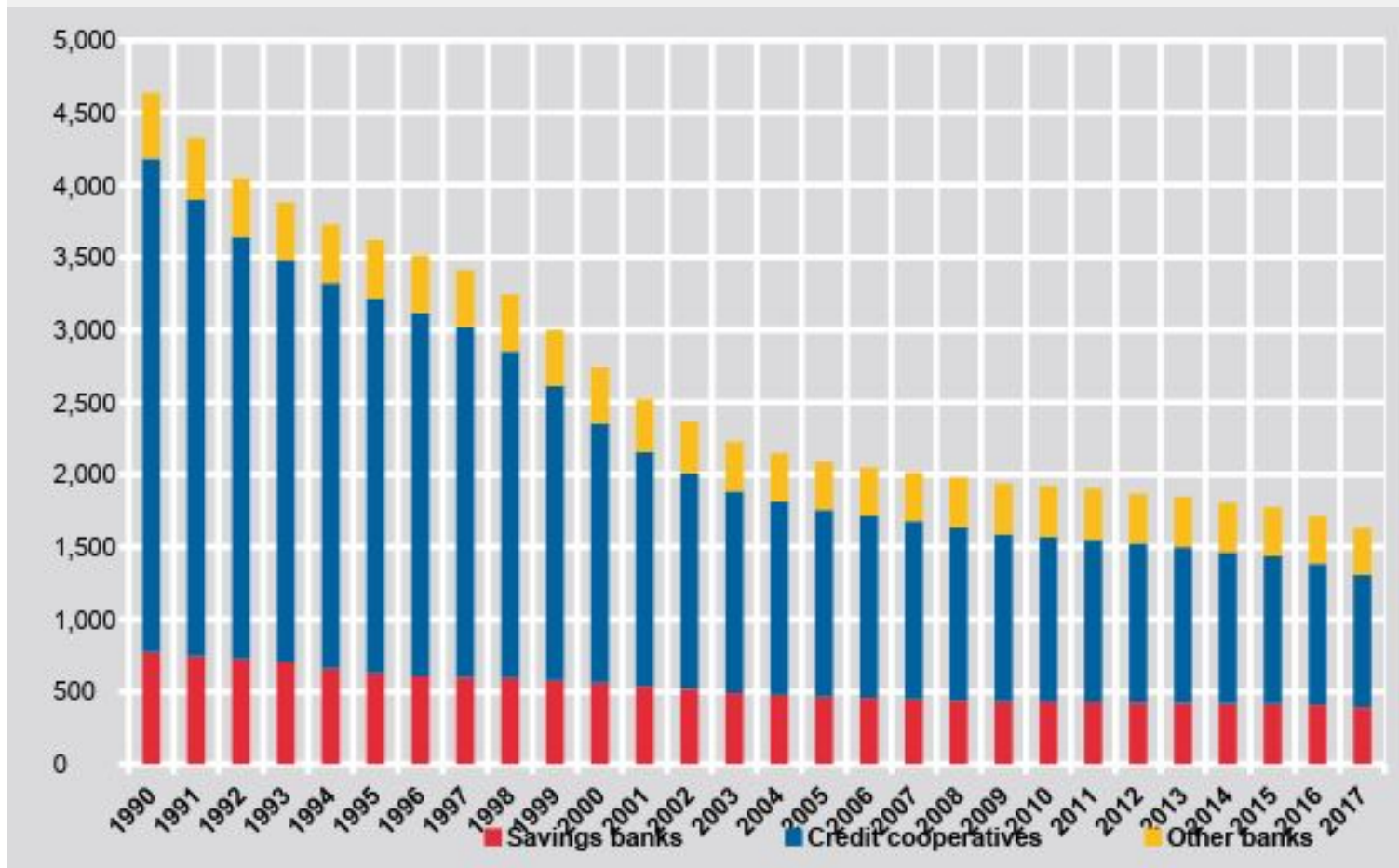
* Change in valuation in 2011 and 2014 as a result of Capital Requirements Directives CRD III and CRD IV. ¹ 12 major German banks with an international focus which did not outsource positions to resolution agencies in the observation period.

Source: Deutsche Bundesbank, Financial Stability Review 2017

3. Performance of German LSIs

Consolidation trend

Number of banks in Germany



4. The supervisory perspective

Supervisory SREP stress tests

3 different stress tests in 2017:

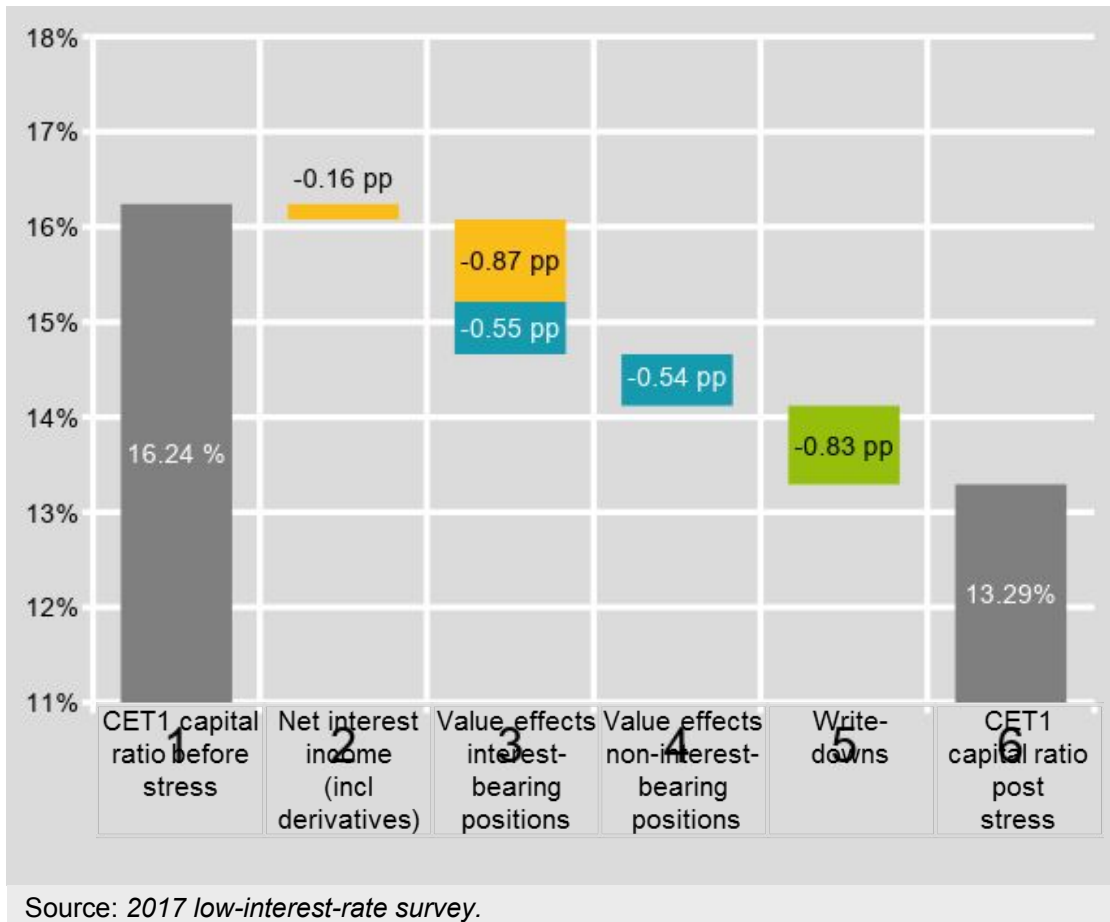
SRE P stre ss test s	Interest rate risk	Baseline: constant yield curve
		Stress: +200 bp interest rate shock
	Credit risk	Probability of default: +155%
		Loss given default: +20%
	Market risk	Interest-bearing items: +30 bp to +1500 bp risk premium
		Other positions: 20% haircut

For the Pillar 2 Guidance all three stress effects are aggregated and mapped to capital add-ons (0 % - 10 %; bucket approach)

4. The supervisory perspective

Impact of supervisory stress tests

Impact of the stress effect on CET1 capital ratio
Aggregate in percent and effects in percentage points



- The **stress test** has shown that German institutions are **mostly well capitalised** in each of the stress scenarios.
- CET1 capital ratio drops by **2.95 percentage points** in aggregate in one-year stress horizon (16.24% to 13.29%).
- Main drivers are **value effects on interest-bearing positions** as a result of interest rate increases.
- Additionally: **hidden reserves** may serve as **another capital buffer** for some institutions.
- Taking hidden reserves into account, **roughly 4.5% of institutions** would fail to meet supervisory **requirements** (Pillars I & II plus capital conservation buffer) **in a stress event**.

4. The supervisory perspective

Supervisory activities

- Supervisory focus for LSIs
 - Profitability risks (including business model risks)
 - Interest rate risk
 - Digitalisation and IT risks
- The low-interest-rate environment continues to weigh heavily on small and medium-sized credit institutions in Germany. BaFin and Bundesbank continuously monitor the related risks by conducting a low-interest rate survey and a stress test on a bi-annual basis (2019).
- Supervisory focus on the viability and sustainability of banks' business models in ongoing supervision and SREP assessments.

5. Outlook

- The ongoing favorable economic situation will benefit German banks' earnings situation, while low interest rates and the flat yield curve will continue to present challenge.
- The resilience of German LSIs is expected to remain relatively high with most institutions intending to increase their CET ratio in the upcoming years.
- Competition will remain high.
- Mergers can be one option for small regional banks within their sector, but not the sole solution for the challenges ahead.
- Increase of commission income.
- Adaption of business models – Sustainability is essential.
- German banking sector will maintain its three-pillar-structure.
- Finding the best-fitting strategy is the responsibility of each institution's management.

Thank you for your attention.
Any questions?

Christian Otto

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+49 69 9566 6957

Small credit institutions and commercial banking for SMEs and natural persons

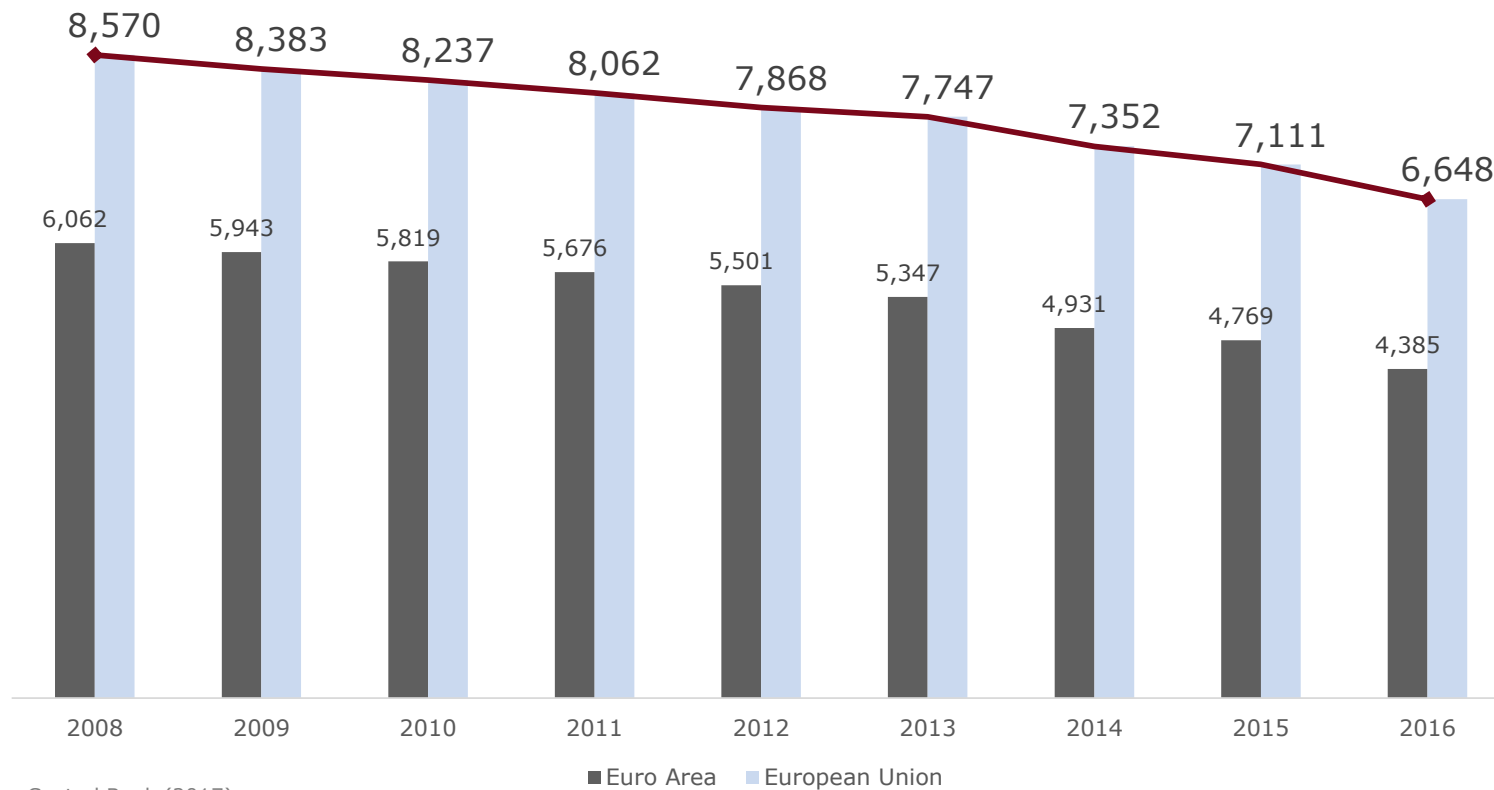
Author:	Martina Küster
Place:	Ljubljana
Date:	19 October 2018
Name of the event:	What future for small commercial banks in Europe?

