Presentation of the 2018 annual report

of the *Autorité de contrôle prudentiel et de résolution* (ACPR)

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Ladies and Gentlemen,

[**Slide 1**] I am pleased to welcome you to the presentation of the 2018 annual report of the *Autorité de contrôle prudentiel et de résolution* (ACPR), alongside Bernard Delas, Vice-Chairman of the ACPR, Rémi Bouchez, President of the Sanctions Committee, and Edouard Fernandez-Bollo, Secretary General of the ACPR. In 2018, the women and men of the ACPR continued to work tirelessly to safeguard financial stability, in a context marked by the uncertainty – and at times the emergency – of Brexit. I would like to thank them for their work. This morning, I shall focus on a topical issue – the profitability of banks and insurers in France and Europe [**slide 2**].

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I. The profitability of French banks and insurers remains resilient

The **return on equity** of France's largest banks edged up by 0.4 percentage points to 6.7% in 2018,[i] coming back in line with 2015's level. The maintenance of profitability levels needs to be viewed alongside the sharp rise in bank capital. French banks have strengthened their **solvency** and are now more robust. They have more than tripled their capital since the crisis. In parallel, they have raised their core capital ratios (CET1) by nearly 8 percentage points since 2008, from an average of 5.8% to 13.6% in 2018 [slide 3]. French banks' profitability is in line with the euro area average and well above that of their German counterparts. At an international level, only the US banks stand out as having an ROE in excess of 10%.

French banks have come a long way in the past ten years, in a demanding economic, financial and regulatory environment. We need to be wary, therefore, about using two misleading points of reference, the first of which consists in comparing current ROEs to pre-crisis levels – when they were clearly too high – and the second in focusing on the cost of equity. Apparently, the cost of equity for French and European banks is still too high at over 9% compared with less than 7% in the US; this figure fails to reflect either the strengthening of their solvency and hence resilience, or the sharp decline in risk-free rates [**slide 4**].

With regard to **insurance**, the industry remains solid. Figures for end-2018 should show that insurers' solvency capital requirement coverage ratio has reached nearly 240%, which is similar to the level seen in 2017. But I shall let Bernard Delas come back to that in more detail later.

II. That said, the trend going forward is less favourable, calling for mobilisation

2.1 Three factors are currently raising concerns

Despite the quality of this snapshot for 2018, the outlook – the medium/long-term trend – calls for vigilance and mobilisation. Three factors are effectively weighing on the profitability of both French and European banks. The first two mainly concern retail banking: continuing low interest rates and digitalisation. The **maintenance of a low interest rate environment** is completely justified and necessary in light of the economic situation in the euro area. However, it is also squeezing net interest margins for retail banks, which finance themselves with deposits and not at variable rates in the market, as well as reducing returns on insurers' investments. In the case of banks in particular, the issue should certainly not be ignored, but we also need to avoid blowing it out of proportion by claiming it is the only factor weighing on euro area bank profits. On April 10 the Governing Council explicitly said: "In the context of our regular assessment, we will also consider whether the preservation of the favourable implications of negative interest rates for the economy requires the mitigation of their possible side effects, if any, on bank intermediation."[ii] Let's allow time for this work to be done and for the necessary decision to be taken. It would be an exaggeration, however, to say this is the only reason profits are under pressure: monetary policy also has favourable effects for banks, including a reduction in the cost of risk and an increase in lending volumes; and certain banking systems, notably those in Nordic countries, are generating higher profits with interest rates that are at least as low as ours.

On a more structural level, financial institutions – banks and insurers alike – are facing an existential challenge, that of their **digital** transformation which is revolutionising modes of use and opening up a world of possibilities for customers. However, adapting to this new ecosystem requires huge investment as well as placing downward pressure on revenues. Faced with this challenge, financial institutions will need to find new productivity gains and new tailored services, by tapping even deeper into the possibilities of automation and artificial intelligence (AI). The ACPR is working actively on these issues. Following the publication of a discussion paper on the challenges posed by AI in the financial sector, in February the ACPR launched a call for candidates to participate in joint workshops with financial industry participants. Three key processes are concerned: AML/CTF, internal models and customer protection.

The third factor warranting attention relates to **investment banks**. According to some estimates, in the past ten years European investment banks have lost 10 percentage points of their market share to US banks.[iii] This can be attributed to the difficulties European banks face in achieving the critical mass needed to operate in a global market. And Brexit will do

little to change this trend if the European market remains fragmented. Conversely, US investment banks have the benefit of a huge domestic market where margins are higher. Their size gives them a decisive advantage when it comes to achieving economies of scale and competing for large-scale financing transactions. Faced with these structural challenges, French banks' CIB divisions have already begun to refocus on more profitable activities and implement major cost-cutting plans. However, there is still a lot to be done, notably when it comes to industrialising processes and flows; digitalisation is also changing trading activities.

