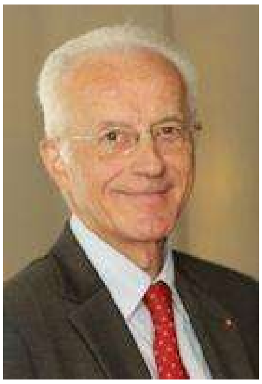
Belgian Financial Forum

Panel report 'How sound are banks today?'



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ABSTRACT

This is a report of the panel discussion, following the masterclass of Mathias Dewatripont, at the Universiteit Antwerpen, April 4th, 2019.

In his introductory remarks **Mathias Dewatripont** underlined the important step in regulation made since the financial crisis, resulting in a better solvency, liquidity and profitability of Belgian banks. The digital challenge is impressive and there is still overcapacity. Are cross-border mergers a solution? They have potential advantages as far as financial stability is concerned and in terms of efficiency and competition trade-off. One should not underestimate the potential costs, especially in a world where bank capitalisation remains modest and where large banks' size does not translate into significantly higher capital requirements. See also a more extensive report of the remarks of Mathias Dewatripont in a separate article in this issue.

Prof dr. Lucrecia Reichlin of the London Business School focused strongly on the Italian banking sector with its problems and rescue initiatives in recent years. There were two major challenges: the issuance of subordinated bonds convertible into stocks to retail clients in order to recapitalise the banks after the financial crisis and the challenge of the old system with state intervention and the use of the deposit insurance scheme by the interpretation of the new rules on state aid.

Since 2014 Italy had five mini bank crises. In 2014 Banca Terca failed and was recurred via the interbank deposit protection fund to cover the losses. There was state aid to help Banca Populare to take over that bank. This rescue was not approved by the European commission due to the state aid. But 2 years later the European court approved the Italian solution. It is not yet clear how this ruling will be handled by the European commission. In 2015 four small banks were put in resolution just before the acceptance of the European resolution rules. Once more the deposit fund was used. The bondholders lost their invested money but were compensated by public funds; In 2016 two medium sized banks were put in liquidation to avoid the bail in rules. A public subsidy was given to Banca Intesa to take over those two banks. Public money was also used to compensate the bondholders. The fourth crisis was Banca Populare Siena which was precautionary recapitalized via state aid. Bondholders were compensated by public money. The fifth case is still going on. Meanwhile a new law has been approved concerning public capitalisation and it is not yet clear how this case will be ended.

What are the lessons drawn from these events? Even with strict fiscal rules, a very flexible resolution is still possible. Avoiding bail in is the ambition. State aid has not disappeared and will be needed. The burden sharing for the shareholders has not been avoiding, but compensation was given to bond- and shareholders. We live in a hybrid situation and there is an urgent need for a harmonisation of the national and EU rules.

There are a few problems with the new regulation:

- moving from bail out into bail in is a naive approach; complementarity is needed;
- there is no real framework for resolution, no real level playing field;
- the approach per individual bank is complex and not feasible due to contingency;
- a compensation for the creditors is not evident.

According to the resolution mechanism it is certain that up to now the intergovernmental governance of the resolution authority is weak. Decisions can be blocked. The reliance on national authorities is a weak point. There are not enough resources for major events. There is no framework between the ECB, the European commission and the European Resolution Board to create temporarily liquidity. Furthermore, backstop must still be approved by national parliaments.

It is an illusion to believe that we can tackle a new crisis with only new rules and new institutions and without a fiscal union and democratic accountability.. A reinforcement of the whole picture is needed.

Mister Tom Dechaene, member of the Executive Committee of the National Bank of Belgium, started his intervention with the good news composed of the realisations since 2008: a sharp declined of the size of the banking sector, the increased solvency, the lower leverage, the upswing of liquidity, the acceptable level of return on equity, the launching of the single rule book, the supervision by the SSM of the 120 largest banks in Europe, the harmonisation of the methodology used by the internal models and the standardised approach on the European level, the common method of auditing, the more transparent governance, the wide spread recognition of risk, the implementation of IFRS 9 accounting rules, the launching of macro prudential buffers, the clearinghouse and collateral rules for derivatives.

But only half of the work is done. Following issues are partly finished: MRL, the problem of non- performing loans, the difficulties to implement the resolution rules, cyber risk, ethical hacking.

Other problems have not been solved up to now: the doom loop linked to the huge investments of banks in national government bonds, the money laundering which is still governed by national rules, the increasing role of big tech, the start of PSD2 for payments, the capital markets union, the overbanking in many countries, the European deposit guarantee scheme.

According to mergers and acquisition, the track record of the obtained performance is quite bad. We know that the top 5 US banks are larger than the top 5 in Europe, but if we take the top 30 then Europe is much larger than the US. Furthermore, the insolvency laws are still national.

All in all, the SSM is a major step forward, the SRB is uncompleted, and the EDIS is still not realised. Meanwhile new risks are ahead of us and they are increasing quite rapidly.

Prof dr Herman Daems, Chairman of the Board of Directors of BNPParibas Fortis, expressed his relative optimism by underlining the fact that banks are more than liquidity providers. They invest also more in risk management, they allocate more money to the real economy via their transformation of deposits into loans. The size decreased strongly which is not so evident but belonging to a big financial concern it is easier to eliminate the overlaps. Liquidity is in a much better shape and risk management is more performant. The cost to income ratio came down from an unacceptable level to a more decent level. Alternative activities were restarted, such as private equity, or taken over, such as Arval leasing. The customer satisfaction became a crucial management performance instrument. The digital revolution is of course not neutral, but it not a tsunami. The closing process of branches is one of the consequences.

Cross border mergers are a strange concept, because all European groups are already cross border entities covering differences in regulations. National regulations doesn’t exist anymore because all is driven by the European Commission and or the ECB.

BNPParibas Fortis is already active in Belgium, Luxemburg, Turkey and Poland. This is important for the big companies operating in many European countries and even beyond. For the bank there are a lot of opportunities to realise major synergies, but this implies also unique computer systems which are not yet a reality.