Agenda

1. Consolidation: European and German banking market
2. Diversity
3. Private Banks in Germany – Association of German Banks
4. Small banks
 - a) Special corporate culture and fundamental values
 - b) Key assets
 - c) SMEs - Natural counterpart to small banks

The European banking market

How many banks are there in Europe?



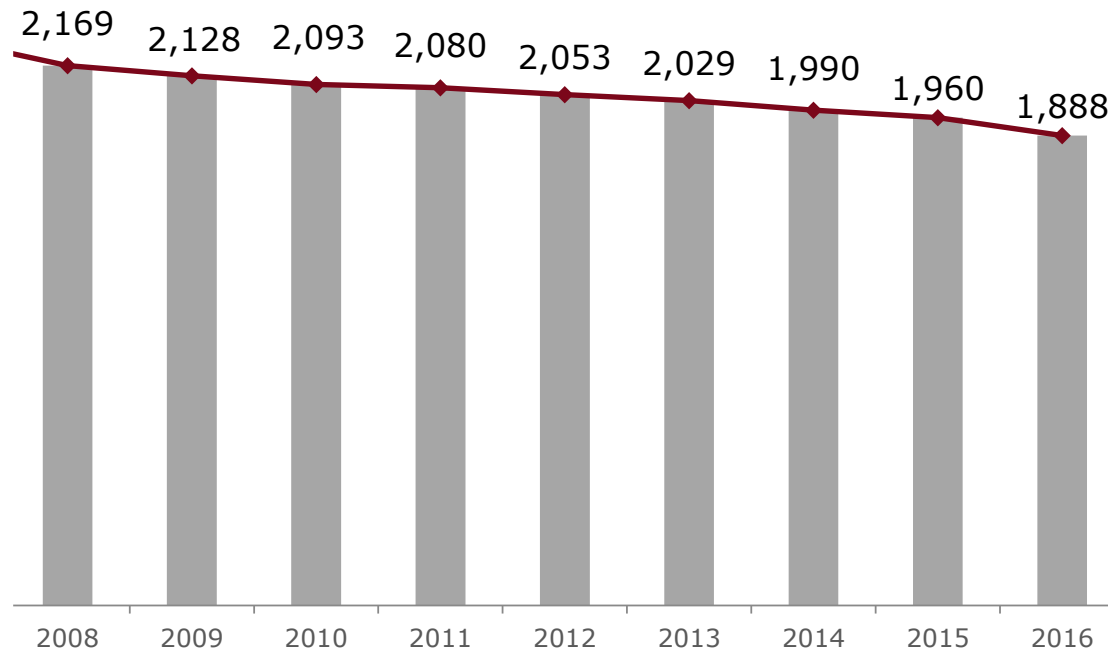
The German banking market (1)

The German Banking Industry Committee (Deutsche Kreditwirtschaft)
– member associations



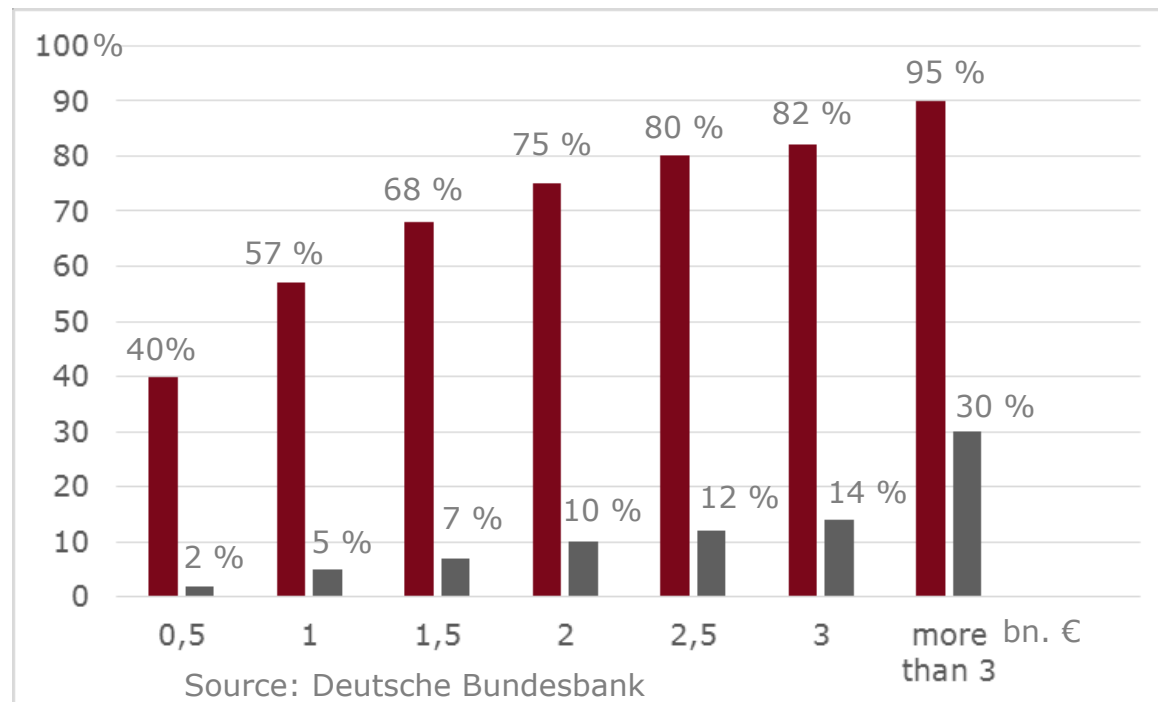
The German banking market (2)

How many banks are there in Germany?



Diversity in the banking sector

- 82% of all banks in Germany are small.
- Many of them are private banks; they compete with each other.



- Number of institutes in % of all institutes in Germany
- Total assets in % of the whole banking market in Germany

The private banks in Germany

281

private banks with

(204 association
members and a further
77 private-sector
institutions in Germany)

9,407
domestic branches

41%

market share

(measured in terms of
the total assets of the
German banking
industry)

175,000 employees



Sources: Deutsche Bundesbank, private banking sector employers' association (2017)

The Association of German Banks

- 204 banks: from global bank to regional bank
- Sub-divided into:
 - Big banks (4)
 - **Regional banks (78)**
 - Foreign banks (86)
 - Private bankers (21)
 - Extraordinary members (15)
- All member banks compete with each other
- Eleven legally independent member associations

Small banks

Special corporate culture and fundamental values

Fundamental Values		
Tradition	Entrepreneurial independence and a sustainable approach	Partnership-based relationship with clients

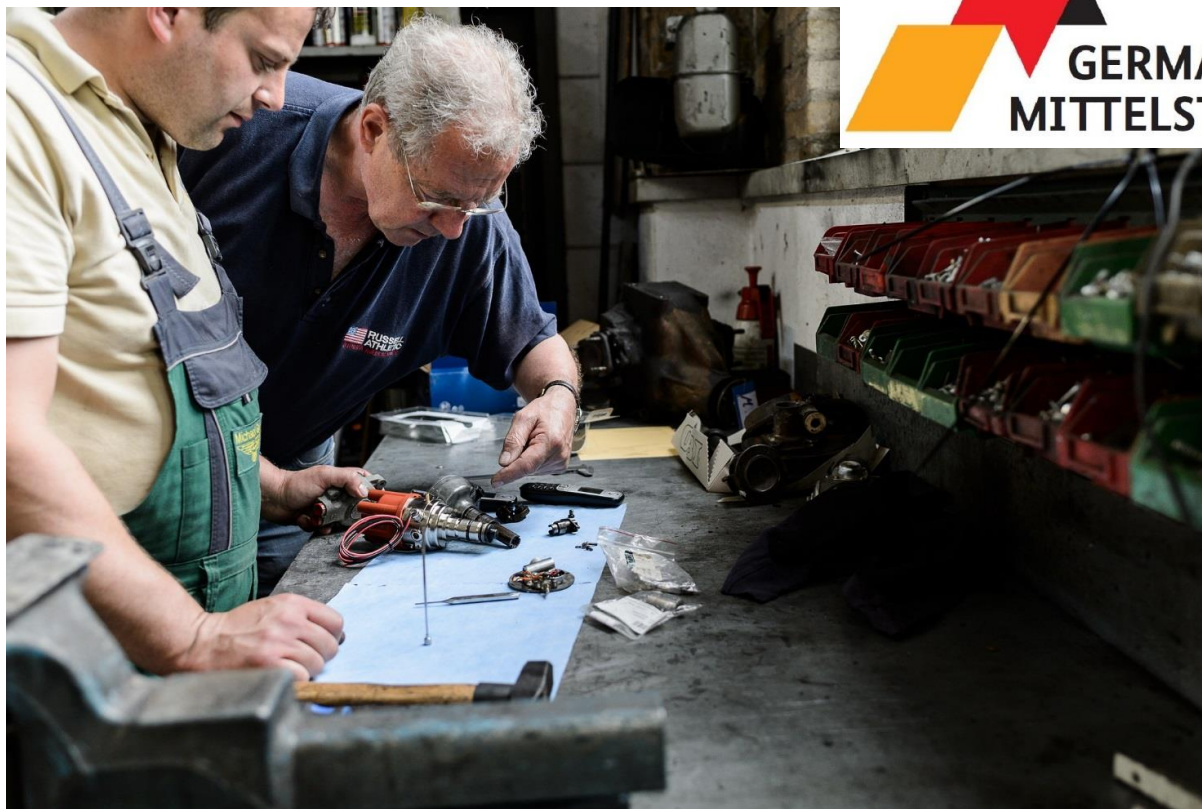
Small banks

Key assets

- Regional institutes are often the backbone of the regional economy and consumers
- Physical proximity / On-site service
- Better access to so-called soft and local information in lending

The German Mittelstand (SMEs)

Natural counterpart to small banks



Thank you for your attention

Association of German Banks

Name: Martina Küster
Title: Adviser Corporate Finance
E-mail: martina.kuester@bdb.de

**Third session: Current and future challenges
from digitalisation for small credit
institutions: new distribution channels, data
processing, and higher competition**

Chair: Marko Bošnjak

Panelists:

Prof. Dr. Santiago Carbo-Valverde

Dr. Thomas Gstädtner

Ms. Anja Rijavec Uršej

Centre for Legal and Economic Studies: CLES@pf.uni-lj.si

What future for small commercial banks in Europe?

