Deloitte.

# European Banking Trend Radar 2022

**Edition 2: Trends in ESG, Regulatory & Political, and Economics & Financial Markets Perspectives**

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Executive summary 04

Climate change is the overarching banking risk 06

Excursus: Our structured process to identify, analyze and monitor significant trends 08

The banking trend radar 10

Environmental, social and corporate governance trends 12

Regulatory and political trends 20

Economics and financial markets trends 30

The way forward 36

Notes 37

Contacts 38

# Executive summary

The banking landscape is facing a massive shift. Trends relating to ESG, regulatory & political and economics & financial perspectives are merging to cause a seismic shakeup for the industry in the coming years.

This report, the second in a series of three, focuses on emerging trends in the European banking sector, following our structured process to analyze trends. Whereas the first concentrated on client trends, this report highlights trends in the three dimensions "environmental, social and corporate governance (ESG)", "regulatory and political", and "economics and financial markets".

In sum, all three dimensions contain 15 critical trends. Sustainability concerns are the most crucial force being the main driver for seven trends. Overall, the most pressing trends within the next five years – according to our expert assessment – are:

- **Environmental, social and corporate governance (ESG) dimension – the trend Banks under green pressure:**
  From investors to regulators, stakeholders increasingly demand that banks contribute to a more environmentally friendly society. The trend is growing faster than could be imagined by most bank executives not long ago. Financial institutions need to find ways to cope with the pressure, turn these challenges into opportunities and develop new business models. Besides green pressure, our experts consider sustainable investments and conscious bank customers as highly relevant trends in the dimension. Both are themselves drivers of green pressure.

- **Regulatory and political dimension – the trend Regulatory work on sustainability:**
  Regulators are constantly introducing new rules to inhibit and disclose unsustainable behavior. The trend complements more traditional regulatory topics, such as financial stability, and is developing at a surprising speed. The changing regulatory environment poses several challenges for banks. Companies who act early, however, will be able to generate competitive advantages. The supervisory focus on business model viability and digitalization and innovation are the two trends that follow in relevance. Advancement of those trends can lead to more scrutiny and open opportunities for banks to experiment with new technologies.

- **Economics and financial markets dimension – the trend Actions concerning Capital Markets Union:**
  After years of sluggishness, the EU will advance its plans to create a single capital market, according to our experts. Its completion would fundamentally change the market environment and open new business opportunities. Besides this influential trend, digital currencies and intensifying locational competition are the following most relevant trends. Both forces could cause pivotal changes in the near future.

# Climate change is the overarching banking risk

Many trends impacting the European banking sector are best summed up by a single color – green. Public opinion is finally paying attention to more than 50 years of warnings concerning dramatically changing weather patterns.[1]

This report, the second in a series of three, focuses on emerging trends in the European banking sector. Whereas the first report focused on client trends, this one highlights economics and financial markets trends, those in the regulatory and political sphere and trends that influence the environmental, social and corporate governance dimensions.

**No more business as usual**

Sustainability concerns drive seven of the 15 trends canvassed in this report. Today, our atmosphere contains more carbon dioxide than at any point in the last 4 million years.[2] Carbon dioxide is the primary greenhouse gas emitted through human activities. It traps solar radiation in the atmosphere and, like glass on a greenhouse, heats our planet. Temperatures are now around 1.2 degrees higher than before humans began burning massive amounts of fossil fuels.

The latest Intergovernmental Panel on Climate Change report makes clear that last year's burst of extreme weather – freak floods, unprecedented temperatures in the Arctic and heat domes – results from rising average temperatures.[3] Each fraction of a degree increase in warming will bring greater rainfall, higher rises in sea levels and more intense droughts and wildfires.

According to a worldwide survey, 64 percent believe climate change is a global emergency.[4] Such attitudes are driving a public shift against "business as usual." Companies are increasingly expected to do more than make profits. This, combined with emerging regulatory pressures as governments move to realize commitments to reduce greenhouse gases under the 2015 Paris Agreement, could lead to a fundamental reshaping of finance around a green model.

Whether this will give rise to a sustainable financial system that deploys capital towards low-carbon, resilient investments is an open question. However, the shift in opinion is evident in the changing behavior of consumers (see pp. 35), and it is having a significant impact on the banking business.

**Increasing regulatory pressure**

In the past, customers cared little about what happened to their money once it was deposited and made good returns. But conscious customers (pp. 17) want to be assured that their money is "doing good."

For example, figure 1 depicts the total amount of green bonds (bonds linked to climate-related projects) issued in Europe. There was a sharp increase from $ 18.1 billion in 2014 to $ 156 billion in 2020. To stay relevant and competitive, banks need to show increasingly to customers, employees, investors and legislators that environmental, social and governance (ESG) standards are at the heart of their decisions, products and services.

While the service nature of the industry means banks generate relatively little carbon emissions, they will come under scrutiny for supporting heavily polluting sectors. Concerns about "greenwashing," the practice of making an investment sound more sustainable than it is, is also leading legislators to introduce transparency laws about the sustainability of bank portfolios (see pp. 15), further ratcheting up green pressure on banks.

