EURO-MEDITERRANEAN ECONOMISTS ASSOCIATION

EURO-MEDITERRANEAN NETWORK FOR ECONOMIC STUDIES
الشبكة الأورو-متوسطية للدراسات الإقتصادية

EMEA WEBINAR

WHAT ARE THE SUSTAINABLE BANK BUSINESS MODELS FOR POST COVID-19 RECOVERY IN EUROPE, MEDITERRANEAN AND AFRICA?

Thursday 04 March 2021, 15:00- 17:00 CET

“***What are the sustainable bank business models for post COVID-19 recovery in Europe, Mediterranean and Africa?”*** on **Thursday 04 March from 15:00 to 17:00 CET** on Zoom.
The EMEA Webinar on what are the sustainable bank business models for post COVID-19 recovery in Europe, the Mediterranean and Africa, discussed the conditions for banks to exit the exceptional regulatory environment and to examine the factors of sustainability of bank business models.

AGENDA

Moderator: **Prof. Rym Ayadi**, President, Euro-Mediterranean Economists Association (EMEA) and Professor at the Business School (Former CASS), City University of London

Panellist(s):

Prof. Barbara Casu Lukac, Professor, the Business School (Former CASS), City University of London and Director, Centre for Banking Research, UK

Prof. Giovanni Ferri, Professor, LUMSA University and Founder of Sustinentes SRL, Italy

Mario Quagliariello, Director, Economic Analysis and Statistics, European Banking Authority, France

Jorge Sicilia, Chief Economist, BBVA Group and Director of BBVA Research, Spain

Discussant (s):

Doriana Cucinelli, Researcher, Università degli Studi di Parma and Research Fellow EMEA

Rapporteur: Sandra Challita, Research Fellow EMEA

WHAT ARE THE SUSTAINABLE BANK BUSINESS MODELS FOR POST COVID-19 RECOVERY IN EUROPE, MEDITERRANEAN AND AFRICA?

Prof. Rym Ayadi provided the welcome address, focussing on the importance of sustainability of Banking Business Models (BBM) for economy and society. During the COVID-19 pandemic, banks became partners for policy makers to channel public guarantees and state aid to mitigate the effect of this crisis. The objective of today's webinar is to discuss the sustainability of BBM in Europe, Africa and the Middle East and provide updates on the BBM initiative[1].

Prof. Barbara Casu Lukac presented the key challenges facing the sustainability of banks and their impact on their BM. Bank sustainability is to rethink the current business models of banks to meet changing expectations of regulators, investors and customers[2]. She discussed four challenges for bank sustainability. (1) The post financial crisis environment led EU banks to have low levels of profitability. Profitability strengthens the banking sector and provides a source of investment in the country. Therefore, it matters for the sustainability of BBM. (2) The increased regulatory scrutiny, with a growing number of fines for EU banks, makes conduct risk important for bank sustainability. (3) The competition from non-bank financial institutions (NBFIs), FinTech's and Big Tech is increasing, but banks remain the largest single sector in the financial system in most countries. (4) The weak economic growth coupled with the current COVID-19 crisis are also challenging for BBM, but the pandemic has accelerated digitalisation of financial services.

Big Tech firms (GAFAM) are playing an increasing role in financial services, given their large asset size and customer base and by collecting and analysing data. Their competitive advantage over FinTech's remains their ability to scale rapidly across business lines, their large resource capacity and their ability to access funding at a lower cost than some financial firms. Their competitive advantage over banks is due to their larger market capitalisation, greater profitability and their increasing presence in developing countries. Therefore, the

[1] For more info visit : https://bbmresearch.org/

[2] This while showing the difference with sustainable banking that integrates the ESG principles in banks.

power of big tech (size and profitability) is a massive challenge for banks. The entry of Big Techs in financial services has several benefits, such as innovation, diversification, efficiency, financial inclusion and financing for SMEs. But it also presents several risks, such as leverage, operational risk, governance and others. Banks are not disappearing yet, though. The entry of Big Techs in the market will affect banks, since Big Techs have cutting edge technology and are not heavily regulated. These challenges may lead banks to a change of BBMs. They would modernise their IT infrastructure, digitise their provision, develop their own platforms and set up digital banks. They may partner with FinTech and Big Tech platforms on different market segments, with greater specialisation in financial services. These changes will be challenging for policy makers and regulators.

Q: What about the regulation of FinTechs and BigTechs?

A: Banks are heavily regulated, compared to FinTechs and BigTechs. The way forward could be by regulating by type of activity, rather than by type of institution. Or else, banks will have a competitive disadvantage.

Prof. Giovanni Ferri discussed the challenges of BBMs and presents the opportunity of sustainable finance. The key challenges for BBMs are (1) unfriendly regulation that does not appreciate banking diversity, (2) the digitalisation of finance, intensifying competition with NBFIs and (3) unfavourable monetary policy with low interest income and the requirement of fee income and job cuts. Banks need to shift to sustainable finance as well as needing a shift in mentality to move from short term profits to long term value creation.