An event organised under the auspices of the
Faculty of Law, University of Ljubljana
and Bank of Slovenia

19 October 2018

Current and future challenges from digitalisation for small credit institutions: new distribution channels, data processing and higher competition

Santiago Carbo-Valverde
CUNEF and EBI

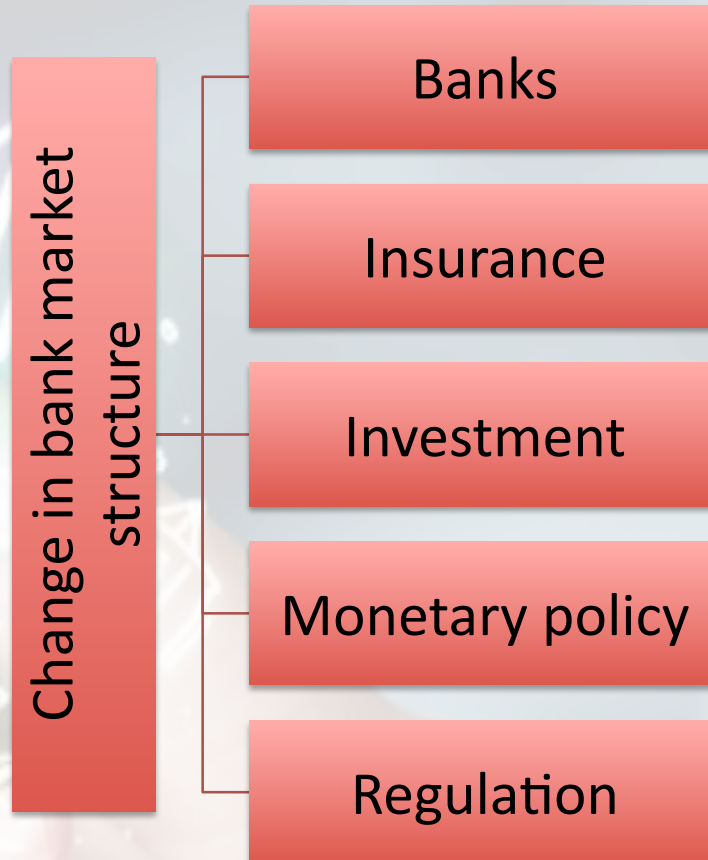


Outline

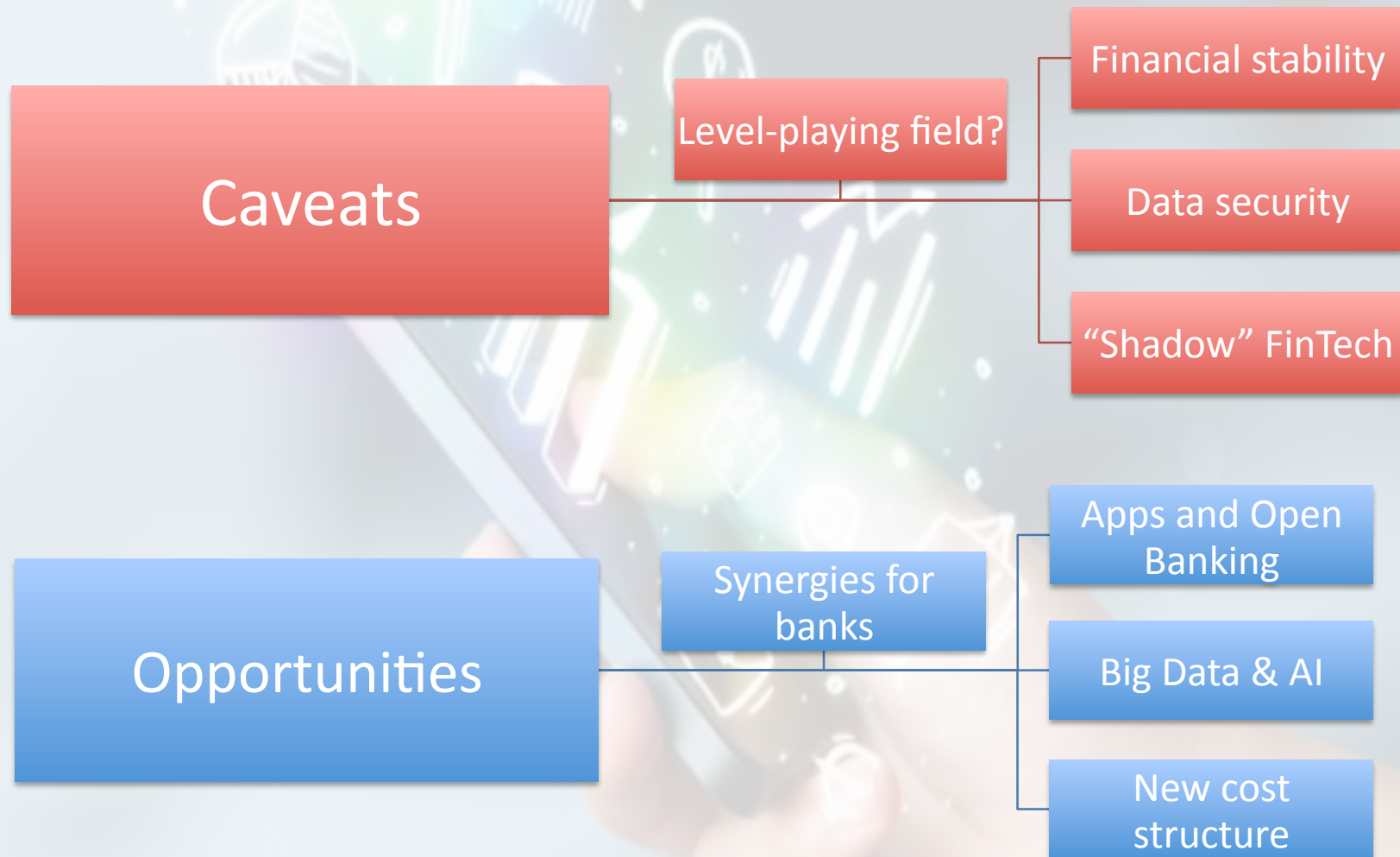
- ① The new competitive map and the role of small credit institutions
- ② BigTech, FinTech and small credit institutions
- ③ Competitive intersection and value-chain

1. The new competitive map and the role of small credit institutions

❏ A wide competitive map with several distribution channels

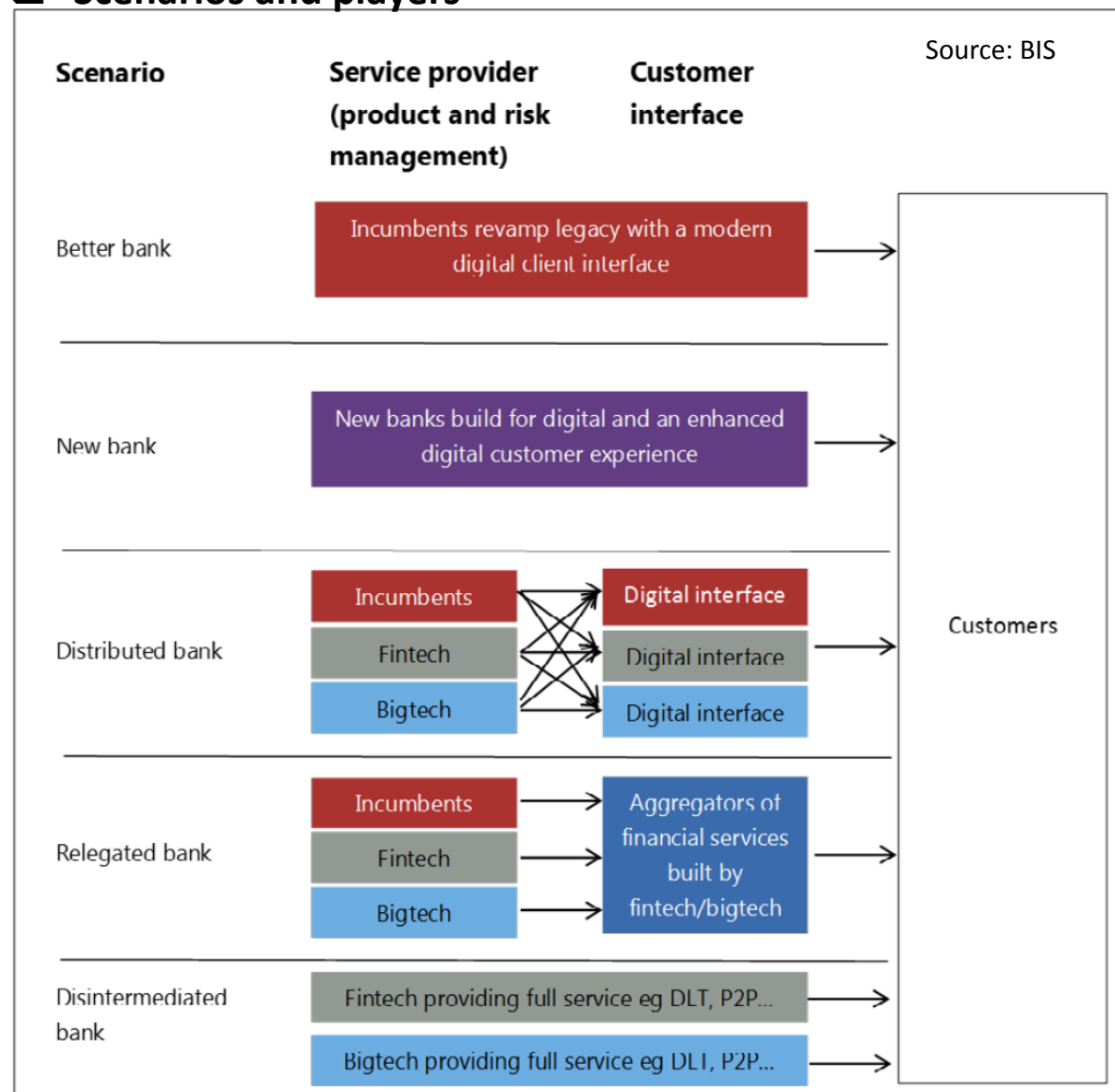


1. The new competitive map and the role of small credit institutions



1. The new competitive map and the role of small credit institutions

❑ Scenarios and players



❑ Check-list for small credit institutions

- ❑ Can I be a “better bank”?
- ❑ What can I get from FinTech ? (competition for ideas)
- ❑ To what extent BigTech is a threat for my business?
- ❑ How can I combine tech and relationships?

2. BigTech, FinTech and small credit institutions

Regulation is changing everything but... is regulation targeting the business or the institutions?



Basel III... y IV

MiFID II

GDPR

PSD2

...

Ubiquitous
regulation

Bad timing

Overlapping

Effectiveness?

Meanwhile...

