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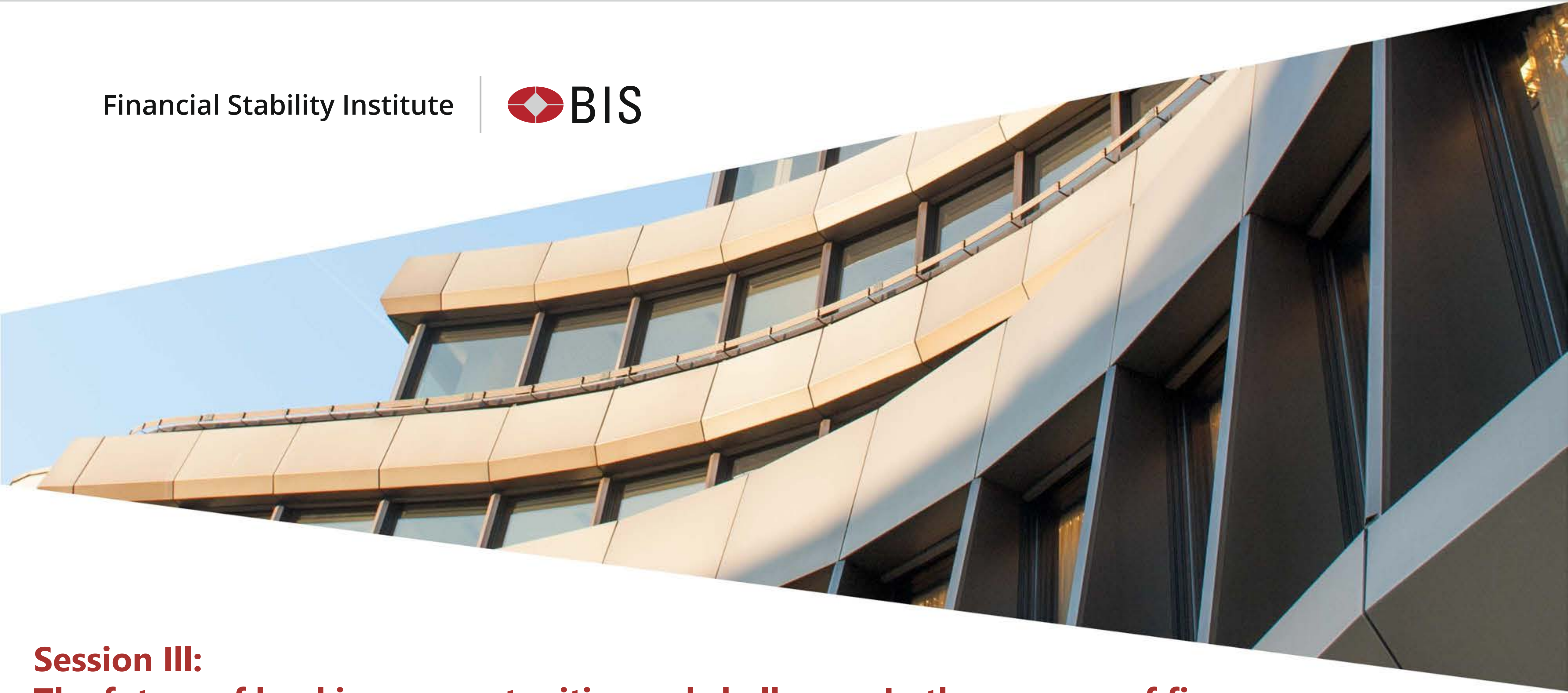

Session III:
The future of banking: opportunities and challenges In the new era of finance

Banco de Portugal conference on financial stability, 2 October 2023, Lisbon

Fernando Restoy, Chair, Financial Stability Institute

2 October 2023

Views expressed are my own and do not necessarily represent those of the BIS

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1. **The evolution of the financial landscape**
   - The technological disruption
   - The new competitive environment
   - The new (more stringent) regulation

2. **Some emerging trends (and new risks) in the banking business**
   - Vulnerability of some (traditional) business models
   - Increased relevance of operational risks
   - Increased interlinkages with big techs/fintechs and NBFIs

