ASSOCIAÇÃO PORTUGUESA DE BANCOS

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1. I would like to start by mentioning three speeches made at the European Banking Federation's Annual High Level Conference on 17 September entitled "A Brave New World for Banks". They clearly illustrate the particularly challenging times that the banking sector is facing.

— Matthias Smalbrugge, Professor of European Culture at the University of Amsterdam said, in a compelling, controversial comment:
  - In the last decade bankers have been humiliated and society has used them as scapegoats.

— David Wright, Secretary-General of IOSCO, said:
  - Today, investors do not want to invest in financial institutions.
  - Change in ethical behaviour must come from the top, but there are important questions in terms of passing messages down to lower levels.

— Frederic Oudéa, President of the European Banking Federation:
  - We are living in very uncertain times in our political, economic and financial environment, when we consider, for example, the crises in the Middle East, Ukraine and Greece, the volatility of the markets and historically low growth rates. All these factors make it very hard for the banking sector to take on long term risks, (I mean five to 10 years);
  - The regulatory environment makes it difficult to reconcile growth, capital ratios and proper returns for shareholders. Over the long term, no sector

can survive if returns make it impossible to invest, grow, and keep and attract investors and human resources;

- Digital technology is the greatest operational challenge for every CEO today. It is disruptive, especially for retail banking and management of the transition period, which will last for a considerable time, and will result in substantial operational challenges;
- A capacity for change, the ability to attract and keep talent, the selection of business segments that create more value for customers and the ability to remain relatively competitive against new competitors are critical success factors.

These excerpts are a good pretext for the three messages that I would like to leave with you today:

1) Managers, workers and other stakeholders in banking need to make an effort to defend and recover their reputation by recognising and correcting their errors and shortcomings. They must assert themselves by refocusing on their fundamental mission as a banking sector, the heart of the economy that is now stronger and more reliable, and also training and retraining human resources and strengthening their relationship with customers;

2) Recovering the profitability of banks is a priority, a difficult one in the current circumstances but one that has to be achieved and a necessary condition for improving remuneration in the sector;

3) Being a bank employee must be a source of pride and satisfaction and foster real personal and professional fulfilment.

2. RESTORING BANKING'S REPUTATION

The causes of the economic crisis triggered by the subprime and subsequent financial crisis are often associated with financial speculation and its consequences (especially in the United States and Europe) and deeply affected the banks' reputations. In Portugal the cases of the BPN, BPP and BES further damaged the sector's image.

In spite of stricter regulation and the progressive revival of the European banking sector, this reputation has still not fully recovered.

And the Portuguese banking sector's performance had actually been noteworthy during the 2008-2010 international crisis. It was one of the EU countries that made the least use of the public resources placed at the banks' disposal. In the end, it only used guarantees and not capital increases. It was a modern sector with a good performance.

But the sovereign debt crisis seriously affected the banks. They were among its victims. It contaminated ratings and prevented access to funding in the international markets, thereby creating liquidity problems and leading to much greater capital requirements and tough deleveraging plans. At the same time, the inherent economic crisis led to substantial growth in default rates (which, for companies, went from less than 1.5% in December 2007 to 13.8% in 2014), impairments (which totalled 32 billion euros between 2007 and 2014) and high pressure on net interest income (Euribor fell from 5.2% in 2008 to 0.3% in June 2014). All this meant that banks' profitability and share prices fell sharply – ROE went from 17.7% in 2007 to -11.5% in 2013 and -19.2% in 2014 (including NOVO BANCO and BES). This year there has been some albeit fragile improvement.

We must not be afraid to say, because it's the truth, that the main causes of the problems that we have been facing were the sovereign debt crisis and non-performing loans resulting from over-borrowing on the part of companies, households and institutions.

On the other hand, it is also true that the problems at the BPN and BES affected public finances and seriously damaged the banking sector's image. This sector is an abstract group in which the innocent have to carry the can for the guilty, which is something that does not happen in any other sector.