ICOs being issued and 12% of them hacked/
robbed

"Shadow FinTech" platforms

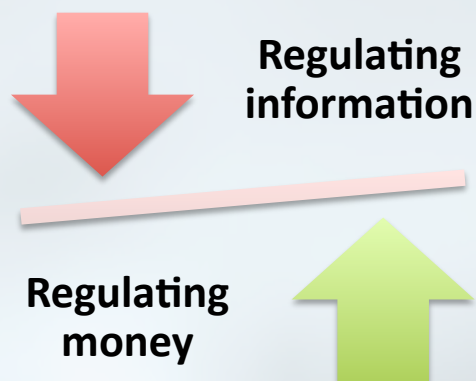
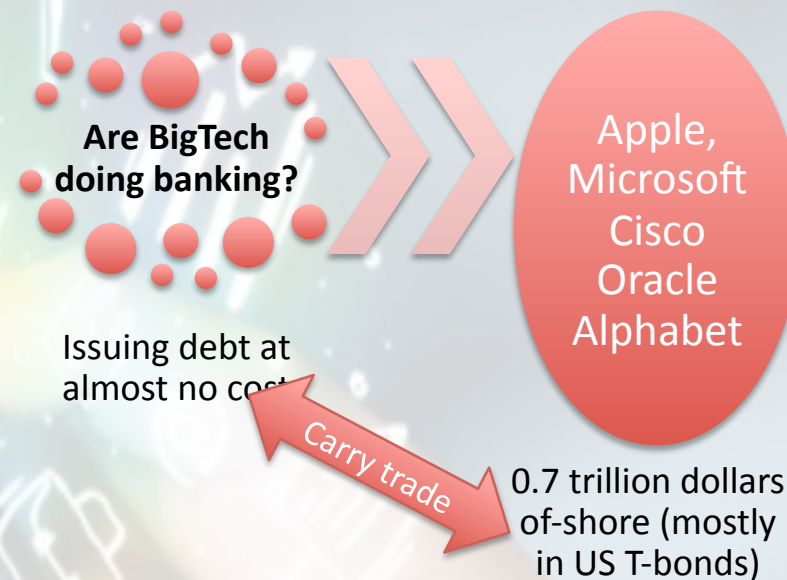
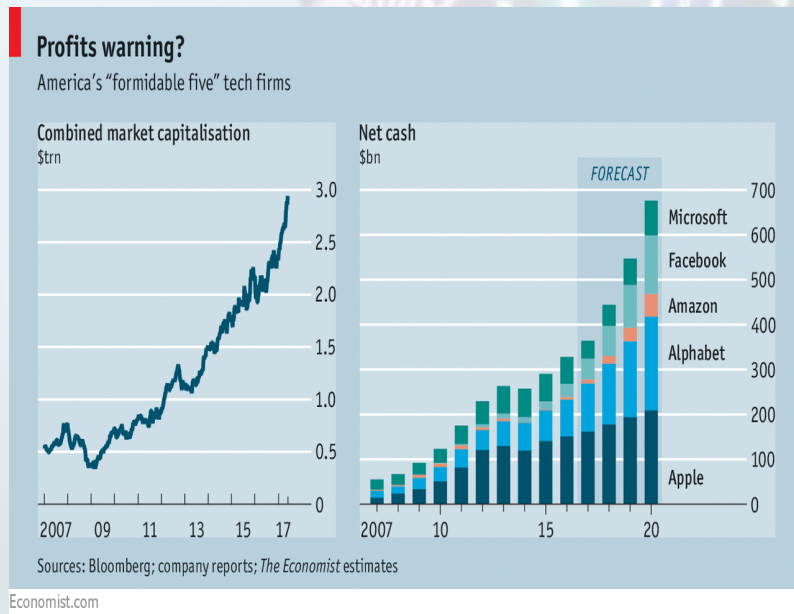
Labour relationships at stake

Only payments or a way to skip bank regulation?

Blockchain opportunities and risks

2. BigTech, FinTech and small credit institutions

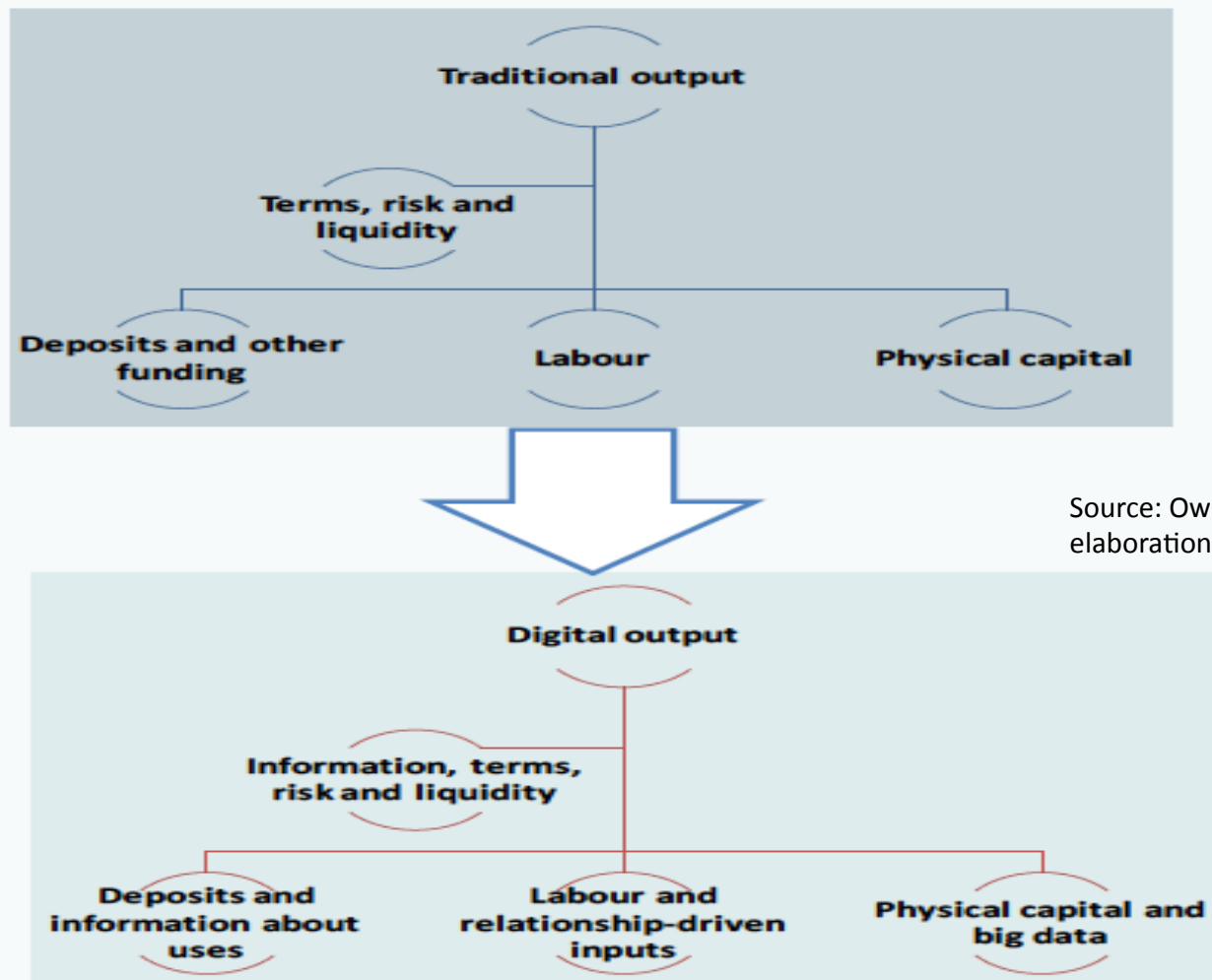
- ❑ Questions on small credit institutions and competition from BigTech and FinTech:
 - ❑ Why BigTech companies do not buy banks?
 - ❑ Should we think of FinTech as competitors or allies?



3. Competitive intersection and value-chain

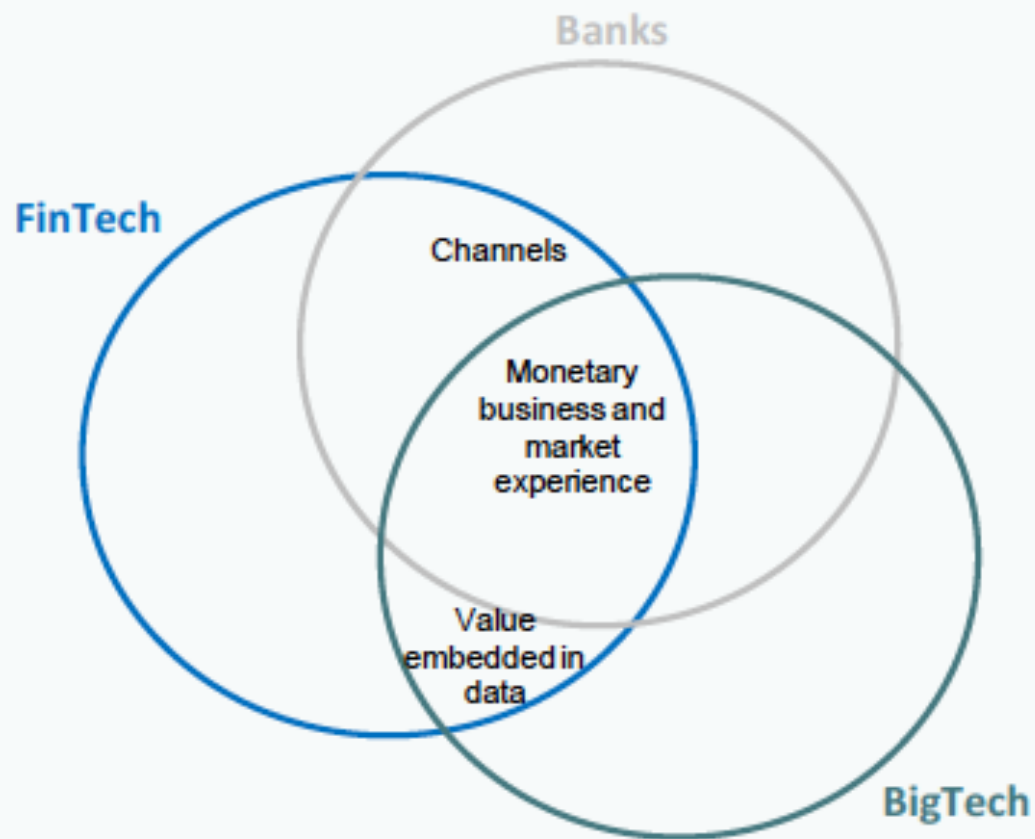
- ❑ Small credit institutions: how to transform the business model

The bank's new digital transformation function



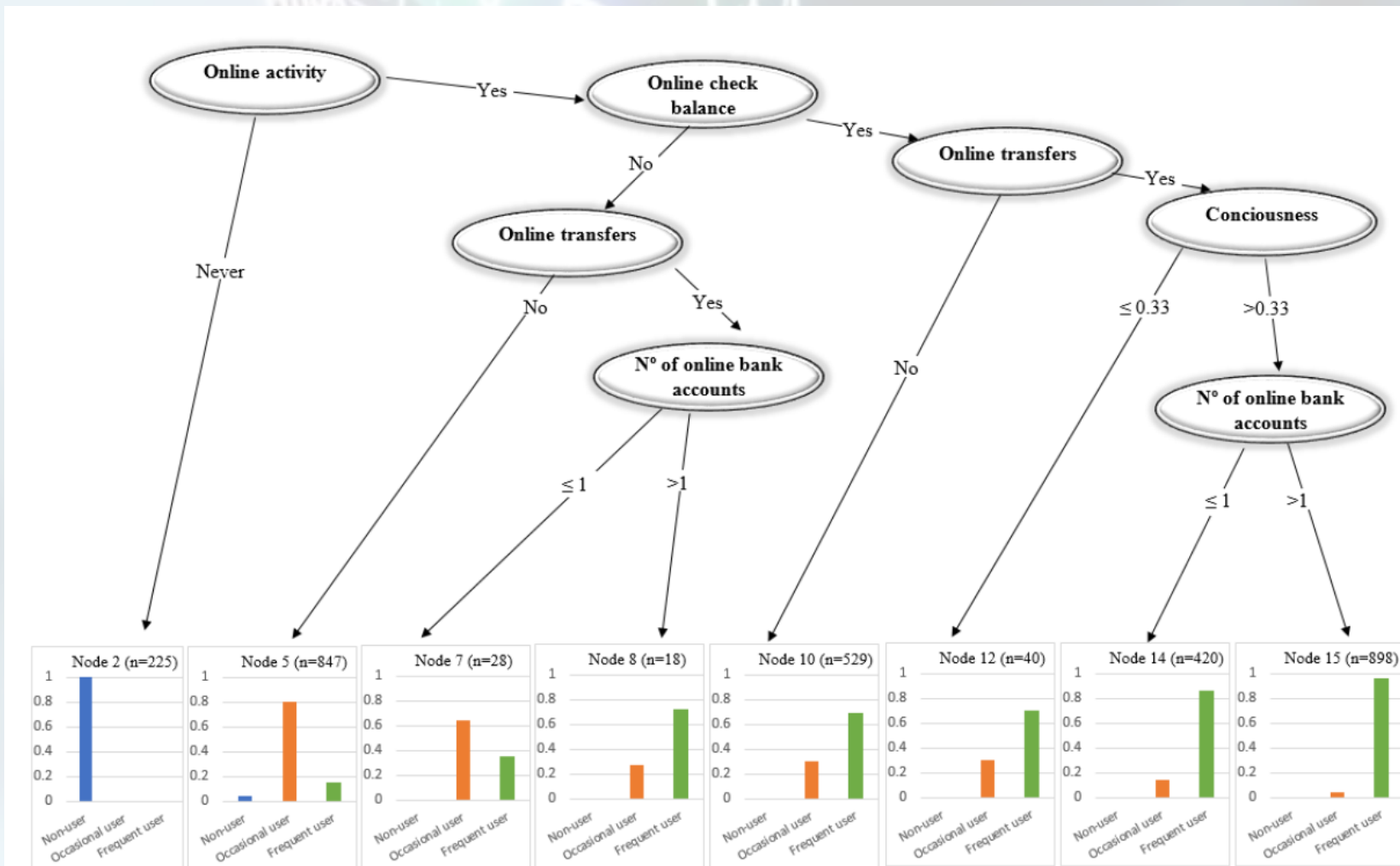
3. Competitive intersection and value-chain

