

Summary of Banking Industry Dialogue on 2 November 2016 in Frankfurt am Main

Participants

- Members of the Governing Council of the ECB
- Representatives of ABLV Bank, Banco Comercial Português, Banco Santander, Bank of Ireland, Belfius, CaixaBank, Crédit Agricole, Crédit Mutuel, Deutsche Bank, DZ Bank, HSBC, National Bank of Greece, Rabobank, UniCredit
- Senior ECB officials from the Directorate General Macroeprudential Policy and Financial Stability, Directorate General Communications and Directorate General Secretariat, and the ECB's Chief Compliance and Governance Officer

Risks for financial stability and macroprudential policy issues

Participants exchanged views on: i) main financial stability risks; ii) the outlook for banks active in the euro area; iii) possible use of macroprudential policies and; iv) medium-term structural challenges for the banking sector.

Participating banks in general agreed that the main risks to euro area financial stability identified in the May 2016 ECB Financial Stability Review remained significant. Weak profitability prospects were seen, in particular, as a great challenge confronting banks active in the euro area. There was broad agreement that the current low levels of bank profitability would be unsustainable if they were to remain suppressed for a prolonged period of time, as, for several banks, the return on equity remained below their cost of equity.

Participating banks agreed that weak bank profitability resulted from different factors among the various jurisdictions including i) high volumes of non-performing loans; ii) high cost levels (partly due to the need for investments in the areas of digitalisation and financial innovation); and iii) low interest rates.

Regarding non-performing loans, there was broad agreement on the need to reduce and resolve large non-performing exposures. Several impediments to reducing non-performing loan volumes were highlighted, including large gaps between the prices investors are willing to pay and the prices asked by banks. Participating banks and Governing Council members saw a need for further improvement in the simplification and harmonisation of insolvency and resolution frameworks. Although the process would

take time, and full harmonisation would not be possible, there was a need to continue making gradual progress.

Participating banks acknowledged that cost reductions were needed in several areas. They noted, however, that investments were also needed, for example in the areas of digitalisation and financial innovation, in order for banks to remain competitive and to be able to offer products that meet customer demand. Such investments would lead to costs and dampen profitability in the short term but were necessary to ensure efficiency and competitiveness, and thus profitability, in the medium term. One possibility for reducing costs could be consolidation in the banking sector. Participating banks noted the challenges posed by bank mergers, however, especially across borders, also in view of uncertainties in the regulatory agenda.

Low interest rates were seen as dampening bank profitability achieved through traditional maturity transformation business lines. However, the effects of low (or negative) interest rates in the euro area were not considered to have caused major problems yet – as also highlighted by relatively sound profitability levels of banking sectors in some countries outside the euro area where rates are even lower – although they were expected to have a more negative impact if rates were to remain low for a prolonged period. It was acknowledged that low levels of interest rates were benefiting borrowers and had contributed to lower credit risk for banks thanks to lower debt servicing costs for their customers.

Regarding other challenges confronting banks, participating banks called for stabilisation of capital requirements and transparency on remaining new regulatory requirements. The uncertainty surrounding future regulatory requirements was seen as an obstacle for banks when planning and investing for the future, and a key reason as to why investors remained sceptical towards investing in banks. Participating banks also highlighted that differences in how bank supervisors across the globe address and supervise conduct issues were creating complexities for banks active in several jurisdictions, with accountability and transparency requirements sometimes contradicting data protection needs. Participating Governing Council members concurred that remaining regulatory dossiers should be finalised in the coming months, and reiterated their commitment to contribute to this process.

Looking beyond the banking sector, participating banks highlighted risks stemming from the systemic importance of central counterparties, with exposures to such entities needing to be better understood, and the negative impact of low interest rates on life insurers and pension funds.

Economic and financial market conditions

Participants exchanged views on: i) the economic outlook; ii) financial market developments and; iii) the functioning of the euro money market.

Participants noted that the economic recovery and financial markets in the euro area had remained stable and had proven largely resilient to shocks. However, the outlook was viewed as being surrounded by heightened uncertainty, with downside risks in particular stemming from elevated levels of global uncertainty, especially surrounding political developments, emerging markets and oil prices. Participating banks acknowledged that higher economic activity was needed in several euro area countries for banks to be able to increase lending and thereby improve profitability. At the same time, they highlighted the need for banks in the euro area to return to higher levels of profitability and to free up balance sheets from non-performing loans in order to be able to extend new loans to support the economic recovery. The ECB's non-standard measures were, in general, seen by participating bank representatives as limiting financial market uncertainty and positively contributing to the economic outlook, while the new series of targeted longer-term refinancing operations (TLTRO II) was seen as helpful in addressing remaining bank lending supply restrictions.

Participating banks highlighted that the United Kingdom's decision to leave the European Union had created an environment of significantly higher economic and financial market uncertainty for coming years. The decision had also led to many practical issues for euro area banks active in the United Kingdom, for example regarding how they could provide banking services there in the future.

Participating banks welcomed further progress towards completing banking union and capital markets union, but viewed it as being of lower priority compared with removing regulatory uncertainty. Banking union and capital markets union were seen by participating banks as being potentially beneficial for the banking sector, especially if they were to enable banks active in several countries to allocate capital more freely across borders.

Regarding the functioning of the money market, participating Governing Council members highlighted the importance of the ongoing EURIBOR reform process and called on banks to remain committed to the process and to support the transition to the new methodology. Participating banks also highlighted the need for a seamless EURIBOR transition process, not least to avoid disruption in mortgage markets linked to EURIBOR.