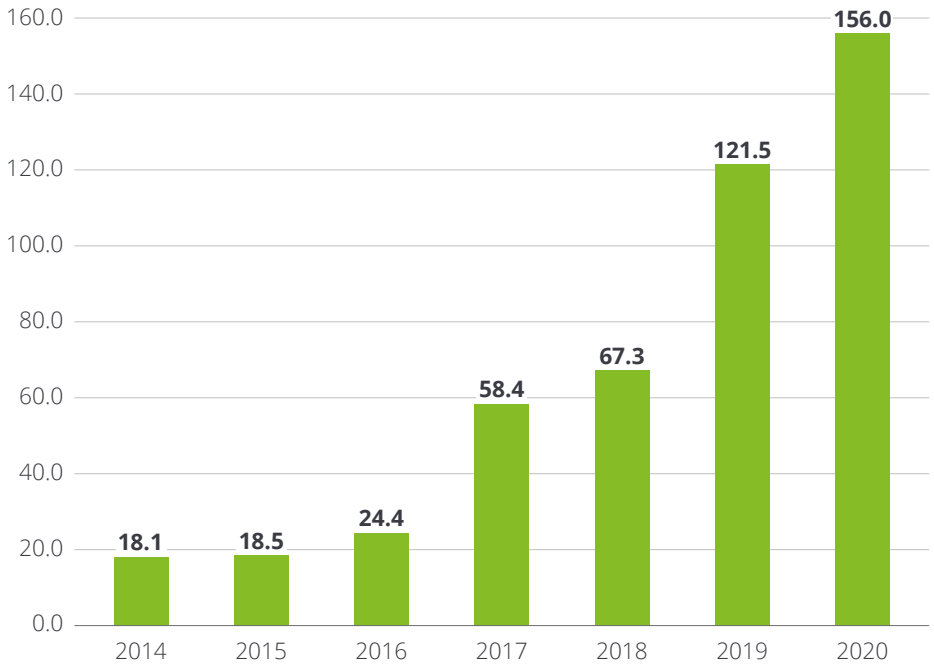
**The next generations**

Demographics drive part of the concern around sustainability. Millennials (those born 1981–1996) and Generation Z (those born later) hold a small share of total global wealth. But by 2030, millennials will make up 75 percent of the European workforce and they are set to inherit substantial wealth.[5] This generation is particularly driven to invest according to personal values. Almost two-thirds are concerned with the state of the world and feel obliged to change something.

The other major trend is digitalization. Digital transformation is a must for banks. Changing customer demands and pressure to reduce costs and increase efficiency leave no alternative to using advanced technology. However, the speed and urgency of the adoption of digitalization – particularly during COVID-19 – have raised regulatory concerns relating to cloud technology, operational resilience, conduct risks in payments and cryptocurrencies, to name examples.

These three factors – sustainability, demographics and digitalization – are shaping the economic environment banks face and creating significant challenges. To remain successful in the market, each of these topics needs to be addressed with high priority.

**Fig. 1 – Amount of green bond issuance in Europe (2014–2020) in $ billion**




Source: Climate Bonds Initiative.

# Excursus: Our structured process to identify, analyze and monitor significant trends

Deloitte has developed a comprehensive, structured process to identify, analyze and monitor significant trends impacting banking. This involves three steps.

In step 1, we screened micro trends relevant to the European banking industry, including specific innovations and projects, and identified 600 significant ones. These helped us define macro trends (the core aspect that multiple micro trends hold in common) and provide use cases to illustrate macro trends. Some 45 critical macro trends were identified during this process. These were clustered into six dimensions:

- **Clients**
- **Environmental, social and corporate governance (ESG)**
- **Regulatory & political**
- **Economics & financial markets**
- **Technology**
- **Company organization**

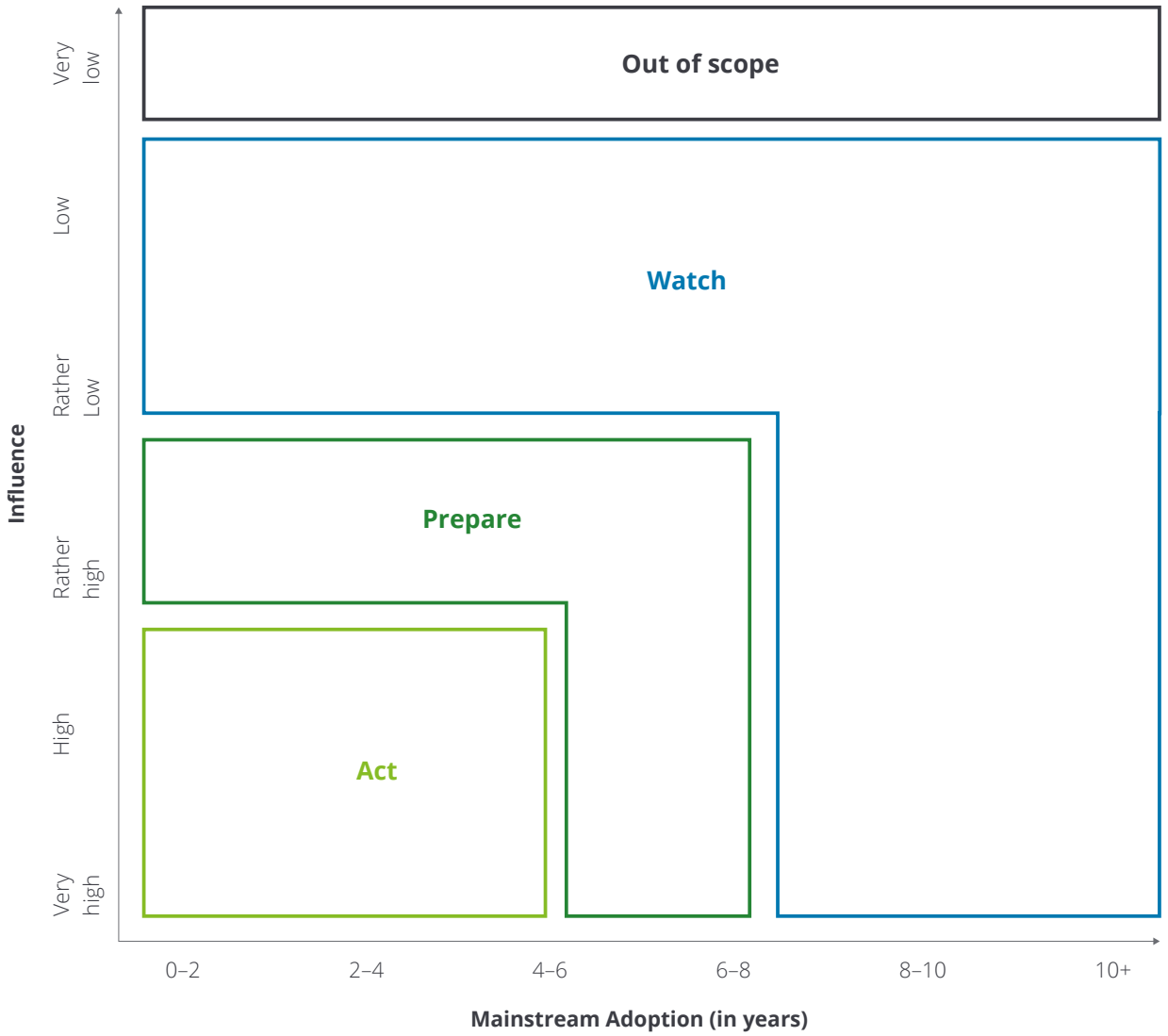
The first report in this series focused on the client dimension. It was released in November 2021. This second report focuses on the ESG, regulatory and political, and economic and financial market dimensions.