Intersection of the value chains of incumbent banks, FinTech and BigTech



3. Competitive intersection and value-chain

- Small credit institutions should revise some facts from the demand size: information matters to build trust



3. Competitive intersection and value-chain

- ❑ Therefore, small credit institutions can:
 - ❑ Rely on the (information) value of existing lending relationships
 - ❑ Exploit local (trust) opportunities
 - ❑ Find cooperation from FinTech (BigTech?)

Dr. Thomas Gstädtner

Head of Division Significant Bank Supervision IX
European Central Bank

DIGITAL TRANSFORMATION OF THE BANKING INDUSTRY

Implications in the context of regulatory aspects

Agenda

1 Major Trends in Digitalization and their Drivers

New competitors, data processing and instant payment

2 Supervisory Implications

Outsourcing, Cyber Risks and Governance

ECB Report on the Thematic Review on Cyber Risk and Outsourcing

3 Summary

Major Trends in Digitalization and their Drivers



The evolution of technological infrastructure coupled with significant **socio-economic trends** and **demographic changes** has resulted in today's fast-paced technology environment.

In this context, **European Banking Authority** identifies **two main trends**, namely

- the **digital transformation** as a transformation of the internal processes with the aim of digitizing and optimizing operations.
- digital disruption** as a change of the traditional banking market from its present form through the creation of a new market made possible by the use of innovative technologies, incl. new types of customer interaction to enhance the customer experience.

At present, however, it is not yet possible to predict whether the industry will develop sustainably (i.e. evolutionarily) or whether it will undergo a disruptive change

Major Trends in Digitalization and their Drivers



The potential disruptions in the provision of financial services through the use of emerging technologies and the entry of new entrants seem to **force institutions to rethink their business models**.

Four main drivers seem to shape and change the way banking services are offered, namely:

- (i) Customer behavior and their expectations,
- (ii) Profitability concerns of established institutions, esp. in the low interest environment
- (iii) increased competition and
- (iv) the regulatory framework.

As of now, digital transformation has **focused on 3 areas**:

- New providers of financial services in the banking market, so-called FinTechs
- Reworking of IT infrastructure and enhancing data processing, e.g. increasing the level of automation of back-office procedures
- (i) The acceleration of transactions through instant payments

FinTech Disruption: New Competitors pushing Banks to Change



FinTech is an emerging field at the intersection of financial service and new technologies. They utilize cutting-edge technologies to provide new and better financial services to consumers and businesses.

- Tech giants like Apple, Google, Amazon and Facebook create **free services for a large circle of customers** thanks to their coverage, high financial strength and their "charisma", and in turn benefit from the evaluation of the payment data.

FinTechs can offer **various forms of financial services** and are increasingly **cooperating with** or being **taken over by incumbent credit institutions** to ensure the achievement of a critical mass of customers.

Their impact on the established banking environment is radical:

- **Omni-channel banking and obsolescence of bank branches:** banking shifts from being a branch-specific activity to one that permeates all digital channels (mobile, social, online)
- **Platform-Banking:** FTs can provide innovative services in the foreground, which access the systems of the banks in the background or loans are concluded via external websites.
- **Robo-Advisory** provides customers with automated, cost-effective custody and thus affecting the wealth management industry.
- Specialized services like **machine learning** and **artificial intelligence** - e.g. for detecting fraudulent transactions - are offered to incumbent credit institutions.

Data Processing and Instant Payment



Banks made considerable efforts of reworking their IT infrastructure and enhancing data processing, e.g. increasing the level of automation of back-office procedures.

After the initial euphoria of **DLT**, which had seen technology as a panacea for all the challenges of digital society in general, one is now intensively engaged in the **search for concrete use cases**:

- **Cross-border payments outside the euro area**, the distributed storage and the peer-to-peer connection enables an increase in efficiency.
- **Smart Contracts**: the very complex trade financing or the management of reference data are further potential applications (i. e. automatically processing contracts without manual intervention when specific conditions are met):

Banks simulated securities transactions via Blockchain: due to their short maturities and simple structures, money market securities are well suited for issuing and trading on the basis of DLT,

By contrast, the **performance of established financial market infrastructures** through instant payments will increase in the coming years:

- Payments can then be processed from account to account **within a maximum of ten seconds**.
- The Eurosystem central banks will provide their own technical infrastructure for booking instant payments in real time (TIPS, **TARGET Instant Payment Settlement** which be part of the TARGET2 family)

Agenda

1 Major Trends in Digitalization and their Drivers

New competitors, data processing and instant payment

2 Supervisory Implications

Outsourcing, Cyber Risks and Governance

ECB Report on the Thematic Review on Cyber Risk and Outsourcing

3 Summary



Prudential Challenges for the Banking Industry (1/3)

Dependence on third-party providers, legal uncertainty issues, reputational and behavioral risks and the general increase in IT risks could potentially pose the greatest regulatory risks, in particular:

I. Risk of Outsourcing IT-Tasks / Cloud-Computing:

All outsourced activities and processes that lead to a **delegation of responsibility** to the outsourcing company are of particular supervisory importance:

➔ **Privacy and other compliance concerns**, as well as legal aspects of liability (in the case of fraudulent activity), and concerns about managing the Distributed Ledger may arise, in particular:

- **Legal risk** – potential for a case of non-compliance with the privacy, consumer and prudential law.
- **Reputation risk** - poor services of the service provider could be harmful for the reputation of bank and will harm customer relationships.
- **Strategic risk** - business conduct of the service provider can be against the strategic goals of the bank.

➔ Potential impact on **overall operational risk** from data security, systems and banking secrecy issues, esp. when cloud services are hosted in jurisdictions that are subject to different institutional laws and regulations, in particular:

- **Operational risk**- technology failure, inadequate infrastructure or any error in providing IT services by the service provider.
- **Country risk** - due to political, social climate in the country in which service is outsourced

Prudential Challenges for the Banking Industry (2/3)



II. Cyber Resilience

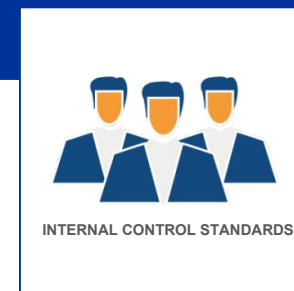
Cyber resilience refers to an **entity's ability to continuously deliver the intended outcome** despite adverse cyber events and brings the areas of information security, business continuity and (organizational) resilience together.

Adverse cyber events are those that **negatively impact the availability, integrity or confidentiality of networked IT systems** and associated information and services. These events may be **intentional** (e.g. cyber attack) or **unintentional** (e.g. failed software update) and caused by humans or nature or a combination thereof.

The ECB therefore takes cyber resilience very seriously as it could **jeopardize financial stability**:

- Banks must not underestimate cyber risks as they can **differentiate them from the complex network of financial market infrastructures** that underlie day-to-day operations.
- **Successful ransomware attacks** such as **WanaCry** (May 17) or **NoPetya** (June 17) have shown that cyber-attack can lead to severe disruption and major losses for the targeted firms.
- In the EU, the **General Data Protection Regulation** (GDPR) requires firms to report breaches to the competent supervisory authority within 72 hours. Failure to comply with the reporting requirements could lead to fines up to EUR 20Mn or 4 percent of global annual turnover.

Prudential Challenges for the Banking Industry (3/3)



III. Governance & Risk Management:

Digitization is also forcing banks to rethink internal governance and risk management regulations as the new technology has significant impact on its overall risk profile and business model sustainability.

Boards need to be able to challenge senior management on IT issues, provide the required expertise, and spend enough time debating issues arising from new technology

- Fostering open and collaborative culture and seamless embedding of risk appetite framework in business decisions

Risk teams need to use their established capabilities to anticipate potential implications of this context, and develop new capabilities for managing risks arising from new technology:

- The **three-lines-of-defense model** must be adapted to digital challenges:
 - Definition of additional controls,
 - Specification of IT risk strategy,
 - Integration of digitalization in audit plans and the associated methods and processes.
- New analytical techniques** like machine learning, natural language processing, and self-learning algorithms can significantly enhance an institution's risk profile:

Credit risk modeling is being significantly improved, card firms are driving fraud discovery down to milliseconds, and natural language processing is revolutionizing conduct monitoring forensics, and optimizing debt collection rates.

SSM Thematic Review on Cyber Risk & Outsourcing



The ECB has recently carried out an **in-depth assessment of credit institutions' cyber risks and outsourcing** to better understand the IT risk landscape in the banking industry and to detect areas that need further investigation:

Stocktaking of IT risks outside the euro area

- helped identifying best practices that define supervisors' expectations.
- work will continue as part of our contribution to the EBA work program.

On-site inspections of current IT and cyber risks

- With the aim of carrying out such inspections for large banks every three or four years.

Result: Concentration of companies to which banks outsource IT functions

Consequence:
ECB has created a reporting framework for cyber incidents

- Since mid-2017, banks must report significant cyber incidents
- This will help supervisors react quickly in a crisis and draw attention to common weaknesses.

- The results of these assessments will **feed into the SREP**, which will analyze the information provided by banks and serve as the basis for a thematic review of IT risks.
- In addition, the review allows to make a comparison of the banks.

Agenda

1 Major Trends in Digitalization and their Drivers

New competitors, data processing and instant payment

2 Supervisory Implications

Outsourcing, Cyber Risks and Governance

ECB Report on the Thematic Review on Cyber Risk and Outsourcing

3 Summary

Summary



To accommodate rapid technological change, banks must consider a number of aspects and consider the changes required in their corporate governance and operating models to achieve their strategic goals:

- While **new entrants** exert competitive pressure on incumbent institutions by reducing revenues mainly in the payment, settlement and retail sector, they could **facilitate innovation in terms of stability and integrity** in the banking sector.
- At present, the prevalent model is that banks strive to collaborate and build **relationships with FinTech** companies. Banks continue to play a central role in the same market structure.
- A potential concern is the **concentration of companies to which banks outsource core elements** of their digital banking business to a single provider – e.g. for systems for processing payments. In effect, such arrangements can create a concentration risk for the industry as a whole.
- The institution's **IT strategy** must be carefully designed – and the decisions and potential impact embedded within the new technology must remain well understood by banks' leaders.
- SSM Banks are not immune to **cyber risk**. Onsite inspections often reveal information security vulnerabilities that could be used by determined cyber criminals to obtain unauthorized access or wreak havoc.
- The **ECBs continuing message** to banks is that they themselves are solely responsible for taking the appropriate measures to protect themselves from cyber risk and the negative impacts such threats pose.

