THE CONDITIONS TO BENEFIT IN THE EU FROM THE DIVERSITY OF BANKING MODELS

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1. The diversity of banking business models favours financial stability and bank service diversification

The diversity of banking business models is a source of financial stability for the EU banking sector. Indeed, a reduced number of business models results in an increased correlation of risks between institutions, increasing financial instability in the event of a shock. The more diverse the banking sector, the more resilient it is overall to a variety of shocks.

In addition, the more diversified banking models are, the best customer needs are addressed because this leads to a diversification of bank offers and services.

Business models' diversity is rooted in various aspects among which ownership and governance, physical proximity, extent and complexity of the product mix, value chain arrangements, ...

Regarding capital holding for example, state-owned banks, private owned banks, or cooperative banks are very specific.

Similarly, while universal banks provide a large variety of customers with a one-stop-shop service whatever their needs, other business models enable certain banks to be more tailored regarding a specific type of clients or service.

Banks with a very dense network have an advantage in terms of proximity with their clients, which is expected to enable them to better adapt to clients' needs and provide them with more tailored services. Furthermore, such a proximity corresponds sometimes to public service missions certain banking networks are entrusted with (e.g., financial inclusion…). Proximity also facilitates covering local or regional authorities, local public services like hospital.

As general principle, banking institutions should therefore have to fulfil regulatory requirements which fit both their size and their business model although it would of course be easier for supervisors to address a limited number of bank models. For example, smaller and less-complex banks that operate at a regional level only, need a more proportionate regulatory and supervisory approach.

One should also do away from assuming that answering local specificities goes against building the EU single market or reduces the level of competition.

2. Combining banking rules uniformity and businesses model diversity is not so easy

A certain level of standardisation and homogenisation of the banking rules as part of Banking Union, is unavoidable. Furthermore, the appropriate balance between the uniformity of banking rules and the diversity of businesses is not so easy to find.

Consequently, certain EU regulation as well as the SSM benchmark model approach, fail to fully factor in the benefits that a diversified European banking sector generates nor the fundamental differences existing in comparison to banking markets in other regions globally.

Indeed, it is difficult to have a uniform approach for the sector as banking models are different on several dimensions.

In this context, the risk reduction measures implemented in the 'RRM'-package should be only a first step on a longer journey toward further enhancing the application of the principle of proportionality. This is - for example - particularly true in the areas of disclosure (Part 8 CRR) and outsourcing requirements (the EBA Guidelines on outsourcing arrangements require from decentralised banking sectors, a high level of resource to comply with bureaucratic burdens).

3. Banking diversity also challenges supervisory practices

The SSM sets a European supervision framework that is intended to be the same for all banking players, which tends to ignore the specificity of their business model. In this context, the overall supervisory pressure has contributed to the increase of mergers between smaller banks and therefore to an overall reduction of smaller institutions in the Eurozone. This process will continue in the coming years.

Indeed, this EU supervision focuses mainly on the currently observed risk and profitability parameters of the clients of a bank. Doing so the EU supervision tends to ignore their historical profitability as well as the wide knowledge of each client that the bank gathered all along the relationship, which improves notably risk decision making. Indeed, institutions that accompany their clients on a long-term basis are best able to support them in the event of difficulties and consequently play an essential role in financing national economies, especially in times of economic crisis.

Additionally, the use of activity-based harmonised supervisory approaches has also failed to consider the specificities of banking institutions, which leads to the standardisation of banking practices. Transaction based banking models are favoured to the detriment of those which put the emphasis on the individual relationship with each customer, and which elaborate the consistent set of financial services they require.

Moreover, the SSM seeks the harmonisation of governance arrangements and practices within the institutions (the technical competence of managers is favoured at the expense of knowledge of local specificities and potential advantages resulting therefrom).

Similarly, the SSM based on its main objective of improving for prudential reasons, the profitability of European banks up to levels corresponding to those of listed institutions being active globally, call to question the approach of those banks aiming to serve all clients (rather than most profitable clients or businesses).