2.2 Banks and regulators therefore have three focuses for action

The main prerequisite for improving profitability is for banks to put in place individual **restructuring** strategies. There are a number of levers they can use for this: technological innovation, cost control or the diversification of revenue sources [**slide 5**]. On this latter issue, I would like to underline the resilience of the French "universal" or diversified banking model. Combining the three core businesses of retail banking, specialised financial services and corporate and investment banking helps to open up opportunities for cross-selling, and reduces banks' sensitivity to the interest rate cycle by giving them access to more diverse sources of financing. Even in retail banking, profitability has been better preserved thanks to the increase in fees on activities that are not linked to interest rates: payment services, asset management and insurance investments. For the six largest French banks, net interest margin thus accounts for 44% of net income compared with 57% for their euro area peers.

The challenge of bank profitability also raises another imperative: **cross-border consolidation**, which would allow genuine pan-European banking groups to carry out their activities more efficiently and better withstand the international competition. Compared with the US market, the European banking sector remains fragmented: the 5 main European banks have a market share of just 20% compared with more than 40% for their US peers. Meeting this target is in part the responsibility of public authorities: concrete progress finally needs to be made on the Capital Markets Union, and the Banking Union needs to be completed in a true single banking market. It is particularly important to prevent geographical ring-fencing practices, which stop groups from managing liquidity and capital on a consolidated basis. These policies could prove dangerous in the event of a crisis as they would make it harder for entities within cross-border groups to support each other. That said, private sector actors do not need to wait for public authorities to do everything before starting to think about consolidation strategies.

Lastly, we also need to ensure that institutions are **treated equally** under international regulations. If we are to reach an agreement, two conditions must be met. The transposition of Basel III must be **reasonable** and take into account the application of the "output floor" at

the highest level of consolidation. Above all, the transposition must be **fair** and applied to the letter in all jurisdictions, including in the United States. Let me be clear about one thing, however: the solution to our banking challenges is not deregulation but rather innovation; not a step backwards – towards the financial crisis – but a leap forwards.

III. We need to remain fully mobilised with regard to two deadly risks: ALM/CTF and cyber-security

The fight against money laundering and terrorist financing (**ALM/CTF**) calls for unwavering commitment. The 23 inspections carried out by the ACPR revealed major failings in supervised entities' compliance with their AML/CTF and asset-freezing obligations. In 2018, the Sanctions Committee imposed nine sanctions, one of which amounted to EUR 50 million. In parallel with the Financial Action Task Force's assessment of France in 2020, the ACPR will be closely involved in the implementation of a robust and renewed AML/CTF system at the European level. I have every confidence that the European Banking Authority – which is moving to Paris on 13 June this year – will encourage effective cooperation and the useful exchange of information between national supervisors. Edouard Fernandez-Bollo also chairs the EBA's internal AML/CTF committee. The ACPR conference on 21 June, which will focus on AML/CTF in its morning session, will be an opportunity to remind ourselves of the efforts we all need to keep making in this field.

The ACPR and Banque de France are at the frontline of efforts to increase **cyber-security** in the financial sector, which is one of the priorities of France's G7 presidency. Let me remind you that there is no more certain threat to the financial sector than that of cyber-risks. Given this urgency, we will be implementing concrete measures in the near future. The main ones are the shared "categorisation" of cyber-incidents, and the lessons to be drawn from the G7 cyber stress-test that will be organised by the Banque de France at the start of June.

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The French economy has the advantage of having a solid financial system, the most solid in the euro area: France is a leader in essential activities such as life and non-life insurance, and asset management, and is home to four of the euro area's eight global systemically important banks. The European supervisor can also rely on the expertise and experience of the ACPR, which are recognised both in Frankfurt and in Europe. Let's make the most of these strengths in the context of Brexit: without resting on our laurels – the supervisor will always remain vigilant and all of our institutions are aware of the scale of the challenges – but rather by drawing on our collective intelligence.

[i] Source: Financial disclosures from BNPP, SG, GCA, GBPCE, GCM and LBP. According to the EBA, the ROE of French banks (a broad sample) is 6.60 %.
[ii] ECB, Mario Draghi's introductory statement to the press conference on 10 April 2019.
[iii] Study by Thomson Reuters.