After what happened to the BPN and BPP, the BES situation clearly shows that financial and economic crises can trigger deep crises in businesses and financial institutions. But, when all is said and done, it is unlawful conduct and failure to meet strict management standards that lead to loss of reputation and credibility. This unacceptable behaviour tends to affect everyone, rather than being limited to the concrete case in question. The damage to the banking sector’s reputation requires action is a number of fields:

a) **Communication** is necessary to keep the public better informed on sensitive issues and particularly to ensure they understand how banks work and their essential role in the economy and people’s lives;

b) **Corporate governance** is essential in preventing financial crises and therefore vital to the financial system as a whole. There has already been a significant change in the legal framework on credit institutions Europe-wide, after the approval of the CRR and CRD IV, which has already been transposed into Portuguese law (RGIC).

The cornerstones of GOOD GOVERNANCE for a safer banking sector are (see Vitor Bento):

- appropriate rules, structure and procedures that separate executive and supervisory and control functions, which may be in a single body or two different ones – **a governance model;**
- careful selection of the right people as members of the governing bodies (as Carlos Tavares said “No good model can survive bad people");
- a culture of good governance based on values, word of honour and codes of conduct and ethics;

c) **Self-regulation** should include compliance with codes of conduct, ethics and good banking practices.

As the CEO of NY Fed said, “Culture reflects the prevailing attitudes and behaviors within a firm. (...) Culture relates to what ‘should’ I do, and not to what ‘can’ I do”

d) **The customer relations** component needs to be reinforced to include support, advice, protection and clarification.

The job of the network’s employees is of vital importance here. They are the ones who have direct contact with customers. They witness and interpret customers’ attitudes, behaviour, needs and expectations. They are the ones who lay out the choice of financial products. They have to endure states of mind, in which a lot of emotion is unleashed. They are the ones who listen to reasons, opinions, justified or unfounded complaints and even words of appreciation. They create empathy with customers. They generate trust and loyalty. They attract more customers.

These days, this job is obviously more and more demanding. It’s not just a question of increasingly complex expert knowledge but also of sales skills. It also requires broad, consistent knowledge of basic banking issues and those that are in the limelight at any particular time. It means acquiring the soft skills needed to achieve a further degree of empathy with customers and the ability to give clear explanations. Bank employees’ attitudes and accurate specialised knowledge of available financial products help customers to make choices that fit their risk profile and generate trust and empathy. These skills also show bank employees in a good light.

Banks’ managing bodies naturally need to pay added attention to recruitment and, especially, training and talent management.

The Portuguese Bank Training Institute is currently giving and preparing special courses for improving bank employees’ skills, retraining them and providing certification for certain jobs, especially those involving direct contact with customers.

3. PROFITABILITY

I will now go a little further into the second message. This message is about the absolute need to improve banks' profitability. It is hardly necessary to point out that profitability is vital in attracting, keeping and compensating investors. It is essential in strengthening banks and dictating their remuneration policy.

Portuguese banks' profitability has declined in recent years and has not been able to keep up with the climate, albeit tenuous, of recovery in Europe.

The Portuguese banks' ROE was 7.7% in 2010, 6.3% in 2011 and 19.2% in 2014.

Their aggregate, consolidated pre-tax profit was 2.51 billion euros in 2010 and 1.92 billion in 2011, but they made a loss of 5.935 billion in 2014.

I began my presentation with the figures for 2010 just to show the effect of the sovereign debt crisis.

The economic crisis, which resulted in a substantial rise in defaults and impairments (33 bn since 2008), the cost of capital and a reduction in net interest income were naturally responsible for these poor results.

The recovery of profitability will not be easy.

When it comes to **earnings**, we are faced with the following situation.

- Any increase in loans is conditioned by a persistently insufficient demand for the banks' needs, while competition for customers caps any rise in spreads;
- Net interest income is under serious pressure due to extremely low Euribor rates;
- Fees have been strictly limited by regulatory and legislative restrictions. On the pretext of the undeniable need for consumer protection and transparent conduct on the part of the banks, sometimes unjustified measures compromise the legitimate, I repeat legitimate ability that the banking sector has to have in a market economy to pay its costs and be

properly compensated for its services. Indeed, those who suffer most if banks are less efficient and less competitive are their customers, who are the ones that were originally being protected. Furthermore, fees are much higher in most other EU countries. When it comes to fees, it's as if the banks were regarded as public services, but with no corresponding budget;

- Income from financial operations, which depends a lot on circumstances and each bank's portfolios, may not improve very substantially in general terms;
- This is because room for manoeuvre on the earnings side is pretty limited;
- Recovery of loans and control of impairments are still very important, as the high level of defaults on loans and the handling of the real estate legacy are real priorities for the banks' management.