3. **The policy response**
   - Regulation
   - The (new) role of supervision

THE EVOLUTION OF THE FINANCIAL LANDSCAPE: Technological disruption

- New production processes for traditional financial services: new internal processes (data management, internal control, risk-return assessment…), new supply chains (external clouds), digital distribution channels (digital banking).
- New products: particularly for payments (crypto/digital assets) facilitate non-bank-centric (possibly, decentralised) financial transactions.
- New players: fintechs, VASP and, especially big techs: Potential for excessive concentration, anticompetitive behaviour, personal data mishandling, uncontrolled interconnection between financial and non-financial businesses.

THE EVOLUTION OF THE FINANCIAL LANDSCAPE (2): Regulation

- Substantial overhaul of the banks' regulatory framework:
  - More and better capital
  - Additional prudential regulatory controls: large exposures, liquidity…
  - And new resolvability requirements: resolution plans, TLAC/MREL…
- Which may be affecting overall profitability (at least via compliance costs) and deteriorate the business case of some activities (eg market making).

2019

Facebook (Meta) creates Libra

Alibaba buys WorldFirst

Apple launches credit card (Apple Card)

2020

Google launches Google Plex (discontinued)

Amazon launches SME lending

Apple buys Mobeewave

Amazon launches Amazon Card

2021

Google and **Alibaba** apply for a "crypto license" with MAS

Alibaba authorises NFTs exchanges

Amazon launches BNPL

Mercado Libre buys Redelcom

2022

Apple buys Credit Kudos

Instagram (Meta) announces the integration of NFTs

Mercado Libre invests in 2TM and Paxos

MetaMask integrates **Apple Pay**

Apple launches BNPL

Mercado Libre launches own cryptocurrency in Brazil (Mercado coin)

2023

Apple offers BNPL product through own subsidiary

Apple launches high-yield savings account (with Goldman Sachs)

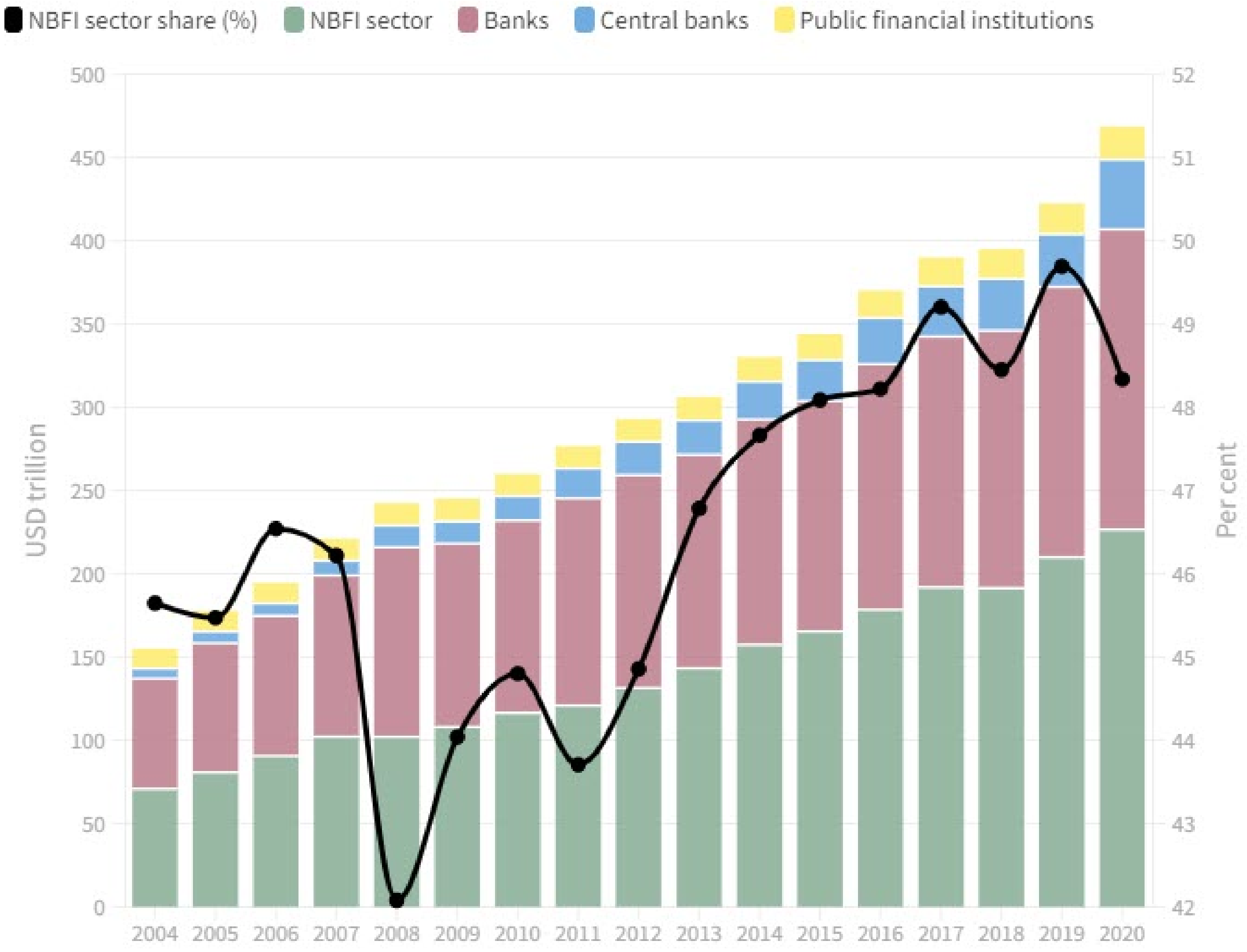
Mercado Libre partners with Paxos to offer stablecoin, Pax Dollar, in Mexico