In step 2, we assess the trends. We asked banking experts to evaluate each macro trend using two aspects. The first is influence: that is the size of the impact that the trend is likely to have on the European banking market. The second is the time to mainstream adoption, which refers to the point at which most market participants in the industry are likely to have applied the trend in one way or the other.

In the third and last step we categorize the macro trends into "act," "prepare" and "watch," as illustrated in figure 2. Trends identified as "act" are those with a high or very high influence where mainstream adoption is expected within the next five years.

"Prepare" includes trends that are not part of the "act" category, have a rather high to very high influence, and with mainstream adoption expected within seven years. The "watch" category contains all remaining trends with a low to very high influence and mainstream adoption taking more than ten years.

**Fig. 2 – Framework for ranking trends in the radar**




Source: TrendOne.

# The banking trend radar

The framework serves as the basis for our interactive trend radar (see figure 3). Each macro trend is assigned one of the six dimensions exclusively. All 45 macro trends are located within the radar according to the result of the expert assessment:

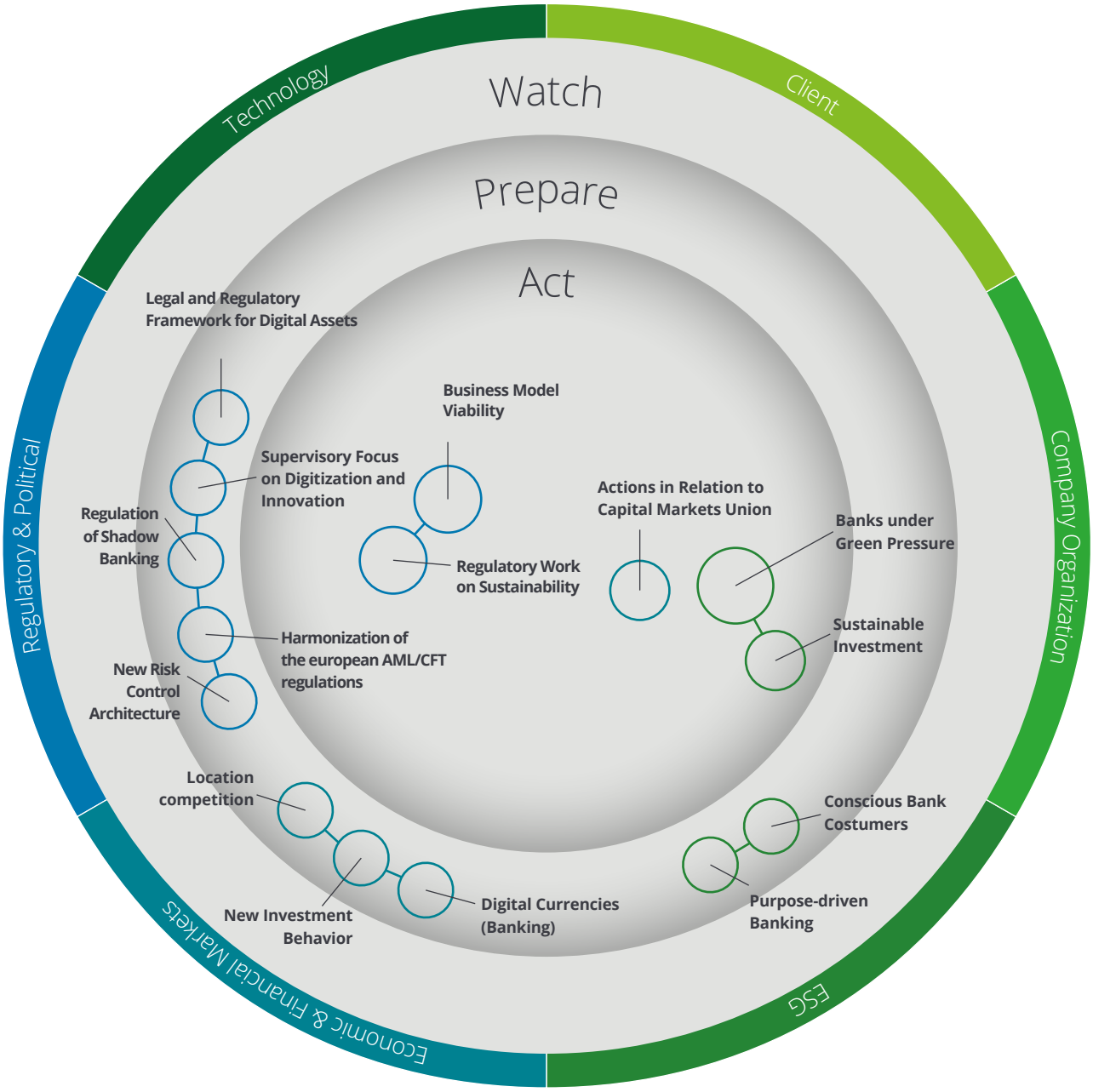
(1) The closer to the center a macro trend is on the radar, the more mature it is.

(2) The more prominent the trend bubble, the greater its impact on the banking industry. As the radar is constantly evolving, it may be adjusted from edition to edition.

(3) The coloring of the bubble reflects the dimension to which it is assigned.

