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"Banks, trust and new technologies"

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Good morning. I would like to thank Expansión and Unidad Editorial for their invitation to take part in the opening session of the eighth *Encuentro Financiero*. It is a pleasure to be here with you today. Allow me to express my thanks also to the Chair of the Supervisory Board of the Single Supervisory Mechanism (SSM), Danièle Nouy, for having found time in her agenda to visit us.

The president's speech could not be more timely. After carefully taking in her words, I should say that I subscribe to her thoughts on the European banking sector. In particular, I share her concern for the possible overcapacity of the sector, which makes it difficult for banks to compete with the necessary guarantees in an increasingly more complex environment.

Spanish banking sector

As I shall proceed to explain, I believe an orderly correction of this excess capacity is one of the main means available for achieving the necessary improvement in the efficiency of credit institutions.

True, following the recent financial crisis, the soundness and stability of the Spanish banking sector has improved substantially. As of today, Spanish banks are more capitalised, healthier and better prepared to face potentially adverse economic shocks.

In terms of capital, for example, Spanish banks have increased their solvency ratio by practically 1 percentage point over the past three years, raising their common equity tier 1 capital (CET1) ratio as of March 2017 to an average of 12.2%.

In addition, it is worth highlighting banks' notable efforts to clean-up their balance sheets through provisioning. Since the start of the crisis, the sector as a whole has set aside provisions that have exceeded €310 billion, a figure close to 25% of the country's GDP.

Finally, the volume of non-performing loans to the private sector, while still high, has continued to decline. The latest figures, for July 2017, show that non-performing loans have fallen from their end-2013 peak by close to €90 billion, and are now more than 40% lower than then. As a result, the NPL ratio of the sector as a whole for business in Spain stands at 8.6%.

Despite these improvements, factors of uncertainty persist. Recent credit developments continue to show negative growth rates and only weak signs of picking up in some sectors. And bank profitability remains one of the fundamental challenges credit institutions face to ensure their viability in the medium and long term. The latest available figures on profitability mean banks cannot be complacent.

The average profitability for the sector remains low and some way off the levels observed in the pre-crisis years. The return on equity (ROE) for the aggregate of Spanish deposit institutions stands at around 5%. While these ROE figures are slightly higher than the European average, they undoubtedly fall short as regards meeting the cost of capital, which on the latest estimates might be standing at around 10%.

Admittedly, some of the factors weighing on bank profitability may foreseeably be temporary. I refer, for instance, to the current, very low interest rate levels which, while they have been a key factor in the pick-up in economic activity, may have exerted downward pressure on financial institutions' net interest income. This circumstance is particularly intense in a setting of interest rates close to zero, where the reduction in interest income can hardly be accompanied by further cuts in financing costs, especially in the case of retail deposits.

In any event, we should be cautious and assume that the environment of moderate interest rates might still prove persistent to some extent; accordingly, this will be a factor to bear in mind when analysing developments in bank profitability over the coming years.

In addition, there are other phenomena, such as those derived from the adoption of new technologies and the possible entry of new competitors, the consequences of which for banking business may prove more profound. Allow me to voice some thoughts in this connection.

Technical innovation and other challenges

Undoubtedly, ongoing technological innovation in the banking industry offers great opportunities for financial institutions to improve, both in terms of lower costs and the possibility of offering new and better services to customers.

Much of the innovation we are witnessing is in the form of tools that credit institutions can incorporate into their bank operations. These include most notably: innovations in the provision of payment services, in particular through mobile devices (such as that offered by the Bizum platform); technology that enables automated investment services to be offered through digital channels; innovations that use the analysis of a large volume of data from various sources at high speed; the growing use of artificial intelligence to optimise internal processes; and the so-called "in the cloud" services, which offer banks the opportunity to save on information processing and storage costs, along with greater operational flexibility.

However, the process is not free from uncertainty and from notable risks, many of which are now heightened by the speed of change, and by the emergence of new interdependencies.