Mercado Libre launches credit card in Mexico

Amazon launches credit cards in Brazil, including BNPL

Legend
- Payments-related initiatives
- Lending-related initiatives
- Crypto-related initiatives
- Deposit-taking initiatives

Total global financial assets



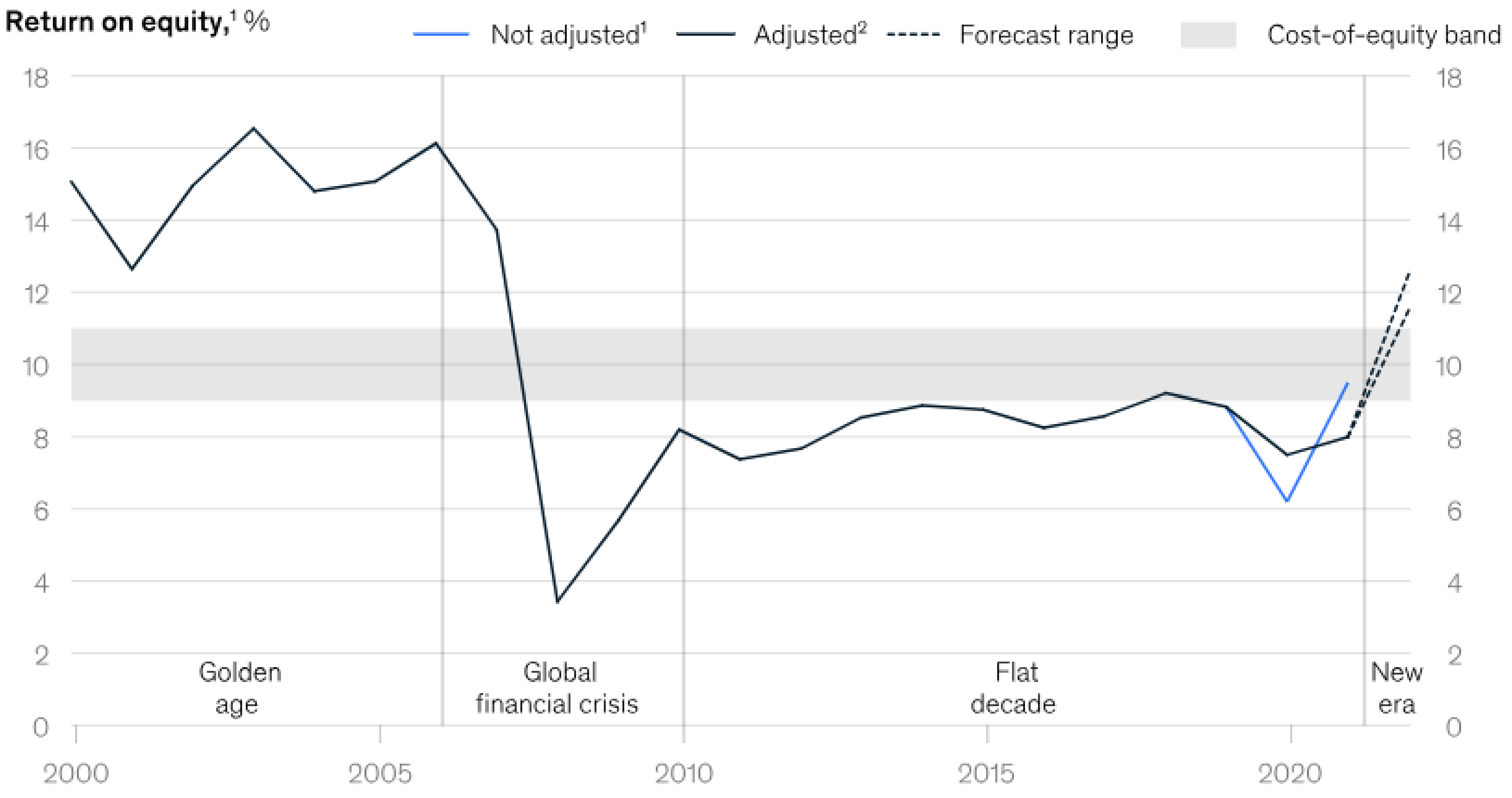
Source: Global Monitoring Report on Non-Bank Financial Intermediation 2022, FSB