Dr. Thomas Gstädtner

Head of Division Significant Bank Supervision IX
European Central Bank

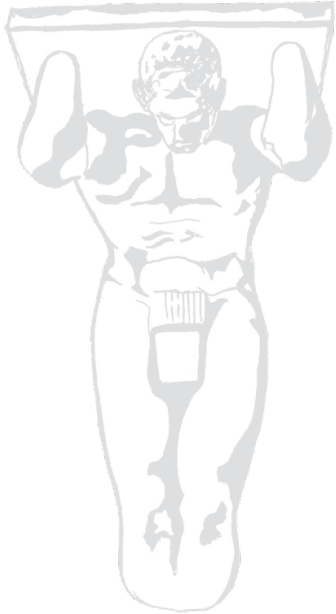
DIGITAL TRANSFORMATION OF THE BANKING INDUSTRY

Implications in the context of regulatory aspects

BANKA SLOVENIJE

BANK OF SLOVENIA

EUROSYSTEM



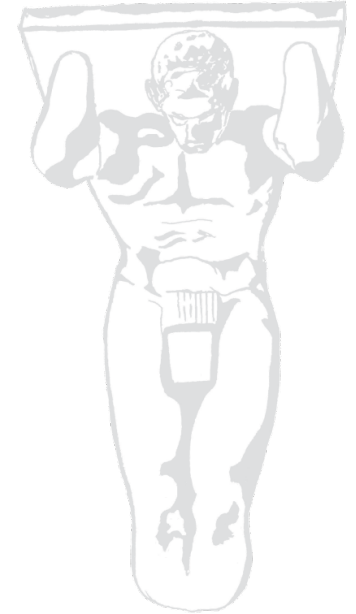
Banks and FinTech

What future for small commercial banks in Europe?

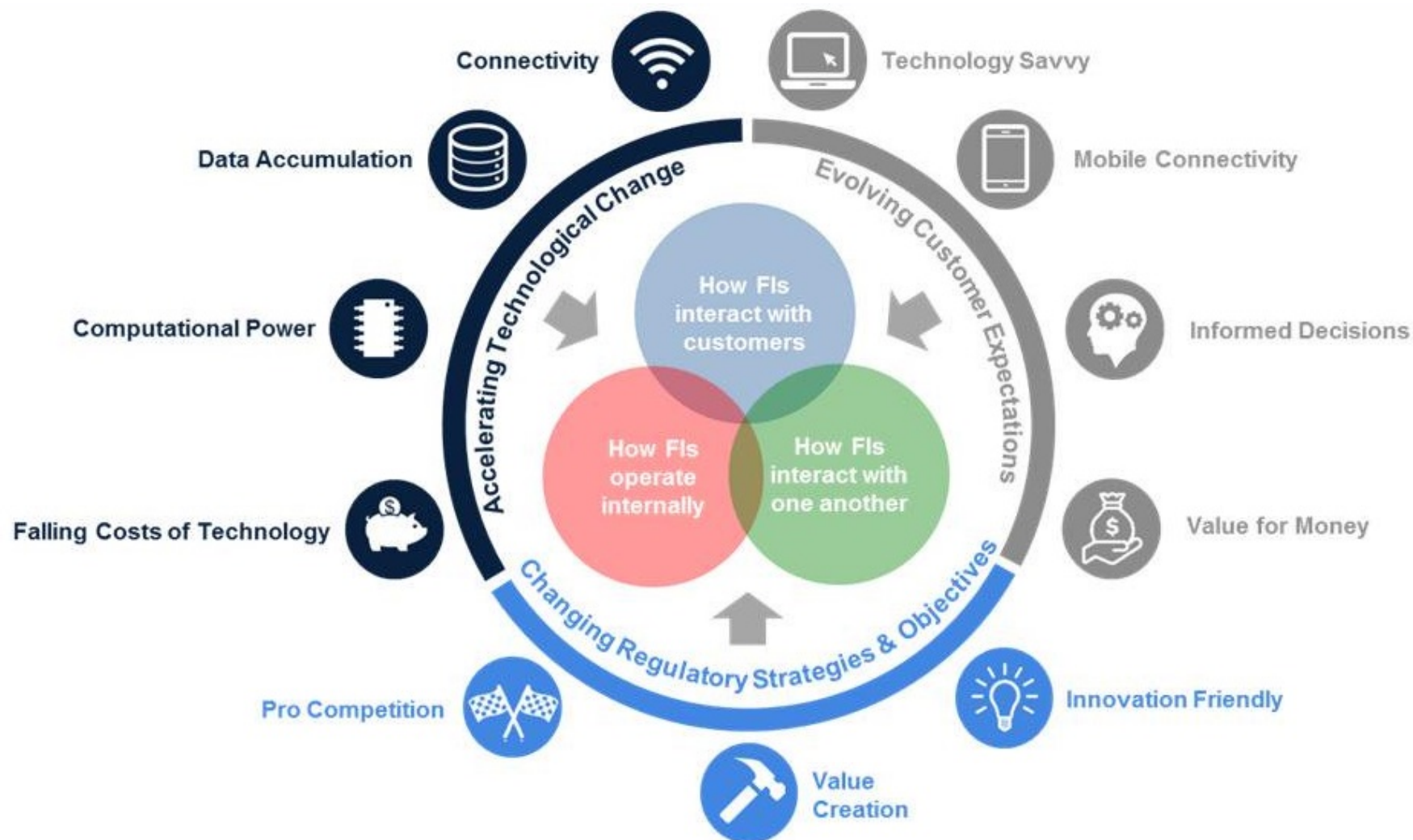
19 October 2019

Anja Rijavec Uršej

Payments and Settlement Systems Department



Financial Ecosystem is changing

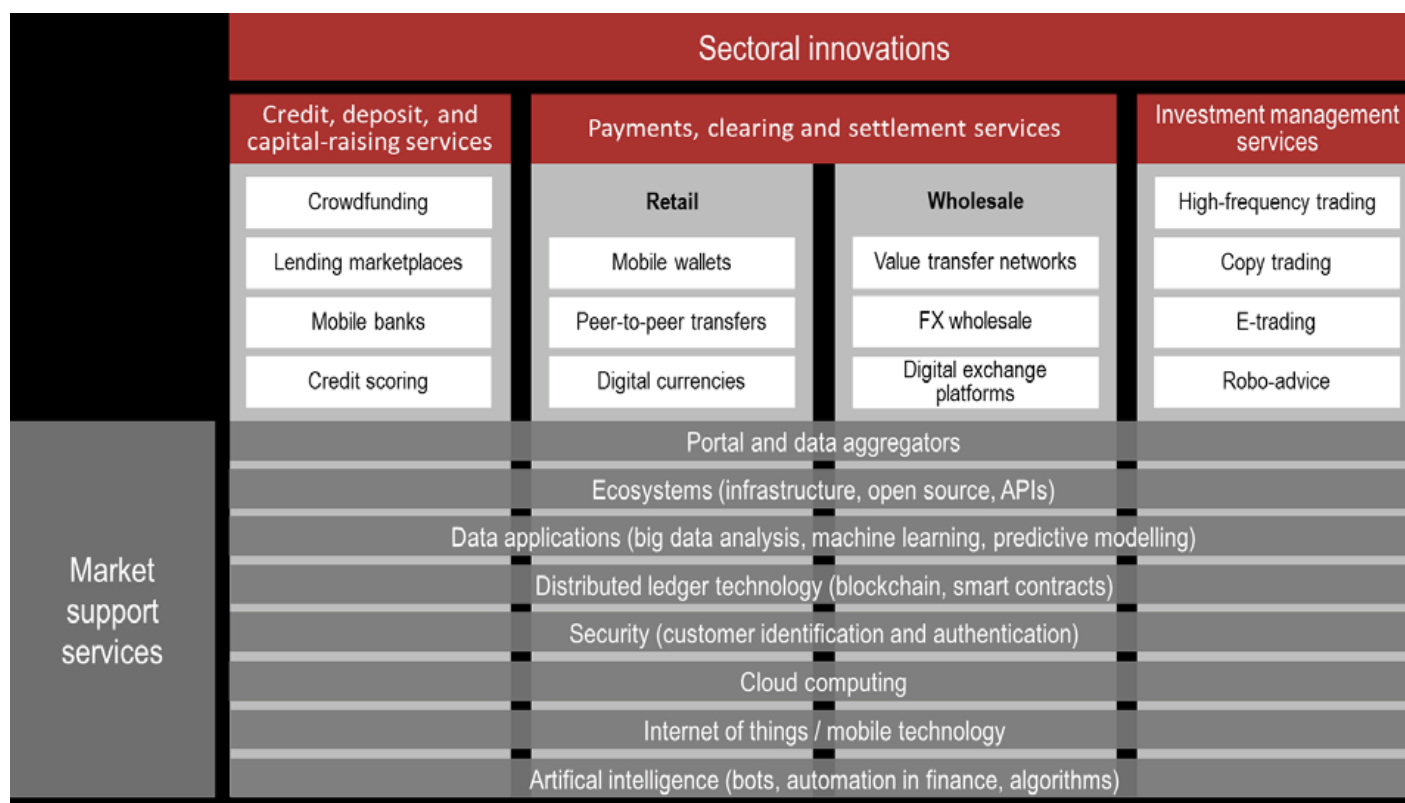


Source: The Future of Financial Services, WEF 2015

FinTech

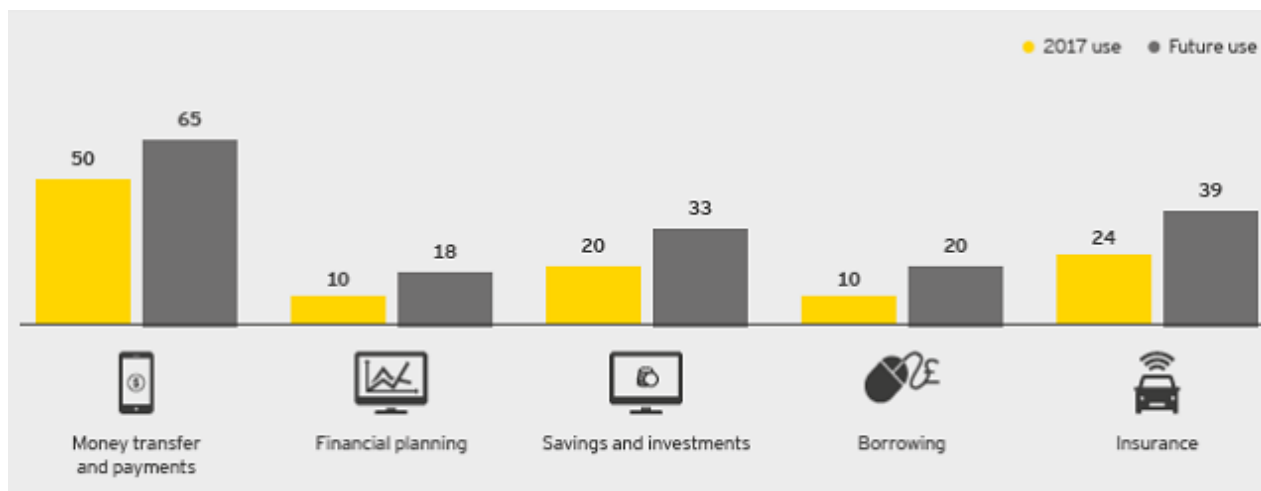


FinTech = *technologically enabled innovation in financial services that could result in new business models, applications, processes or products* with an associated material effect on financial markets and institutions and the provision of financial services.



Payments – important category of services for banks

Comparison of current and anticipated future use of FinTech, by Fintech category



Source: EY FinTech Adoption Index 2017

- Providing payment services enables banks to have *frequent contacts with their users* (availability of rich data about user's behavior and their needs, opportunity for cross-selling).
- As payment services are far more frequent than any other financial service, *being innovative PSP can improve bank's reputation* on the market.

