Joachim Wuermeling: Introduction to the book "Banking Business in Germany"

Opening speech by Prof Joachim Wuermeling, Member of the Executive Board of the Deutsche Bundesbank, at the occasion of the publication of the book "Banking Business in Germany" from the Association of Foreign Banks in Germany, Frankfurt am Main, 16 October 2019.

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Introduction

Ladies and gentlemen,

Thank you very much for the invitation. It is my pleasure to introduce the 6th edition of “Banking Business in Germany”.

Previous editions have been a valuable guide, with clear and insightful descriptions of

- The structure of the German banking sector,
- the structure of banking supervision in Germany and the EU, and
- the relevant legislation for banks and investment firms active in Germany.

These information are very helpful for foreign banks entering the German market, which is why it has become something of a go-to guide.

As this book is about German Banking I would like to take this opportunity to make three remarks on the sector.

First, I would like to make a brief assessment of the Brexit preparations.

Second, I would stake stock of the incoming financial institutions due to Brexit

Third, I will then talk about the strategic options post Brexit.

State of Brexit preparations

The book as well as the Association of Foreign Banks in Germany are as important as ever given the developments we are seeing due to Brexit. This event has a major impact on the German banking sector not only in the short, but also in the long term.

For the short term, I may say that banks and supervisors have more or less completed preparations for a hard Brexit. This is due to the hard word of the banks but also to the clear stance of supervisors and – last but not least- the delay from March to October. We as supervisors have been very strict; we saw no alternative than to prepare for the worst-case scenario, which is a hard Brexit. That proved to be the right stance, despite of the promising rumours ahead of this week’s European Council meeting and glowing hopes that there finally may be a withdrawal agreement between the EU and the UK.

A hard Brexit is exactly what institutions have been preparing for in recent months. I am well aware that this was a very challenging process for all firms, but I am convinced that these strict measures are a valuable advantage in light of the current, difficult circumstances.

Moreover, in areas where banks were not able to do this alone, like in clearing, contingency measures are in place to contain key risks.

One thing needs to be very clear, however. Contingency measures are – quite rightly –

temporary; they do not relieve institutions for aligning with the new legal environment.

Yet, the uncertainty of how Brexit will take place and what future partnership will follow, has weighed on the banks' preparations. It has also led to a withholding of the transfer of portfolios until the last moment, until the final decision concerning Brexit is taken. This creates an additional operational risk of course, when enormous sums (trillions) are to be shifted overnight.

The risk of the uncertainty remains though. There is no playbook and no experience for a thing like Brexit. But as of today I do not expect a risk for financial stability even in the case of a hard Brexit.

Thankfully, I can provide another reassurance here. We are unlikely to see a bottleneck in the supply of financial services or even a credit crunch. The vast majority of financial services and products should still be available on the continent even after Brexit.

Incoming financial institutions

Ladies and gentlemen,

Some simple numbers on business coming into the German financial market reveal the extraordinary impact.

In a first wave, we expect roughly 2,000 employees to be transferred from Britain to or newly recruited in Germany in the wake of Brexit.

There have been 22 Brexit-related licensing procedures for credit institutions in the SSM as a whole, of which eight were for Germany. Of these, seven have since been finalised, and the remaining licence probably won't be pursued.

A further ten credit institution procedures concerned an expansion of business activities in the SSM under existing licences; three of these were in Germany.

41 licencing procedures concerned investment firms. Germany accounted for nine of them, all of which have been finalised.

In addition, we have seen the Brexit-related establishment or expansion of seven branches of third country firms, five branches of banks domiciled in the European Economic Area and two financial holding companies in Germany.

At present, the target operating models (TOMs) available to us envisage an increase in asset positions in the total amount (i.e. across credit institutions and investment firms) of around €637 billion, or about 300%. In the SSM, the 11 largest banks are set to transfer € 1.1 trillion of assets.

In my view, it is especially striking that the aggregate total assets of the securities trading banks operating in Germany up to now (as a peer of investment firms) came to around €350 million; now there will be individual institutions in this segment with total assets ranging from €100 billion to over €400 billion. Individual investment firms therefore account for many times the existing overall market in Germany.

Let me conclude here with a caveat: This is only a snapshot for day one and certainly not the end of the story. The figures may further develop depending if a hard Brexit will happen or not and how the future relationship between the UK und EU will be shaped. Much more business may be transferred along the road – depending on individual decisions of the banks and their clients.

Strategic options post Brexit

That leads me to strategic options post Brexit.

After all, the outcome of the Brexit negotiations and the future relationship between the UK and the EU27 will obviously influence the structures in which institutions are able to operate after Brexit.

But whatever form Brexit takes, the consequences will shape financial markets for years, and probably decades, to come.

What will Brexit – and the resultant changes in capital flows – mean for the future of the EU27 financial market?