The risks we are perceiving are related, inter alia, to potential fraud, to cyber-attacks, to the wrongful use of personal data and, in short, to risks that may pose a threat to the stability of the overall system. In today's digital world, the system is only as strong as its weakest link.

At the same time, banks' adoption of new technologies may call for high initial outlays, occasionally on multiple projects until one of them should prove profitable.

Lastly, technological development is in turn acting as a catalyst for new firms that may ultimately compete with banks in specific segments of the banking business chain.

In some cases, these firms may target banks' key business, as is the case with crowdfunding platforms, which compete for the provision of credit, benefiting from the advantage afforded them by not having to bear the costs or rigidities to which traditional banks are subject. While new firms may manage to grow with some intensity, their offerings usually address segments which are very specific and, in general, less attractive to banks. Moreover, the credit risk the operations entail and possible reluctance by the financing customers may restrict their scope.

In other cases, the new firms may target more profitable sections of the bank business chain, focusing on accessory services (such as payment services).

This may have a greater impact, since it might ultimately change the dynamics of the relationship between banks and their customers, with the emergence of intermediary, non-bank entities that would provide services to the final customer. Paradoxically, this situation might arise without the new entities operating customer accounts and without the usual interbank payment channels being substantially changed.

An example along these lines are the payment initiation or account information services regulated in the new payment services directive (PSD2). In this latter case, firms compile data on the payment accounts of a single customer in different banks, whereby these firms not only offer the possibility of obtaining an overall and immediate view of a customer's financial position, but potentially open the door to direct assessment.

Lastly, in addition to digital change, banks must face other challenges, such as those derived from greater regulatory requirements in respect both of solvency and bank resolution. European resolution regulations require that banks hold sufficient loss-absorbing financial instruments on their balance sheets, thereby providing for the internalisation of such losses and the assumption by the private sector of the costs of bank crises. Setting up such a minimum requirement for own funds and eligible liabilities (MREL) is no mean task and poses a particularly demanding challenge in the case of banks with no experience in the issuance of this type of instrument on the market.

Banks thus face a complex environment, where low profitability, the demands made by new regulatory requirements and technological innovations are among the main challenges. But there are others, such as those arising from sociodemographic trends and foreseeably lower population growth, which may bear on the demand for financial products and services in general.

Possible measures

As I said initially, banks are better prepared to adapt to the new environment, maintaining a proactive strategy enabling them to harness the opportunities the environment offers and to ensure their viability in the medium and long term. On one hand, they must take further steps to improve operational efficiency, reducing potential excess capacity; and, on the other, they must give priority to customer care and to enhancing their selling practices.

Corporate operations are one possible means of reducing excess capacity and improving efficiency. It would be desirable for such operations to take place at the European level, between banks from different euro area countries. Regrettably, this does not appear to be the prevailing trend. We ourselves, in using the expression "cross-border operations", continue to emphasise the existence of borders in the banking sector, even within the euro area, which does not seem to fit with the Banking Union project. In this respect, I believe we should continue working to identify the elements that may be curtailing such operations.

As regards looking after bank customers, I shall tirelessly insist that their trust is banks' main asset. The recent financial crisis and the use of certain bank practices undermined this trust. Regaining their confidence and improving the sector's reputation is one of the main challenges banks face. They will be required to improve transparency in communication with their customers, to apply best selling practices and, in short, to safeguard bank customer interests. The importance of customer care is magnified by the extension of the digital world to the sector, which rewards the immediacy and availability of services at any time of day. It is important to be able to respond to these demands, maintaining at all times high levels of security and reliability in respect of services.

To conclude, the banking business is undergoing deep transformation whose consequences are difficult to foresee. We do not know what the future holds for the sector, but we do know that banks must and can prepare themselves. Furthering improvements in efficiency, reducing excess capacity and ensuring bank customer care are factors which, in my opinion, should be present in any strategy.

Thank you for your attention.