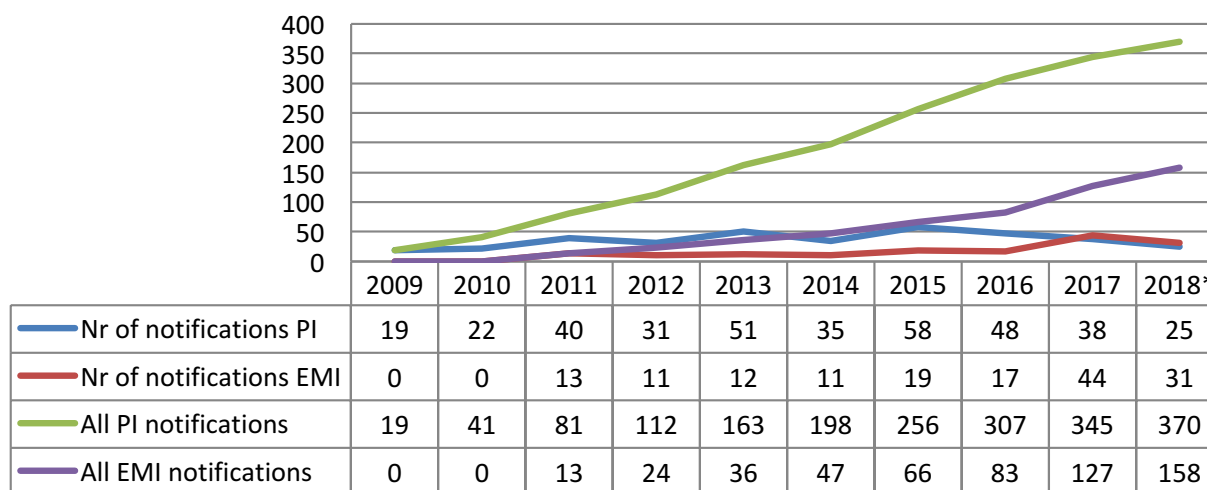
Competition in Slovene payments market

Payment Service Providers (PSPs) in Slovenia on 31. 7. 2018

	Credit Institutions	EMI	PI
Slovene PSPs	14	1	3
PSPs from other member states	71 (2 with a branch)	158	370

Source: Institutions under supervision, Banka Slovenije

Payment Institutions (PI) and Electronic Money Institutions (EMI) that notified providing payment services and/or issuance of e-money in Slovenia



Source: Institutions under supervision, Banka Slovenije

* Till 31.7. 2018

... but banks still have a head start

1. Development of Infrastructure for Instant Payments

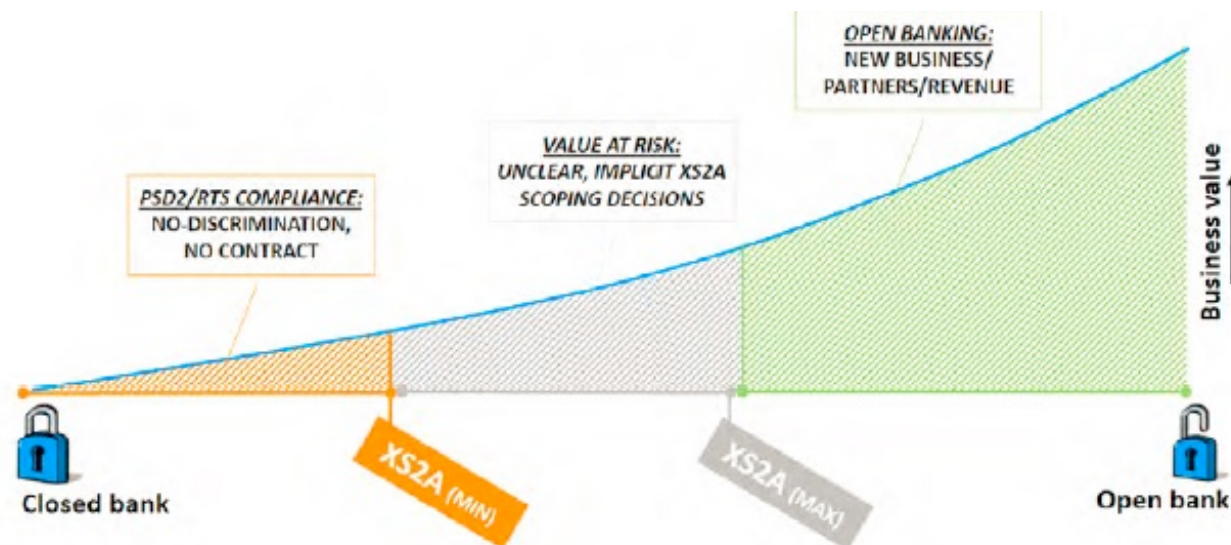


The money will be available on the account of the payee within ten seconds.



SCT Inst transactions will be available 24/7/365.

2. PSD2 and new possibilities for banks



Source: Open Banking & APIs Report 2017, The Paypers and Innopay, July 2017

Questions?



Fourth session: Sustainable finance (social, green, ethical) for small credit institutions

Chair: Prof. Dr. Katarina Zajc

Panelists:

Prof. Dr. Bart Joosen

Mr. Simone Grillo

Centre for Legal and Economic Studies: CLES@pf.uni-lj.si

SUSTAINABLE FINANCE FOR CREDIT INSTITUTIONS

LJUBLJANA, 19 OCTOBER 2018
PROF. DR. BART JOOSEN



LOOKING FURTHER



TABLE OF CONTENTS

- Perspectives of Sustainable Finance;
- The EC Action Plan on Sustainable Finance;
- EC legislative proposals on sustainable finance that will impact the banking sector;
- Sustainable finance in the Dutch banking sector

PART ONE

PERSPECTIVES OF SUSTAINABLE FINANCE

PERSPECTIVES OF SUSTAINABLE FINANCE



[...] For a 2°C compatible pathway, the G20 countries face an enormous investment. The investment required in infrastructure for energy, transport, potable water supply and sanitation, as well as telecommunications over the next 15 years is estimated to be around US\$ 80–90 trillion. Flows will need to be redirected from brown investments into sustainable investments. A scale-up of green investments will not only mitigate climate change, it will also foster economic growth and job creation. **However, public spending will not suffice to finance the green transformation.** The majority of investment must come from the private sector. **It is therefore important to align the financial system – banking, capital markets and insurance – with sustainable development.** [...]

PERSPECTIVES OF SUSTAINABLE FINANCE



[...] Moreover, it is important **that the financial sector prepares itself for risk related to climate change and other environmental hazards**. Three types of climate-related risk have been identified: (i) physical risk, i.e., the risk of economic and financial losses due to climate-related hazards; (ii) transition risk, i.e., the risk of financial losses related to regulatory and economic adjustments in a transition to a low-carbon economy; and (iii) liability risk, i.e., the risk that liability insurance providers have to cover claims related to losses arising from physical or transition risk from climate change.[...]

PERSPECTIVES OF SUSTAINABLE FINANCE

- Meeting agreed upon objectives in Paris Agreement of 2015 will have implications for any individual and any business, **for instance pricing of energy consumption** from “brown” and not “green” production plants. This will have exacerbating effects on costs for anybody, including credit institutions;
- Credit institutions will particularly be exposed to **transition risk**, for instance in respect of revaluation of assets and collateral and the potential constraints in the performance of obligations and debt service by counterparties that merged too late to the green environment;
- **Microprudential concerns** include information asymmetry, maturity mismatches between long-term green investments and the relatively short-term time horizons of savers, and, inadequate analytical capacity, particular for smaller institutions;
- **Reputational effect of the profile of the bank**, in particularly expectations of retail customers about the alignment of the banks’ objectives and strategy with climate change constraints. This is a broader issue, and also covers for corporate social responsibility, diversity policy and responsiveness to the perceptions of society at large.

PART TWO

THE EUROPEAN COMMISSION ACTION PLAN ON SUSTAINABLE FINANCE

Brussels, 8.3.2018
COM(2018) 97 final

COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN
PARLIAMENT, THE EUROPEAN COUNCIL, THE COUNCIL, THE EUROPEAN
CENTRAL BANK, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE
AND THE COMMITTEE OF THE REGIONS

Action Plan: Financing Sustainable Growth

ACTION PLAN ON SUSTAINABLE FINANCE

8 MARCH 2018 (I)

Background

- > Involvement of the financial sector will boost efforts to reduce the EU's ecological footprint
- > Following up on the Paris Agreement of 2015 and the UN 2030 Agenda for Sustainable Development, private sector investments of EUR 180 million are required to meet the EU's 2030 climate targets

Goals

- > Reorient capital flows towards sustainable investment in order to achieve sustainable and inclusive growth
- > Manage financial risks stemming from climate change, resource depletion, environmental degradation and social issues
- > Foster transparency and long-termism in financial and economic activity

Brussels, 8.3.2018
COM(2018) 97 final

COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN
PARLIAMENT, THE EUROPEAN COUNCIL, THE COUNCIL, THE EUROPEAN
CENTRAL BANK, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE
AND THE COMMITTEE OF THE REGIONS

Action Plan: Financing Sustainable Growth

ACTION PLAN ON SUSTAINABLE FINANCE

8 MARCH 2018 (II)

Action points

1. Establishing an **EU classification system for sustainable activities (taxonomy)**
2. Creating **standards and labels for green financial products**
3. Fostering investment in sustainable projects
4. Incorporating sustainability when providing **financial advice**
5. Developing **sustainability benchmarks**
6. Better integrating sustainability in ratings and market research
7. Clarifying duties of institutional investors and asset managers
8. Incorporating sustainability in **prudential requirements**
9. Strengthening sustainability disclosure and accounting rule-making
10. Fostering sustainable corporate governance and attenuating short-termism in capital markets

PART THREE

EC LEGISLATIVE PROPOSALS ON
SUSTAINABLE FINANCE THAT WILL
IMPACT THE BANKING SECTOR

IMPACT ON THE BANKING SECTOR (I)

AMENDMENTS TO EXISTING REGULATIONS

Sustainability considerations in financial advice

- > An amendment to a **MiFID II Delegated Regulation** has been proposed to take into account sustainability preferences in the suitability assessment (24 May 2018)

Standards and labels for green financial products

- > The European Commission may adopt a **Prospectus Regulation delegated act** that specifies the content of the prospectus for green bond issuances (Q2 2019)

Sustainability in prudential requirements

- > The European Commission will explore the feasibility of including climate and environmental factors in risk management policies and the potential calibration of capital requirements in **CRD/CRR**

Brussels, 24.5.2018
COM(2018) 353 final
2018/0178 (COD)

Proposal for a
REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL
on the establishment of a framework to facilitate sustainable investment

(Text with EEA relevance)

{SEC(2018) 257 final} - {SWD(2018) 264 final} - {SWD(2018) 265 final}

EU TAXONOMY FOR SUSTAINABLE ACTIVITIES, PROPOSAL FOR A REGULATION

Proposal for a regulation on the establishment of a framework to facilitate sustainable investment, 24 May 2018

- > A framework is proposed to gradually create a **unified classification system** ('taxonomy') that sets out criteria to determine whether an economic activity is 'environmentally sustainable'
- > The taxonomy will serve as the foundation of the entire sustainable finance initiative, providing it with a common language applicable to its different areas
- > The taxonomy applies to financial products and corporate bonds (but not to sovereign bonds)
- > The main body of these rules will not apply until six months after the entering into force of the relevant Delegated Acts (between July 2020 and December 2022)

Brussels, 24.5.2018
COM(2018) 355 final
2018/0180 (COD)

Proposal for a
REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL
amending Regulation (EU) 2016/1011 on low carbon benchmarks and positive carbon
impact benchmarks

(Text with EEA relevance)

{SEC(2018) 257 final} - {SWD(2018) 264 final} - {SWD(2018) 265 final}

LOW-CARBON AND POSITIVE CARBON IMPACT BENCHMARKS, AMENDMENT TO THE BENCHMARKS REGULATION

Proposal for a Regulation amending Regulation (EU) 2016/1011 on low carbon benchmarks and positive impact benchmarks, 24 May 2018

- > New categories are proposed for **low-carbon** and **positive-carbon impact benchmarks** to measure a company's footprint and an investment portfolio's carbon footprint.
- > These benchmarks will provide a tool for investors to compare the environmental performance of their investment.
- > This Regulation increases transparency and counters 'greenwashing' of investments