For more details on the creation of the banking trends radar and its entire process, refer to part 1 of the series.

**Fig. 3 – Banking trend radar with focus on ESG, regulatory & political, and economics & financial markets trends**




Note: Figure 3 illustrates a static view of the interactive banking trend radar.

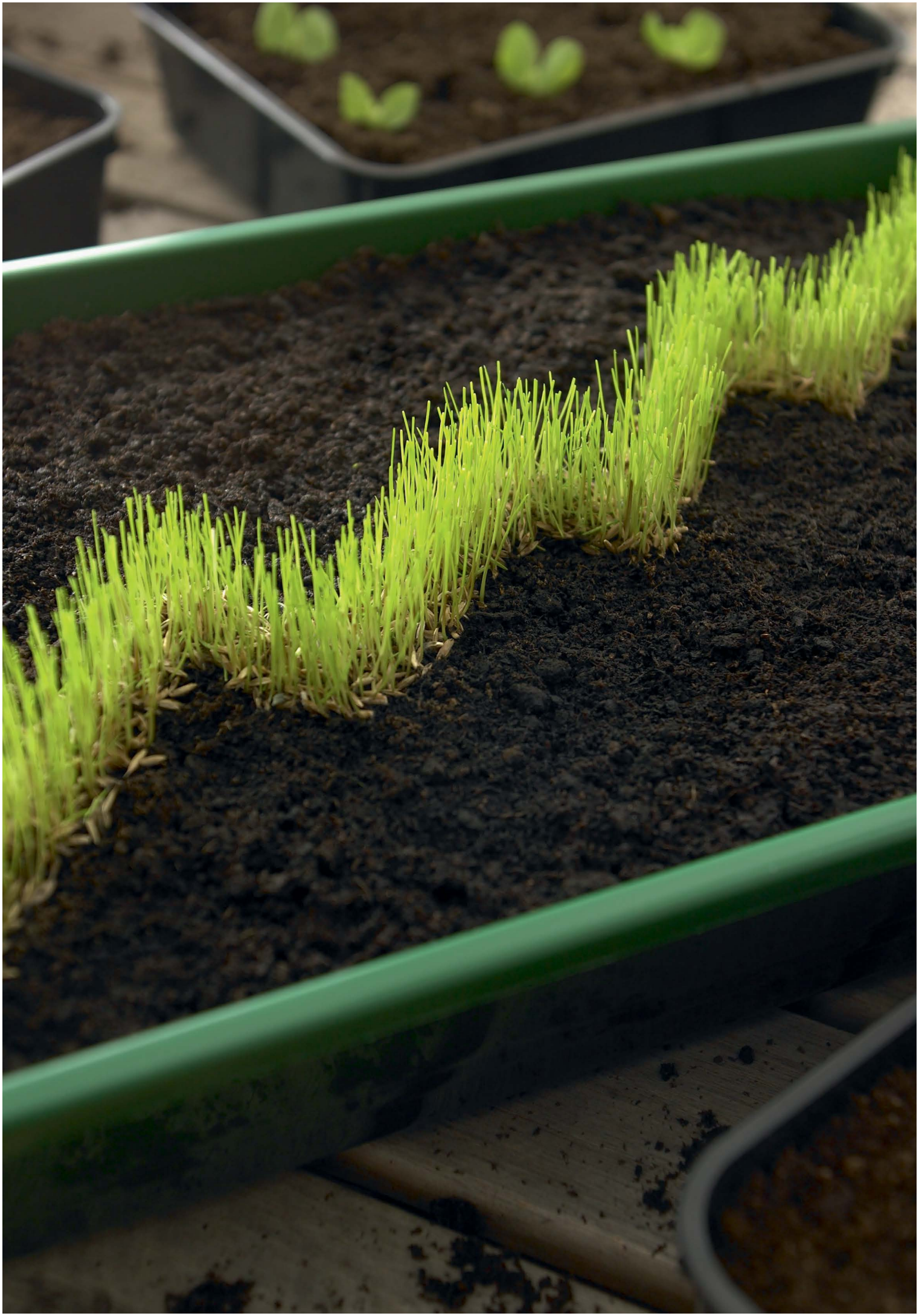
# Environmental, social and corporate governance trends

ESG is one of the most influential mega-trends and has rapidly gathered speed over the last few years. Its origin is a shift in society towards a more purpose-driven economy. In this context, making high profits can no longer be the sole purpose of business. Instead, companies must serve a social purpose. Investors, employees, customers, regulators – all demand that firms consider environmental, social and corporate governance aspects when doing business.

Naturally, the trend has a tremendous impact on all sectors. Banks, however, are affected particularly and in a distinct manner. Typically, they are not directly involved in activities that ignore ESG standards. Yet, their financing activities partially support companies that do so. Therefore, banks contribute to the trend by steering funds towards more sustainable projects.

However, ESG does not stop at this point. There is an enormous variety of opportunities for banks in the context of ESG. From the adaptation of internal processes to the development of socially responsible banking products and services, ESG affects every area of business.

Making high profits can no longer be the sole purpose of business. Instead, companies must serve a social purpose.



# Banks under green pressure

### What is it about?

Banks face challenges from the climate crisis in two ways. Extreme weather and sea-level rises could eventually force them to adjust internal processes. For example, climate change may see values fall on assets used as collateral for loans, which might cause credit losses. Banks are also exposed to transition risks from lending to emissions-intensive industries. For example, if governments impose a carbon tax, fossil-fuel firms could hit financial trouble, and there could be knock-on effects for banks exposed to industries dependent on energy created by burning fossil fuels.

More immediate is the growing expectation that the financial sector will play a critical role in the transition to a low carbon economy. Customers demand sustainable products; investors want sustainable investments and younger employees prefer working for employers with positive environmental records. Regulators and politicians are also moving to realize their pledges on emissions reductions as part of the Paris Agreement (2015) which is impacting the financial industry.

