The new environment for banking

Companies constantly face changes in their environment: technology, actions taken by their rivals, society's habits, input prices, demand conditions, regulations... all these factors evolve incessantly. At certain times, however, the speed and extent of such changes escalates, radically transforming entire sectors. Europe's banking sector has undoubtedly been going through such a transformation, and for some years now.

This new environment for banking has been shaped by several factors. Firstly, the loss of reputation suffered during the crisis; and, by definition, a business such as banking cannot prosper in a climate of mistrust. Improving reputation, through humility, focusing on customers and social responsibility, has become a priority.

The new regulatory framework established by the principles of Basel III and European banking union also represents an incredibly important challenge in terms of anticipation and adaptation. The considerable increase in capital and liquidity requirements resulting from Basel III has made bank intermediation more expensive and put pressure on the profitability of the sector. Some rules that have yet to be specified could raise these requirements even further, and we have already seen that transition periods are of little use: the markets demand in advance what regulators demand within a few years.

European banking union also entails a process of regulatory harmonisation that will take years to complete; changes in the supervisory mechanism with adjustment costs for all parties concerned; and new resolution rules (applicable to institutions that may be in trouble), with important aspects that have yet to be detailed. It would certainly be useful to dispel all these uncertainties as soon as possible and enter a period of regulatory stability.

Banking union will also help to create large pan-European institutions; perhaps not in the short term but we are bound to see significant integrations at a European level within a few years. The strongest institutions will take the lead.

But regulation is not the only factor pushing down banks' profits, and not even the most important one. Low interest rates, the still high cost related to provisions and weak growth in business volumes are the strongest headwinds. Given this situation, cost discipline and innovation to offer customers the best value proposition become essential. Achieving sustainable profit levels is not optional; it is the only way to ensure that banks continue to play their fundamental role in financing the real economy. In this area, by the way, a false dilemma is often presented between banks and capital markets when the reality is that both are more complementary than substitutes.

In terms of technology and society's habits, digitalisation is opening up a new world of possibilities to interact with customers, improve our insight into their needs and offer them a better service. It also increases competition with the appearance of new competitors. All this tests the agility and capacity of traditional banks to innovate. Only flexible organisations, those capable of constantly wondering whether the way we did things yesterday is how they should be done today, have a chance for success.

This *Monthly Report's* Dossier deals with some of these issues: the new regulatory framework for banking, the pressures on profits, interaction between the banking sector and capital markets and growth in online marketplace lending. These elements of change are creating a hugely challenging environment for the sector. But the ultimate challenge remains the same: gaining the trust of customers, shareholders and society as a whole.

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