What is at stake is an excessive focus on cutting costs in order to increase profitability and subsequently capitalisation on the short term. In turn this encompasses reducing the number of outlets and reducing staff to the detriment of service coverage and inclusive banking, bearing the danger that certain EU citizens are left behind.

Yet, while the profitability of banks that ensure a long-term, global, and multi-product relationship is lower than that of specialised, short-term-oriented banks, it is at the same time more stable in the medium to long term and more resilient in times of crisis. In addition, the sustainable-relationship banking model does not prevent the voluntary adoption of digital and innovative solutions (see for example the successful app. of the Deutsche Sparkassen).

The current supervisory approach, by trying to apply a similar supervisory approach to all banks, also ignores the differences in legal systems, size of market and customer preferences prevailing in each member states of the European Union.

An additional risk is that, beyond to the abandonment of less profitable clients and the reduction of customer convenience, such a European approach also lead banking institutions more and more to adopt capital markets behaviour including by increasing risk-taking in search for yields.

Finally, harmonising banking practices play against the plurality and diversity of different business models and the proximity to the clients contribute to financial stability in Europe.

4. Implementing forthcoming regulation evolutions and completing the Banking Union require cautious policy approaches

Regarding prudential regulation, Europe has long been following a particularly uniform approach with common binding rules for all banks. This has had an asymmetric impact penalising smaller institutions due to fixed-costs effects.

The introduction of the new Basel III rules will magnify such a risk. Indeed, the increase in regulatory capital regardless to banks' risk profile (a consequence of the output floor concept) will encourage banks to take more risks and to develop leveraged businesses to achieve levels of earnings usually required by shareholders in line with global standards. Alternatively, in the absence of such riskier practices, increased prudential requirements would result in these institutions reducing the financing of the economy. Consequently, the European legislator should implement the new Basel III rules in a well-balanced way for smaller banks as they are primarily designed for globally active banks and should also take the opportunity to further enhance the principle of proportionality in the current legal framework of CRR/CRD.

An increasing awareness of policymakers has led to more proportionality in EU legislation, as seen in the banking package (CRD V & CRR II), which lays the initial groundwork for a ruleset better tailored to smaller and non-complex banks. It is important to follow through with a commitment for proportionality when implementing the final revisions to the Basel III framework.

Looking at the debate on the completion of the Banking Union, the primary focus should be to combine a proper functioning of the single market and maintaining the diversity of the EU banking system and its stabilizing effects. These objectives require considering that for a sustainable economic environment, profitability – especially in the short term – is not the only performance indicator to measure the value added of the financial industry to the economy.

5. Better understanding the added value of each banking models and their diversity, is necessary

A "one size fits all" regulation runs the risk to undo the stabilising effect of a diversified European banking sector and the advantages it brings for individuals, households, industry and small businesses sectors. Decision makers should have this in mind when responding to the current situation, but also when shaping the regulatory framework of tomorrow.

For them to succeed, one open question is to clarify how the different banking models among which those of networks of banks (e.g., the savings banks in Germany) or cooperative banks, avoid excessive risk-taking and allow low-priced services to be offered.

In other words, it is necessary to clarify how such banking models beyond the mere level of remuneration going to shareholders, offer more to all the stakeholders, or whether their feature early warning and intervention systems that prevent effectively excessive risk-taking.

In the same way, one should try to clarify - let alone their culture and history - the elements, notably public policy ones, that support specific regulatory and supervisory approach for state-owned banks. There is a need to focus - not in abstracto but in the challenging context of a rapidly changing world - on identifying and fostering the key success factors specific to each business model rather than unwittingly triggering their gradual standardisation.

Finally, achieving an effective regulatory and supervisory framework, makes also unavoidable to accurately assess the added value notably in financial stability terms of the diversification of the banking models in the EU.