However, he underlined the great opportunity of sustainable finance, led by Europe. Regulation is moving towards supporting the green factor and climate risk will be factored into the monetary policy amework. Alongside this, it creates the need for ESG (Environmental, Social and Governance) ratings for firms. These ratings are of poor quality for smaller sized firms[3] and there is a need for better rating capability. Banks can take the lead on these ratings, using their proprietary soft information resulting from their relationship banking. They can provide sustainability certification, allowing SMEs to buy into green finance. This certification can provide valuable fee income for banks.

Q: Isn't there a conflict of interest that can be created if banks provide this sustainability certification?

A: The reputation mechanism can avoid this. However, there is a need to change the mindset to ensure better performance at all levels.

[3] There is a significant bias in terms of size in the ESG rating. Micro-cap ESG ratings are often contradictory and confusing, compared to mega-caps. Many ESG agencies do not agree much with the rating.

WHAT ARE THE SUSTAINABLE BANK BUSINESS MODELS FOR POST COVID-19 RECOVERY IN EUROPE, MEDITERRANEAN AND AFRICA?

Mario Quagliariello presented the situation of EU banks during the COVID-19 crisis and their future role. EU Banks entered the COVID-19 pandemic with sound capital positions and lower leverage. They had more stable funding and ample liquidity buffers and a significant decrease in NPLs. During the current crisis, they became part of the response to the pandemic, through shifting loans under public guarantees and offering debt moratoria. After the crisis, we expect to have a deterioration in NPLs, a deterioration in asset quality and an increase in the share of foregone loans. Profitability and operational resilience remain key concerns for banks. Banks are reducing material costs and operating expenses, due to teleworking and digital banking. Post-COVID, banks need to maintain prompt, conservative and transparent recognition of risks. Digitalisation, cost efficiency, greener economy and sustainable profitability will be key to the future, without excluding operational risks such as money laundering and terrorism financing.

Q: How do you qualify a non-sustainable BM in banking?

A: The objective measures of sustainability are profitability and cost efficiency. But there is also a need to focus on digitalisation.

Jorge Sicilia discussed banks' sustainability and their ability to adapt to the environment in which they operate. The current framework of lower credit and low interest rates will naturally affect the profitability of banks. However, cost cutting is crucial. In the EU, cost cutting efforts are remarkable, but we can do more, compared to US banks. The cost of risk will be too high in the aftermath of the crisis, meaning that in the near term, profitability is a key issue and cost efficiency needs to be kept under control. Banks need to adapt their business models in several ways. (1) They should shift their preference by accelerating digital solutions for customers and providing services for larger customers. (2) They need to reduce their costs to gain in efficiency. (3) They ought to shift to teleworking and (4) operate with new business models offering a full menu of products and services for customers. But banks also need to deal with their challenges by embracing digitalisation, adapting to their clients' needs, embracing efficiency and diversifying their sources of revenue. They also play a key role in attaining sustainablility goals, by supporting climate transition via financial products and households through financial inclusion and SME financing.

Q: What is your view on sustainability certification for banks?

A: The problems of these certifications are related to conflict of interest and the bank's role is as an intermediary rather than do-it-yourself.

Doriana Cucinelli presented updates on the BBM Monitor for Europe and the current work of banks for the MENA region and Africa. In MENA and African countries, they identified the 5 BM for Europe, plus other types of diversified BM. However, 82% of banks are either focussed retail, diversified type 1 or Investment. The analysis is done per country. She also highlighted the next steps of the BBM on including ESG scores in the analysis. The information on banking diversity is publicly accessible.

Q&A:

Q: How do you see the impact of the timetable on lifting the regulatory measures on BBM?

José: The timetable is crucial. There is a danger in both coming too early and too late. What would help is to make sure that there is a long-term plan on what is conditional on the state of the economy. We need to differentiate between the policies. For fiscal and monetary policies, there is room to keep them for a longer term. The impact on the banking sector will depend on the sector's ability to make an effort on debt and to build equity. For now, the current policies need to stay the same.

Mario: On the phase-out of the measures, we need to check whether all the measures remain effective over time, especially the debt moratoria. There should be clarity on the phasing out of the measures.

Giovanni: He agrees with Mario on the effectiveness of the moratoria. Carrying them forward in the long term, they tend to be ineffective. The moratoria were a response to the sudden drop in demand for businesses and income for households. So, there is a need to differentiate between sectors, with a granular approach taking into account the "new normal'. If you assume that, in the future, the sector will be back to normal, the moratoria are effective, or else, it is better to close the businesses and help workers shift to different sectors.

Barbara: The economic impact of the 2nd lockdown is smaller than the 1st lockdown in the UK, for example. Businesses have managed to work differently. This crisis did not impact different sectors equally, therefore the decision should be made by sector. Also, do we need to support sectors that might be phased out?