### What is happening in the market?

The green pressure currently affecting banks is coming from various directions. A global Deloitte study, in which corporate executives were surveyed, comes to this conclusion. The participants feel green pressure from different types of stakeholders. Among the most prominent groups are regulators (77 percent), consumers (75 percent), investors (71 percent), competitors (65 percent) and employees (65 percent).[6]

The European Commission, for which climate change is playing an increasingly important role, is a good example thereof. It has already delivered a taxonomy defining which activities are environmentally sustainable. This is seen as essential to provide transparency about the sustainability of bank portfolios, to create security for investors and protect against greenwashing.

Central banks worldwide are taking similar initiatives. For example, China's central bank has been promoting green bonds, an approach the ECB is considering in the form of "green quantitative easing."[7] For that purpose, the ECB plans to take the new taxonomy into account when purchasing corporate bonds.[8] The new EU Green Bond Standards introduce a corresponding label.[9]

Banks are responding to green pressures by appointing Chief Sustainability Officers (CSOs), a role likely to gain greater prominence in coming years.[10] With this new executive level position, the issue of sustainability is given top priority. While the climate crisis does not pose an immediate threat, it is driving the trend with the most immediate implications. The expert assessment is that this trend will be highly influential, and banks are advised to act.

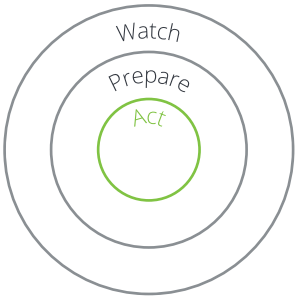
## Trend Assesment

### Influence

very low | low | rather low | rather high | high | **very high**

### Time of Mainstream Adoption

0–2 years | **2–4 years** | 4–6 years | 6–8 years | 8–10 years | 10+ years



# Sustainable investments

**What is it about?**
Wealth and asset managers are seeing significant funds flow into sustainable investments, particularly funds and ETFs. Globally, the percentage of retail and institutional investors applying ESG principles to a quarter or more of their portfolios jumped from 48 percent in 2017 to 75 percent in 2019.[11] This is expected to increase further as regulatory emissions oversights increase.

This development is strongly driving the second major trend in the ESG dimension. Traditionally, investments were typically judged on characteristics such as liquidity, maturity, return and risk. But the emphasis by clients on sustainability means investment strategies that seek to consider both financial return and social/environmental good alongside traditional metrics are coming into favor.

With social responsibility increasingly considered a key criterion for investments, products need to incorporate ESG factors into investment decisions. Millennials (those born 1981–1996) are particularly driven to invest according to personal values and are helping to popularize sustainable investing (see pp. 35). This generation will inherit $ 22 trillion by 2042, so sustainable investments are a long-lasting trend that will shake up the market.

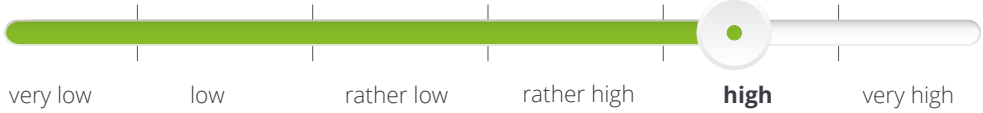
**What is happening in the market?**
Sustainable investing has been one of the most rapidly growing investment categories worldwide over the last decade.[12] In Europe, the demand for sustainable funds continues to grow. In 2020, it exceeded the demand for conventional funds for the first time. Equity is the most important asset class, but ESG factors are being integrated into fixed income and allocation funds. The percentage of passively managed funds (ETFs) in this segment has also grown to about 20 percent of the market.

Government agencies also contribute to the growing interest by funding internet portals that educate consumers about sustainable financial products and how to invest money ethically. The Money Moves site in Germany is a good example. Launched by the Consumer Protection Agency in Bremen and part-funded by the Federal Government, the site offers information on current accounts, savings plans, investment funds and direct investments. It also includes detailed information and news on ethically ecological financial products.

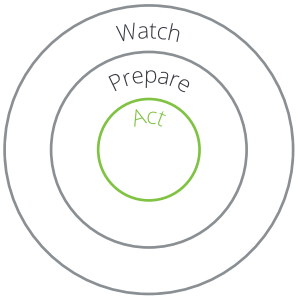
The expert assessment is similar to the preceding trend on green pressure. Sustainable investments will have a high influence with a two- to four-year horizon for adoption.

## Trend Assesment

**Influence**




**Time of Mainstream Adoption**

# Conscious bank customers

### What is it about?

Banks can leave themselves open to accusations of ignoring ESG principles by, for example, investing in multinationals active in sectors known for lax social and ecological requirements. Such behavior risks alienating a new type of consumer: the conscious customer.

There is a marked trend towards consumers who reflect on their consumption patterns. On the personal level, this means thinking deeply about the indirect effects a purchase decision may have, such as exposure to privacy concerns and data breaches. But it also means increasing awareness about sustainability and the impact their choices have on the world around them.[13]

Conscious customers see themselves as agents of change by considering the social, environmental, ecological, and political impact of their purchases. Banks are not immune to this trend. They need to be aware that people are prepared to vote with their wallets through "buycott" and boycott actions.

### What is happening in the market?

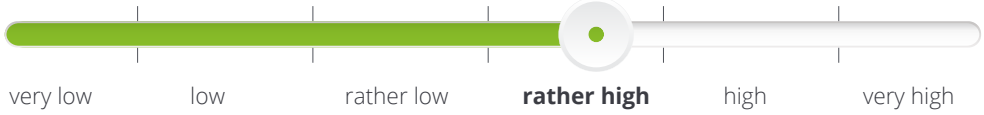
Conscious consumerism is strong amongst millennials, who are expected to be the largest population segment by the end of the decade. Almost two-thirds of millennials are concerned with the state of the world and feel obliged to cause change.[14]

Banks and FinTechs are responding. They are striving to put transparency at the forefront by providing platforms and apps that allow users to see the environmental and social impacts of their purchases. The apps rate businesses on multiple dimensions, including how they treat employees and the environment. Business metrics can include salaries and diversity, while greenhouse gas emissions and renewable energy use feature on environmental scores. The resulting scores give customers a good indication of how their spending habits impact people and the environment. Other financial apps and products compensate for $CO_2$ emissions when paying, or reward climate-friendly and sustainable behavior, for example through cashback or bonus programs.

