BANKING SUMMIT 2020

30 JANUARY 2020

1 - **The development of Portuguese banks over the last decade**

Our banking sector has changed a lot since the global financial crisis and, in particular, the sovereign debt crisis.

The regulatory and supervisory framework changed profoundly in the post-crisis period and the banks carried out significant changes and restructuring.

Their balance sheets are today of much better quality. Intensive deleveraging was undertaken, which led to high liquidity levels. There has been a consistent reduction in NPL, though it has also been expensive.

The capital base is much stronger, which means a greater ability to absorb shocks.

Another major change that has occurred is in the system's shareholder structure.

In the past, before and after the nationalisation of banks in 1975, private banks were largely owned by business groups, entrepreneurs and Portuguese families.

None of these characteristics apply to the largest banks any more. Some no longer exist, while others now have other shareholders. The larger private banks now have a foreign capital majority.

In the perspective of operating accounts, banks are more efficient and more profitable, although profitability is lower than the cost of capital.

At the same time, their business models and operating structure have been adjusting to new realities, and governance requirements have been stepped up and strengthened.

Risk management practices are more technical, stricter and with added prudence. Other functions, such as AML, compliance, auditing, digital security, data processing and protection have been developing significantly.

Technological and particularly digital innovation has been changing many banking functions, to the benefit of customers and operating efficiency.

Despite enormous progress, the sector has not yet recovered from the resounding blow to its reputation. The damage to its image caused by some ended up hurting the banking sector as a whole.

In conclusion, the banking sector today is very different and we must recognise that it is better in many ways than it was before 2010.

2 - The major challenges facing banks

The progress achieved does not mean that we can rest on our laurels, however. Banks are still facing major challenges, particularly the following:

- a traditional business model, based on net interest income, which is under extreme pressure as a result of current monetary policy;
- the need to respond to digital transformation, new demands from customers, pressure from new competitors and emerging concerns about sustainability;
- the commitment to strengthening operating efficiency, retraining human resources and attracting new talent;
- the development of a culture focused on social responsibility, ethics and good practices;
- compliance with the regulatory framework, in a Banking Union that is still incomplete, not fully harmonised and far from its goal of a level playing field.

I would like to focus on profitability issues, an essential condition of an institution’s strength and generation of capital, due to the importance these issues have, in particular, on financial stability.

The challenge of profitability is common to all European banks and, of course, depends on performance in terms of income and costs.

On the income side, Portuguese banks face constraints that are increasing the pressure on net interest income, as a result of low interest rates:

(i) - Demand (solvent) well below supply capacity;

(ii) - pressure on banking fees, arising from arguments often related to the (alleged) need to ensure consumer protection or the belief that banking services are free public services.

(iii) - legal and regulatory constraints that are specific to Portugal, which, combined with the deficient proportionality of European requirements, penalise and create competitive disadvantages for our banks, such as the ban on charging fees on ATM operations, the ban on negative interest rates on deposits, or the contributions to the National Resolution Fund.

On the cost side, despite the sharp reduction in recent years - the cost-to-income ratio is around ten points below the Euro Area average - meaning there is still room for improvement in operating efficiency. This path is, however, hampered by the increased costs the system is facing in order to comply with regulatory supervision and resolution requirements, funding ongoing restructuring, stepping up employee training and retraining and investing in necessary digitisation and modernisation.

This means that we have a setting full of new and old challenges for a sector that is essential to the country's development.

3 - The importance of the banking sector

Let me look at the fundamental aspects of the banking system:

The main missions of banks are to attract savings, finance the economy and the public and provide an effective, secure payment system, based on three pillars: fiduciary duty, risk management and social responsibility. In Europe, more than 70% of companies' financing needs are covered by the banking system.

In Portugal, this dependence has been even greater over the last few decades.

On the one hand, the banks are responsible for supplying and complementing the scarcity of private capital and on the other hand for complying with the public policies in force and the characteristics of the Portuguese economy.

Some obvious examples: mortgages to make up for the weak rental market, financial support for many SMEs (and their jobs) that otherwise would not survive, and funding for infrastructure as a complement to public investment, which has made it possible to modernise the country.

Banks were, are and always will be essential to the country's economic growth and development.

It is very clear that satisfying people’s aspirations, well-being and prosperity is only possible in one way: by sustainably creating more wealth, which requires investment, capital and human resources, and which cannot be done without the banks.

4 - What banking sector do we want for Portugal?

It is important to reflect on the issue that brought us here to this conference: “What banking sector do we want for Portugal?”

The obvious, consensual answer is that banks must be resilient, modern, efficient, ethical and reliable in order to fully accomplish their fundamental missions.

This is the goal of banks, to be pursued with commitment. They have improved a lot in recent years and will have to continue working to improve their efficiency and earn the trust of their customers and society in general.

But no less important is the role of the political powers and the different national and European regulatory and supervisory authorities, to ensure that the banks grow stronger and, consequently, to guarantee their financial stability. Part of their work should also focus on completing Economic and Monetary Union and Banking Union and achieving a real level playing field in Europe.

In short: The banks need to be highly effective and efficient in what they do and the regulators must provide the appropriate legal and regulatory framework.

What banking sector do we want for Portugal then?

There are currently a number of situations that are inconsistent with the end goal: a sound, efficient banking sector.

For example:

1) - On the one hand, a profitable banking sector is sought, capable of attracting capital so that it can do its job properly,

but on the other hand, this is hampered by the current monetary policy, regulation and supervision that many acknowledge as being excessive, and national constraints that do not apply to other players.

2) - On the one hand, we have an expansionist monetary policy, but on the other we have regulation and supervision that impose a restrictive risk policy and have strict capital consumption requirements.

3) - On the one hand, a profitable banking sector is wanted that generates organic capital, but on the other hand increases in bank fees are contested and branch closures and staff cuts are criticised.

4) - On the one hand, we want an efficient, flexible banking sector, capable of competing with the new operators, with Fintech, BigTech and others, but on the other hand, there is no guarantee of healthy, fair competition, especially in terms of the regulatory and supervisory framework.

5) - On the one hand, the banks are required to charge negative interest on loans, but on the other hand they are not allowed to do so on deposits.

6) - And we still sometimes hear that banks do not grant enough credit to companies because they are risk averse, but if they increase financing they are accused of poor management and facilitation.

7) - Basically, how will we be able to create the right conditions so that banks may be capable of attracting capital, an essential factor for the development of their business? Wouldn't it be by further emphasising the importance of the role of the banking sector in a strategy to defend Europe's interests? And national interests?

These are some of the questions that will be addressed at this conference, and I am certain that many will remain unanswered and that this reflection will have to continue.