It is essential to **reduce operating costs** in order to restore profitability, which is what the supervisors are demanding. There are DGCom requirements for banks that resort to state aid.

The measures taken by the banks in this area included downsizing personnel between 2011 and 2014. The overall reduction was 10.4%, and 33% of the employees retired, 29% terminated their contracts by mutual accord, 14% left voluntarily, 12% reached the end of fixed-term contracts and 3% were dismissed.

But going against this need, substantial new direct costs arose from new regulation and supervision, due to the resources used and investments that they entailed.

On top of this there are:

- SSM supervisory fees;
- contributions to the Single Resolution Fund;
- contributions to the Portuguese Resolution Fund for BES.

In addition, there are the impacts of capital, liquidity and leverage requirements. European banks have been drawing attention to excessive regulation and its consequences (which include growth in an unregulated or less regulated financial sector). The Commission has recognised that it is necessary to reassess the impacts of the measures taken and a public consultation on these matters is currently under way. This does not mean that it is not vital to reinforce mechanisms for preventing crises and for increasingly effective, intelligent supervision.

This whole troublesome framework may be worsened if the extremely low three-or-more-month Euribor rate lasts for any length of time. Portuguese banks are among those in Europe that most use variable interest rates. This is a new problem with effects on the present and the future.

With profitability as it is, the banks have found it more and more difficult to attract investors.

The banking sector's is particularly sensitive to the perceptions that economic agents, analysts and even supervisors have of sectors' attractiveness and a country's macroeconomic situation and political stability.

4. Throughout history, bank employees have always been respected and enjoyed social prestige. According to some opinions, the downturn in the banking sector's reputation resulting from improper, speculative and ethically reprehensible practices may have caused a loss of respect for the job. Is this true? Or is it just an extrapolation of the results of certain studies. In general, customers trust **their own** bank and account managers but criticise the banking sector as a whole.

How do bank employees feel about themselves in relation to their customers and their fellow citizens? What lessons have been learned and what needs to be done?

It is clear to me that bank employees' self-esteem has to be boosted.

It is one of the occupations that require the most human and specialised skills, as financial activity is highly complex, diverse and competitive. It is subject to constant innovations and intense technological advances. The banking sector is the most regulated and scrutinised and the demands on conduct, individual and collective assessment, suitability and qualification requirements are unparalleled in any other business. Being a bank employee is a prestigious occupation.

Empirical evidence clearly shows the supremacy of liberal, pluralistic democracy in the political sphere and of a market economy in the economic sphere.

The prevailing liberal economic order has, in fact, led to significant increases in prosperity on all continents. World production quadrupled between the early 1970s and 2008, and is continuing to grow.

The middle classes, on which liberal democracy is based, have expanded all over the world.

Everyone recognises that the richer and more educated a population is, the more demanding it is of its government. It feels entitled to hold its politicians to account. Society has a crucial role to play in the functioning and quality of democracy and the performance of the market economy associated with it.

Before wealth can be distributed it needs to be created and we must demand a business framework as propitious as possible to the creation of wealth, employment and prosperity, which are any country's permanent goals.

But both democracy and the market economy are based on principles and abide by rules.

We all aspire to economic growth, but it will not happen without funding or investment.

In a market economy, businesses act in accordance with their perceptions of risk, their assessment of opportunities, the prospects of a return on their investment and their trust in the country in which they invest. And this is closely related to its political stability and macroeconomic performance and the status of its public finances.

Political uncertainty is part of democracy, but it is bad for the economy.

If an environment is considered high risk, there is no investment, and investment plans are put on hold.

Portugal is in a situation in which its private capital base has been largely eroded in recent years and it therefore really needs an IDE and investor confidence.