The influence of conscious customers will be rather high with mainstream adoption estimated in two to four years. Our experts therefore assess it as falling into the prepare category.

## Trend Assesment

### Influence




### Time of Mainstream Adoption


# Purpose-driven banking

**What is it about?**
In the early 1970s it was accepted that "the business of business is business." Social responsibility of companies consisted exclusively in generating high profits. This benefits all parts of society over the long term. Fifty years later, opinions about business have evolved quite differently. Increasingly companies are being challenged to close the gap between "doing good" and "doing well." The rise of corporate social responsibility (CSR) reflects this, and today it is standard to see businesses pursuing double-bottom-line objectives that include a positive impact on society.

This trend is being felt in banking. In the past, customers had little idea which projects their deposits financed. But conscious customers want to be assured that their money is "doing good," and that banks are operating on ethical grounds. Banks need to show customers, employees, investors and legislators that ethics are at the heart of their decisions in terms of risk-taking and business practices.

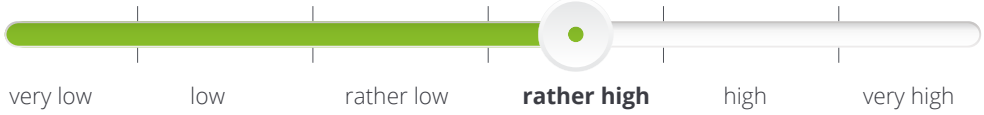
**What is happening in the market?**
Businesses now need to do more than generate profits. In addition to strategic adjustments, the impact on banking is also evident in customers' everyday life. The credit card poses a concrete example. This humble piece of plastic was once a means to pay for a transaction. Today, it represents much more. Now available in a remarkable combination of materials (recycled wood, upcycled recovered plastic waste and biodegradable plastic substitutes) and cards have even gone virtual offering a new way for people to handle their funds via apps. Such credit cards are often linked to inducements that appeal to conscious customers. These include estimating the $CO_2$ produced with each purchase or having a percentage of revenues donated to reforestation efforts.

To further burnish their credentials, banks are also providing solutions to disadvantaged groups previously denied access to traditional banking. Pre-paid debit cards organized together with governments and NGOs ensure funds or welfare payments are readily accessible by some of the most vulnerable people in society.

The influence of this trend will be rather high with the time of mainstream adoption estimated at two to four years. The expert assessment is to "prepare."

## Trend Assesment

**Influence**

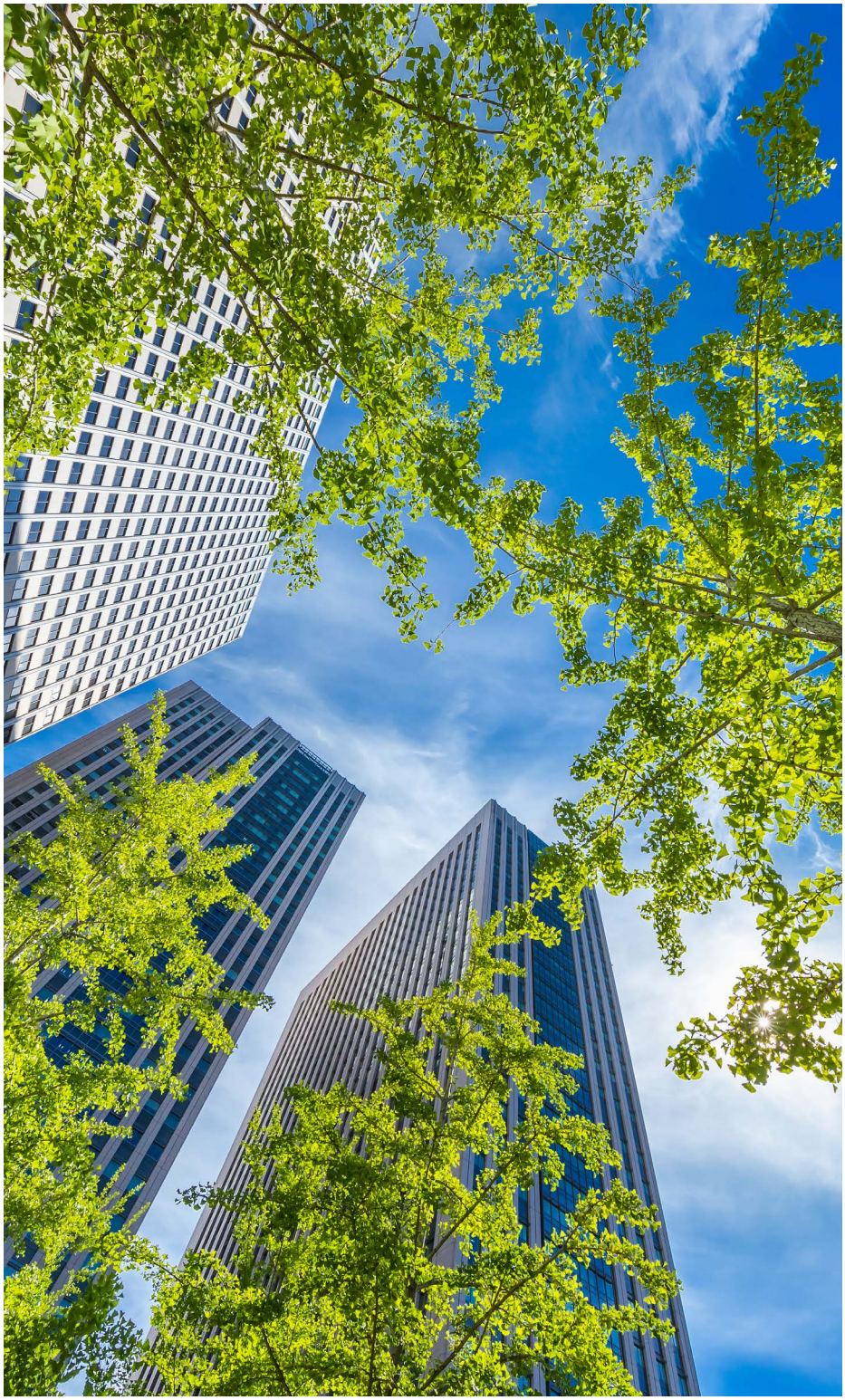



**Time of Mainstream Adoption**


# Regulatory and political trends

Financial services are one of the most highly regulated industries. The dynamic environment prompts legislators and regulatory authorities to adapt to changes at a high frequency. The variety of topics that regulators need to be concerned with is vast, and therefore new trends occur constantly.

