What future lies ahead for traditional banks in the Eurozone?

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Nicholas Hadjiyiannis
Chief Executive Officer
Cooperative Central Bank

European Banking sector: Is it overbanked?

Europe has 130 large banks (over €30bn in assets), servicing a €15.3tn economy- that's one bank per €118bn GDP. For the US the respective statistic is one bank per €302bn. For Canada one per €214bn and for Australia one per €144bn.

Source: PWC

The Eurozone Banking sector
Challenges

Difficult economic environment	• Stubbornly low interest rates causing pressure on net interest margins • Low profitability a cause and effect: the ability and willingness of banks to finance the wider economy is weakened.
More strict regulation	• Higher capital requirements • Increased liquidity requirements (less reliance on short term funding, larger holdings of low yield high quality liquid assets) • Basel 4 to increase capital requirements through a tougher regime for calculating risk weighted exposures • MREL – issuance of longer term debt
NPLs	• NPLs have increased sharply in Europe since 2008 • Negative impact on profitability through raised provisions, unpaid interest and eventual realization of losses.
Fast pace of innovation	• Significant innovations in interfaces, distributions, big data • Pro-actively develop new generation of products and services
Cost to income ratios	• Have remained stubbornly high across EU banks fueled by the downward pressure on interest margins • Need to invest in technology systems • Stricter and more intrusive regulation increases demands

Bank profitability drivers

Net interest margins

- Net interest margins typically lower in the EU (1.2% vs 3% in the US, 2% in Canada
- Downward pressure from low interest rates, central bank actions
- Flattened or even inverted yield curve on expectations of prolonged low interest rates has removed the ‘carry trade” advantage of banks for short-term low cost funding and long-term higher rate lending.

NPLs

- 2013 NPLs at 5% of total loans vs 1.5% in 2006-2007 (Uneven distribution between countries with Cyprus being the “champion’ with 50%+)
- Pressure on banks to off-load their €1.2tn overhang could take decades hindered by the prolonged weak economic environment

New business models

- This could be a sizeable driver of profitability especially for banks who have faced less severe strains on profitability during the banking crisis. For example, a bank with a higher proportion of non-interest income or a smaller trading book.

Cost to income ratios

- Financial innovation and technological progress may offer opportunities to reduce costs over the long term

Data Source: KPMG

Adversaries and Partners: FinTech is reshaping banking

- Majority of financial sector executives believe consumer banking is the sector most likely to be disrupted by FinTechs. As much as 76% of banking respondents fear that some part of their business is at risk by FinTechs
- 42% of banks, engage in joint partnerships with FinTechs to develop narrowly defined, but highly effective solutions to manage customer expectations
- Opportunities exist for partnership and cooperation that would leverage each other's strengths in areas like product design, distribution and infrastructure capabilities by banks. For example, in the last few years an ecosystem has been built that promotes digital payments and reduction in the use of cash. It is estimated that non-cash transactions will grow by 69% from 2013 to 2020 (over 1M transactions per minute!)
- Major impediments inhibiting business relations between banks and FinTechs remain; both sides should come to a mutually beneficial relationship but still early in execution

Source: PWC

Successful banks going forward

- It is vital for banks to increase or at least maintain their net interest margins. To achieve this they should focus on higher yielding assets in combination with cheaper sources of funding
- Increase their non-interest income proportion to shield from adverse interest rate fluctuations
- Non-performing loans should be reduced decisively; this is vital for the long term perspective in profitability.
- Adapt to the revised regulatory requirements
- Reduce cost-to-income ratios through the use of technology to streamline back-office processes. It is also important to utilize digital channels.

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