AMENDMENT TO DELEGATED REGULATION UNDER MIFID II

Draft Commission Delegated Regulation on organisational requirements and operating conditions for investment firms, 24 May 2018

- > **Economic, social and good governance (ESG) factors**, including sustainability preferences will be included in the suitability test
- > Investment firms will be obliged to ask clients about their ESG preferences and ensure that financial products offered are suited to these preferences
- > ESG considerations must be included in the description of financial instruments and in financial advice relating to financial instruments

Brussels, XXX
[...] (2018) XXX draft

COMMISSION DELEGATED REGULATION (EU) .../...

of XXX

amending Regulation (EU) 2017/565 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive

AMENDMENT TO THE CRD/CRR FRAMEWORK

The Commission will explore the feasibility of the amendment of the CRD/CRR framework to include climate and environmental factors in risk management policies and the potential calibration of capital requirements (no date announced)

- > Capital requirements would include factors that reflect sustainability risks associated with assets held by financial institutions
- > Capital buffers may be lowered for 'green' exposures
- > Changes to prudential requirements would be progressively phased in, concurring with the development of the taxonomy framework

PART FOUR

SUSTAINABLE FINANCE IN THE DUTCH BANKING SECTOR

POSITION OF THE DUTCH CENTRAL BANK

THE ENERGY TRANSITION AS A RISK FOR FINANCIAL STABILITY

- ✓ In the view of the Dutch Central Bank, a volatile implementation of the 2015 Paris Agreement may constitute a risk for financial instability.
- ✓ The Dutch Central Bank urges Government not to stall the implementation of climate policies, in order to prevent the need for sudden and disruptive measures.
- ✓ Financial institutions are urged to incorporate measures mitigating climate risks in their risk management.
- ✓ Four scenarios for a disruptive energy transition have been identified:

Policy shock

An abrupt and significant price increase for CO2 emissions leads to a devaluation of carbon-intensive assets.

Technology shock

Advancements in green energy technology lead to a devaluation of carbon-intensive assets.

Double shock

A combination of the risks outlined above.

Confidence shock

A loss of confidence caused by ongoing uncertainty about climate policy.

POSITION OF THE DUTCH CENTRAL BANK

PRUDENTIAL REQUIREMENTS AND SUSTAINABLE FINANCE

- ✓ In the view of the Dutch Central Bank, lowering capital buffers for 'green' exposures could only be allowed when evidence shows that such exposures carry lower risk.
- ✓ As a member of the Central Banks and Supervisors Network for Greening the Financial System (NGFS), the Dutch Central Bank is currently involved in research on the risks associated with 'green' exposures versus 'brown' exposures. The Dutch Central Bank's position on lowering capital buffers for 'green' exposures will depend on the outcome of this research.
- ✓ The Dutch Central Bank questions the effectiveness of a green supporting factor in the framework for prudential requirements as a means to boost green lending.



BANCA POPOLARE ETICA

The highest interest is everybody's interest



WHO WE ARE

- Banca Etica is a **cooperative bank** operating in Italy since 1999 and in Spain since 2014.
- It **started as a Mfi** working with **Ctm-Mag** (1989). It has been founded by thousands people and hundreds non-profit institutions, inspired from the principles of ethical finance:
 - ❖ **participation**
 - ❖ **transparency**
 - ❖ **efficiency**
 - ❖ **awareness of the non-economic consequences of economic actions**





PARTICIPATION

- Banca Etica is free from the influence of politics and economic-financial power groups: **the owners** are 40.000 citizens and social organizations
- Since it is a “Popular bank”, the principle “**one head, one vote**” rules in the General Assembly that elect the main corporate bodies
- **89 groups of active members (GIT)** in Italy and Spain guarantee:
 - the development of local relationships
 - the promotion of ethical finance's culture
 - contribute to determine the strategic orientations of the Bank





TRANSPARENCY

- It's the main condition for the responsible use of money
- We ask customers to sign a **declaration of sharing the principles** of the Statute and **of conformity of the origin of their money** to these principles
- We are the only bank in Italy to **publish on the website all the loans** granted to legal entities
- We deliver accounting reports on our activities according to the economic, social and environmental aspects in the **Integrated Report** and **Online Sustainability Report**, that allow direct interaction with our stakeholders
- We supervise the **compliance with regulations** on the subject of transparency in banking and finance





WHAT WE DO

Banca Etica finances welfare, green economy, microcredit and self-employment, international cooperation, culture and sport.



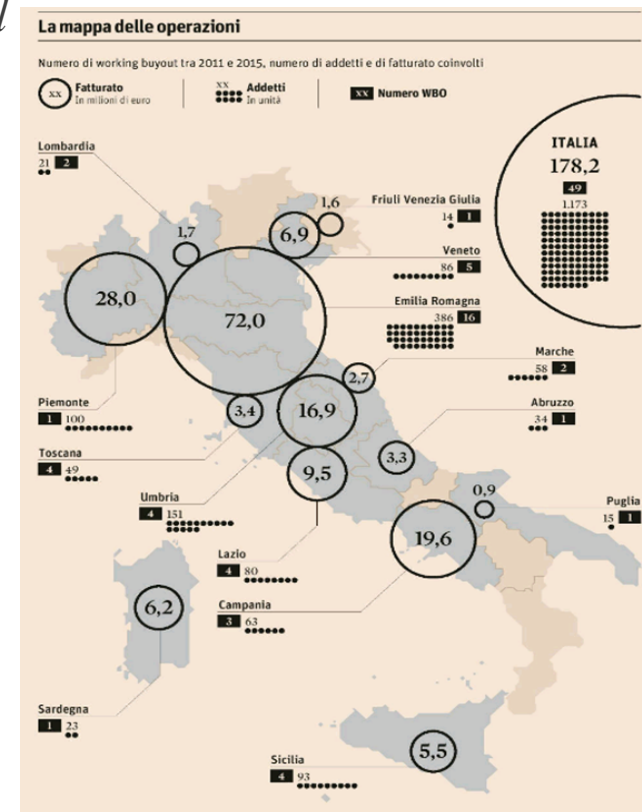


BEST PRACTICES: WBO FOR EMPLOYMENT

During the crisis we started to provide financial support to employees from companies in bankruptcy:

WORKERS BUY-OUT

- 34 companies and 14,3 mln € loans approved
- 863 jobs saved (up. march 2018)

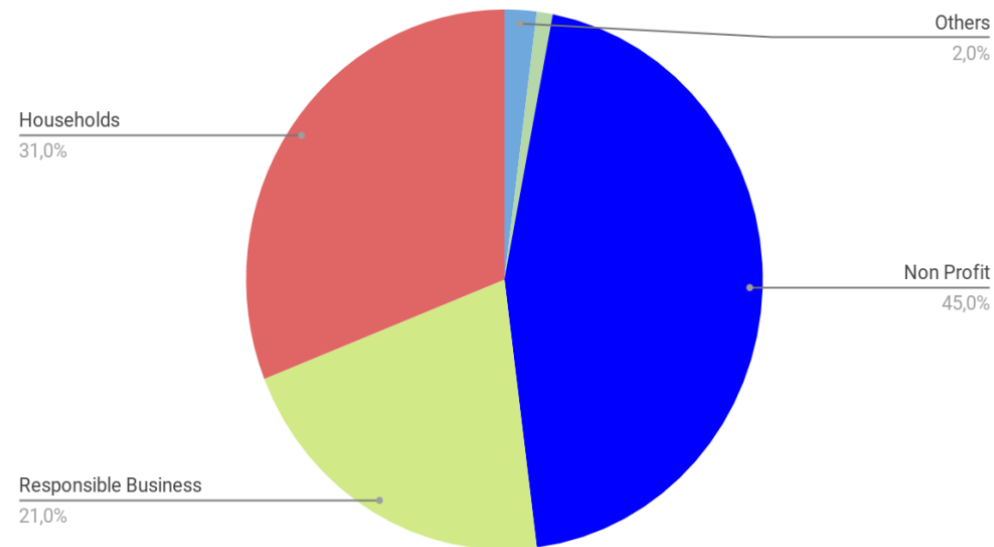




CREDIT POLICY

- **More of 45% of granted loans** is directed to non-profit organisations (social enterprises) and about 20% is delivered to business with social and environmental impact.

Loans Portfolio 2017





HOW WE DO THAT

In our credit-policy the economic investigation is paired with a **social and environmental assessment** of the loan applicant. This evaluation is based on parameters such as: democratic participation, transparency, gender equity, respect for the environment and working conditions, ties of territorial proximity

- The **ESG evaluation** is carried out by a **Social Evaluator**, volunteer shareholder appropriately trained.





BANCA ETICA TODAY

- Banca Etica works in Italy and Spain, divided in **5 territorial areas**: North East, North West, Centre and South of Italy, and Spain.
- Every Area is managed by a **Forum** composed by one member of the Board of Directors, one sales manager, one cultural Manager and one representative of the active shareholders.





ETICA SGR

Etica Sgr is the **asset management company (3 bln assets managed)** of Banca Popolare Etica Group. It's the only one in Italy that places only **ethical investment funds**, which invest exclusively in securities of States and companies characterized by a high profile of social and environmental responsibility.

Moreover, Etica SGR:

- has established the **Fund for microcredit projects in Italy**, whose subscribers can donate 1 euro for every 1,000 they invested
- conducts **active shareholder activities** to raise awareness on social and environmental issues in the companies in which it invests
- offers **consultancy** for institutional investors





ETHICAL FINANCE FOUNDATION

Fondazione Finanza Etica (Ethical Finance Foundation) works at the national and international level with **promotion, research, experimentation** and **training** activities pertaining to the relationship between ethics, economics and finance.

Main projects

- on-line hub to information on ethical finance and sustainable development
- Novo Modo, event in Florence dedicated to sustainable change
- Active Shareholder initiatives



A LAW FOR ETHICAL FINANCE

In 2016, The Italian Parliament passed a law to recognize and promote Ethical and Sustainable Finance as institutions that:

- Evaluate loans according to international recognized ethical rating standards, with particular attention to social and environmental impact
- Give public evidence, at least yearly, also via the web, of allocated funds
- Devote at least 20 percent of its loan portfolio to non-profit organizations or social enterprises
- Do not distribute profits among shareholders, but reinvest them in its activities
- Adopt a democratic and participatory governance
- Adopt remuneration policies to reduce the difference between the highest salary and the average ones earned in the bank (1:5).



ANOTHER STEP IN THE INSTITUTIONAL RECOGNITION

- In December 2017 Italian Parliament approved a Law which allows Public Administrations to held participation in Ethical Finance's Organisations.

This further achievement represents the awareness of politics of the **strategic function** of Ethical Finance in the social and economic development of the country.



INTERNATIONAL ALLIANCES

Banca Etica is a member of:

- **Febea** – European Federation of Ethical and Alternative Banks (30 bln € loans)
- **Gabv** – Global Alliance for banking on values (110 bln € loans)
- **EMN + MFC** (1.5 bln € loans)
- **COOPEST/COOPMED** – Impact Investment Funds – 48,9 MLN € in assets dedicated to microfinance in Eastern Europe and Mediterranean Area.
- **Ministry of Foreign Affairs - DGCS** - Memorandum of Understanding (2009, 2014, 2017): over 100 million of guarantees granted to Italian NGOs involved in Development Cooperation projects in the countries of the South.





FIGURES

(31.12.2017)

SHARE CAPITAL

€ 65.000.000

OWN FUNDS

€ 94.700.000

CET.1

12,00%

TOTAL CAPITAL RATIO

13,09%

DEFAULT RATIO

3,89% (average Italian banking system 5,02%)

NET DEFAULT RATIO

0,88% (average Italian banking system 3,7% -

ABI)

NUMBER OF MEMBERS

> 41.000

SAVING COLLECTION

€ 1.382.000.00

LOANS APPROVED

€ 822.000.000

NUMBER OF WORKERS

290

Thanks for your attention!



www.bancaetica.it