Shifts in public opinion and societal values, for example, eventually reflect in the regulatory framework. Authorities, therefore, increasingly focus on ESG and sustainability aspects. Furthermore, the emergence of new technologies like artificial intelligence (AI) or digital assets can give rise to novel fraud mechanisms or threaten financial stability. Regulators are revising, extending, and adding to the framework to ensure safety. Besides these efforts, legislators are closing loopholes and promoting harmonization and cooperation within the EU.



# Regulatory work on sustainability

**What is it about?**
Trillions of euros are flowing into financial products that adhere to ESG principles.[15] Yet, it is not easy to find a strict definition or develop a common understanding of ESG criteria. Investors and regulators are looking to reduce ambiguity and therefore exert pressure on companies to substantiate their sustainability claims with impact metrics. Until now, regulation relating to greenwashing has been limited or uncertain, but this is changing rapidly. Scrutiny is increasing, particularly in Europe, and is itself a driver of the "banks under green pressure" trend (see pages 15).

Overall, this trend is about introducing rules to evaluate, disclose and restrict unsustainable behavior. New regulations aim to make ESG investing more transparent. Financial institutions must explain how they consider ESG risks in investment decisions and inform investors where such risks exist in their portfolios. Those that don't consider sustainability risks will have to explain why.

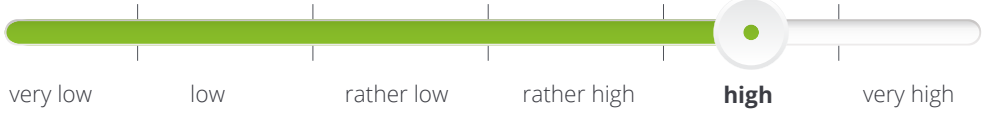
**What is happening in the market?**
SFDR, CSRD, green taxonomy – the European Union launched a raft of ESG disclosure regulations last year. The Sustainable Finance Disclosure Regulation (SFDR) makes sustainability reporting mandatory for funds. The SFDR is part of a package of regulations that include the green taxonomy, which classifies environmental-friendly investments. The proposed Corporate Sustainability Reporting Directive (CSRD) replaces and broadens regulations requiring large businesses to report how they take sustainability into account annually.

Together, these mark significant regulatory changes as the EU attempts to drive capital toward sustainability as part of the bloc's aim to achieve net-zero emissions by 2050. They also highlight EU efforts to consider broader ESG issues. Under the SFDR, for example, investment portfolios will have to consider everything from the carbon footprint to board diversity and water management of the firms in which they invest.

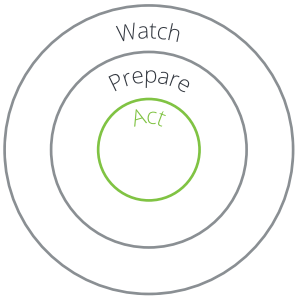
This adds to the complexity of the reporting challenge asset managers, banks and fund brokers face. Given that all these regulations are already being rolled out and will be fully in force within four years, the expert assessment is that this trend will have a high influence. Firms have no alternative but to act.

## Trend Assesment

**Influence**




**Time of Mainstream Adoption**

# Business model viability

**What is it about?**
COVID-19 has posed the harshest challenge to European banks since the global financial crisis of 2008. Already facing structural profitability issues, banks have had to deal with further woes as millions of companies faced bankruptcy amid unprecedented global lockdowns and travel bans resulting from the pandemic.

Governments and regulators made great efforts to ensure the flow of credit and that markets continued to function. However, the European Central Bank is winding back stimulus policies introduced to lower borrowing costs and shield economies from the fallout of the pandemic. For banks, credit impairments will eventually hit capital, while low, zero and in some countries negative interest rates continue to compress margins and depress returns on sizeable liquidity portfolios.

All of this necessitates restructuring within the industry and the need for business models to transform, such as through digitalization. The European Banking Authority and ECB are advocating consolidation to reduce excess banking capacity and costs cutting to return the industry to profitability. However, regulatory barriers restrict major cross-border deals, although smaller or less diversified banks are likely to be targets of in-country bank mergers.

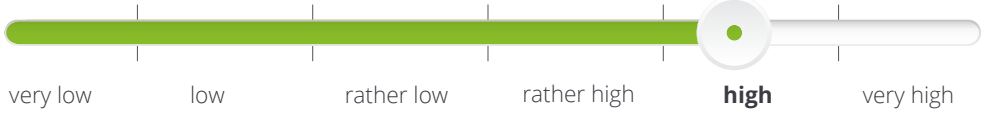
**What is happening in the market?**
The pandemic has compounded weaknesses, necessitating restructuring and business model transformation, such as the need for digitalization. The European Commission confirmed last October that it would grant banks more time to implement new rules on bank capital. The final part of the Basel III agreement, which sets new standards for how international banks should measure their capital so as to create consistency across national borders, was due to come into effect in 2023 but will now be implemented in 2025.

The rationale provided by Brussels was that supervisors needed longer to pass the required legislation, but banks had been calling for adjustments to the rules amid a pandemic-battered economy. The respite provides more space for bank supervisors to focus more on business model viability and removing cross-border barriers.