THE EVOLUTION OF THE FINANCIAL LANDSCAPE (3): the new competitive environment

- NBFI (clearly supported by lighter regulation) now have a prominent role in financial intermediation.
- New tech players gaining presence in several business lines. Big techs have a sizeable unexploited potential.
- Signs of a structural deterioration of banks' profitability (despite recent improvement).

After a decade of flat returns, 2022 represented a new era in banking.

Banking profitability through the eras



[1]Accounting ROE, including the full impact of provisions.
[2]For 2020 and 2021, ROE has been adjusted for cyclicity for provisions during the COVID-19 pandemic.
Source: S&P Global; McKinsey Panorama

McKinsey & Company

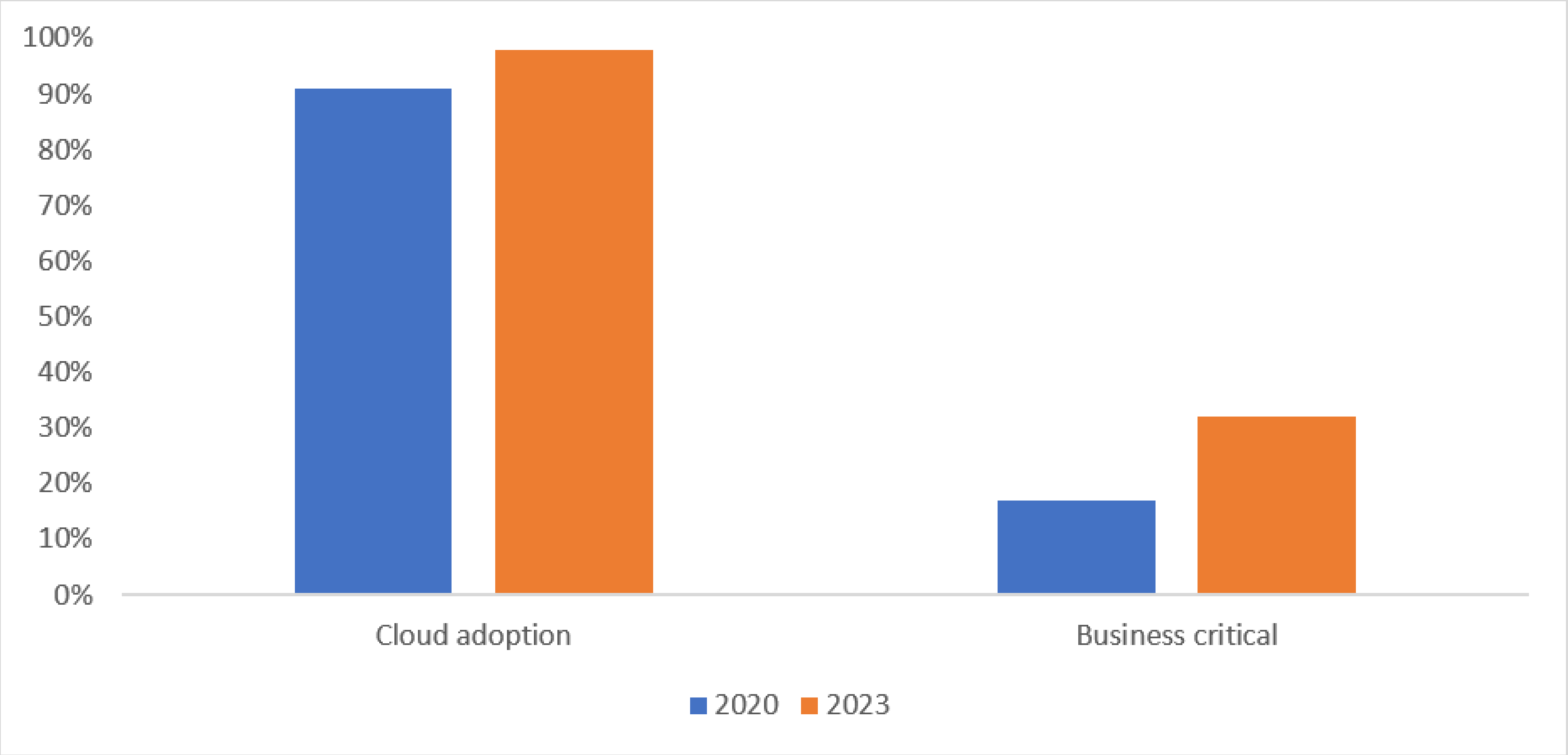
SOME EMERGING TRENDS AND RISKS (1): Business model sustainability

- Increasing challenges for business models sustainability:
  - Lower margins due to competition/regulation/overbanking.
  - Poor asset valuations (in some jurisdictions).
  - Increasing difficulties to compete with non-banks in some areas: payments, venture financing, asset management, market making.
  - Climate-related financial risks.

EMERGING TRENDS AND RISKS (2): Other developments

- Incipient signs of structural reduction of deposit stickiness (helped by digitization).
- Increasing exposure to non-banks.
- Substantial exposure to operational risks:
  - Cyber-risks
  - Reliance on (only a few) third-party, providers of critical service (eg CSP)

Cloud adoption in financial services*



Cloud adoption – percentage of respondents citing that their organisation is using some form of cloud computing
Business critical – percentage of workloads designated by respondents as “business critical” that have moved to the cloud

Source: Cloud Security Alliance (2023): State of Financial Services in Cloud, 5 June.

POLICY RESPONSE (1): Regulation

- Need to consider (new) specific regulation for big techs, NBFI, critical CSP.
- Limited scope to adjust banking regulation: deposit insurance schemes, liquidity requirements, CRFR.
- But already under decreasing returns… (taking into account pressure on profits and valuations.
- … also capital and liquidity not well suited to address issues relating to business model sustainability, op risk and interlinkages with NBFIs.

POLICY RESPONES (2): Supervision

- It is the time of intrusive supervision:
  - More focus on business model, risks management and governance.
  - Empower supervisors (abandon box-ticking).
  - Ensure availability of the required tools, powers and resources.
  - Adopt the required supervisory culture and tone-from-the top.