Having said that, we have to assume that Brexit will transform financial markets. So the question is what shape the EU27's financial market will take in future – and which strategy the EU should pursue for the future of its financial markets. Essentially, there are two options.

Option A: We aim to maintain close links – despite the UK losing its passporting rights, we attempt to preserve a special relationship and thus continue to rely heavily on London's financial hub.

Option B: We rely more on building capacity within the EU – whether it's by expanding EU capacity or increasing the number of independent subsidiaries of foreign institutions.

In my evaluation, option B might be the better strategy for the EU and for Germany. The reason for this is that cross-border risk couldn't be adequately controlled under option A; dependency on London would then be especially problematic.

But what exactly does option B entail?

First off, it means rigorous implementation of the "no empty shells" policy, which is to say that the risk management and capital of institutions operating here have to be accessible to local supervisors.

Second, it means no preferential treatment for London beyond existing equivalency arrangements; this could possibly be improved slightly, as currently planned by the Commission.

This brings us to my third point: some new capacity will have to be created in the EU, and at the same time the internal market has to be deepened in terms of financial integration.

What should happen is that national and regional efforts should be consolidated under the umbrella of a common European strategy to deepen and modernise the internal market for financial services.

I firmly believe that digitalisation holds the key to our success. We are all familiar with examples of how smart digital applications have helped to make buying and selling more transparent (e.g. comparison websites), to break down language barriers (e.g. translation services), to overcome information problems and to build trust (blockchain applications).

Ultimately, the continental financial centres need a strong digital market infrastructure that makes full use of all new digital possibilities. Only then they can effectively overcome fragmentation.

To sum up, it is my firm view that deepening and modernising the European internal market is the best economic strategy to counter the geopolitical challenges posed by Brexit.

Which brings us to the new European Commission. The team of Ursula von der Leyen will officially go to work in Brussels on 1 November 2019. They will shape how the EU approaches our economy's biggest challenges, and they can decisively shape the financial market strategy.

Von der Leyen has nominated Valdis Dombrovskis for the important role of Executive Vice-

President for an ‘Economy that Works for People’. As such, he will lead the work on deepening Economic and Monetary Union.

Von der Leyen has set the goal for Dombrovskis, namely that “Europe’s social market economy helps ensure that social fairness and prosperity go hand in hand” (quote from Ursula von der Leyen’s mission letter to Valdis Dombrovskis). It should also be climate-neutral and work within the ecological boundaries of the planet.

The mission letter states the following goals: “to preserve and improve financial stability, protect savers and investors and ensure the flow of capital to where it is needed.”

To achieve these goals she has identified eight crucial priorities. The new Commission aims:

- To complete the Banking Union,
- To speed up the work towards a Capital Markets Union to diversify sources of finance for companies and tackle the barriers to the flow of capital,
- To develop a new private-public fund specialising in initial public offerings for SMEs,
- To put forward a FinTech strategy to support new digital technologies in our financial system,
- To ensure a common approach with member states on cryptocurrencies, and
- To develop a green financing strategy to ensure that we can direct investment and financing to the transition to a climate-neutral economy.

I very much welcome this ambitious open and clear course.

The financial market agenda in particular provides us with a suitable framework for thinking strategically about the most important developments over the coming five years and the long-term way ahead.

Moreover, I think we should be even bolder when it comes to the three principles of integrated markets, digitisation and sustainable finance as a basis for our success.

In my view, we must come up not only with a FinTech strategy, but also with a bolder approach to digitisation in finance and how this will transform the economy and international trade. Libra or stable coins more generally, cyber-security in algorithmic trading and elsewhere, artificial intelligence and its ethical as well as labour and financing implications, open banking and its implications, BigTechs and how they will affect competition policies and financial stability – these are only the tip of this strategic iceberg.

The ideas behind green finance are still relatively new, and most banks don’t have them on their radar – neither the opportunities nor the risks that they entail.

Banks have to strengthen their management of climate-related risks substantially.

But when it comes to regulation, I do not think that we should try to further sustainability through lowering risk weights – a green supporting factor would be the wrong instrument.

Integrated, digital, green finance can be a huge lever for achieving the goal of a sustainable economy that works for all.

Therefore, it is of vital importance that we, the EU27, pursue a resilient financial market strategy that rests on three principles: integration, digitalisation, and sustainability.

Conclusion

Ladies and gentlemen,

let me conclude my remarks leaving Brexit and commenting a statement of the book. On page 97 it reads: “Progress to achieve greater stability has been made.”

I can confirm that suggestion. Looking back the last 12 month a lot has been done. Big banks are undergoing deep restructuring. Small and mediums sized banks are adapting to the low interest rate environment, as our LSI-stress test revealed. Public-sector banks are heading for new horizons. That are good news for a German, even though vulnerabilities and big challenges remain.

Thank you very much for your Attention.