This trend is well in motion and will have a high influence. Similar to the previous trend on sustainability regulations (pp. 21), banks have no option but to act with mainstream adoption expected within four years.

## Trend Assesment

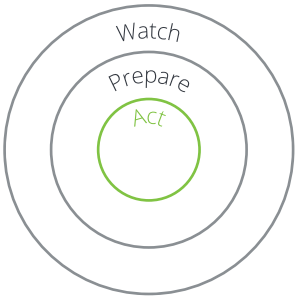
**Influence**



very low | low | rather low | rather high | **high** | very high

**Time of Mainstream Adoption**

0–2 years | **2–4 years** | 4–6 years | 6–8 years | 8–10 years | 10+ years



# Supervisory focus on digitalization and innovation

### What is it about?

Locked in by stay-at-home orders during long stretches of the COVID-19 pandemic, people turned to the digital world for work, amusement, services and necessities. This led to a surge in digital economic activity, a massive increase in e-commerce and an accelerated digital transformation in many industries, including banking.

A report by the EBA last September on the EU banking and payments sector identified the rapid growth of digital platforms to "bridge" customers and financial institutions as a trend expected to accelerate in line with the broader trend toward digitalization of the EU financial sector.[16] This "platformisation," says the EBA, presents a range of potential opportunities for both customers and financial institutions.

This prospect should encourage banks to pursue useful forms of innovation to satisfy customers and reduce costs, shaping a more innovative and competitive sector. However, new forms of financial, operational and reputational interdependencies are emerging, and the EBA wants to strengthen supervisory capacity to monitor market developments. While regulations need to adapt to this new environment, the challenge is to do so without hampering the long-awaited innovation and robust growth expected of the industry.

### What is happening in the market?

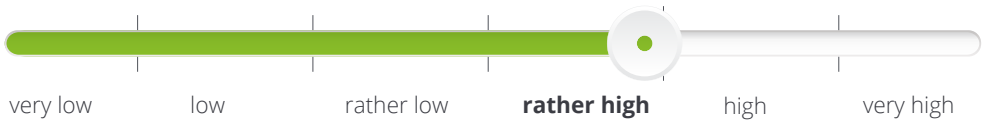
Digital transformation is a must for banks. Changing customer demands and pressure to reduce costs and increase efficiency leave them with no alternative to using advanced technology. However, the speed and urgency of the adoption of digitalization have raised regulatory concerns, particularly relating to the cloud, operational resilience, conduct risks in payments, and the use of AI and big data analytics.

This is encouraging authorities, such as the pan-European securities regulator ESMA, to rapidly adopt more technology. In its 2022 Annual Work Programme, ESMA identified using innovative and digital technologies as a critical focus for supervisory functions (SupTec).[17] For example, innovation and digitalization are expected to contribute to implementing the Digital Operational Resilience Act (DORA) and the regulation on a pilot regime for market infrastructures based on distributed ledger technology.

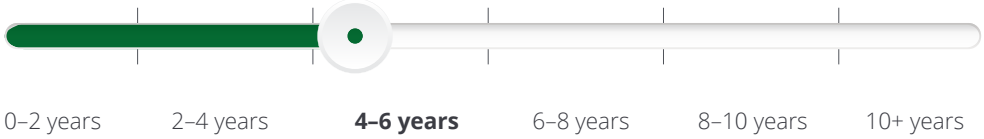
Greater scrutiny can also be expected of the customer funds of payment firms and e-money providers, business continuity and wind-down plans and management of outsourcing risk. The influence of this trend will be rather high. Preparation is advised with the expert assessment expecting it to be mainstream in four to six years.

## Trend Assesment

### Influence




### Time of Mainstream Adoption




# Harmonization of the European AML/CFT regulations

### What is it about?

The European Union is determined to crack down on criminals exploiting the banking system.[18] Since 2019, several nation states within the EU have pushed to toughen anti-money laundering laws, harmonize existing laws and ideas for a new pan-European anti-money laundering agency have been floated.

### What is happening in the market?

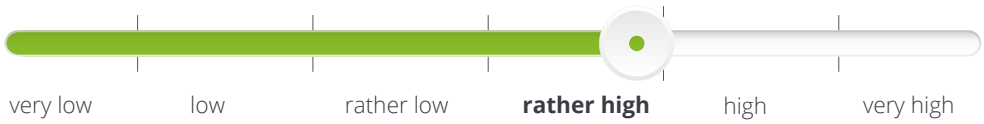
The European Banking Authority (EBA) published revised guidelines last July to strengthen the EU's anti-money laundering and countering terrorism financing (AML/CFT) rules.[19] The package also included a proposal to create a new EU authority to fight money laundering. The aim is to improve the detection of suspicious transactions and activities and to close loopholes used by criminals to launder illicit proceeds or finance terrorist activities through the financial system.

The new EU-level Anti-Money Laundering Authority (AMLA) will harmonize regulations to create a single system across the EU. It will also coordinate with national authorities to ensure the private sector correctly and consistently applies EU rules and directly supervise high-risk financial institutions. In January this year, the EBA also launched a central database, which will be critical to coordinate efforts to counter money laundering and terrorist financing.

This marks a significant ramping up of Europe's response to the money-laundering scandals. The influence is expected to be high, and the expert assessment is to prepare as the impact will be increasingly felt within the next four years.

## Trend Assesment

### Influence




### Time of Mainstream Adoption


# New risk control architecture

**What is it about?**
The accelerated adoption of innovative technologies, such as artificial intelligence and cloud services, is causing new risks. For example, as advanced information and communication technologies become more prevalent, banks become targets for professional hackers. Increasingly specialist banking applications may be provided and run by third-party providers. In both cases, banks need to ensure that customer data is available at all times, secured against unwanted changes and protected against unauthorized access.

As digitalization continues to shape societies and economies, risk control systems need to keep pace. It is not only required by legislators and regulators but is also aligned with the growing expectations of customers, which are partly influenced by the non-financial sector, and partly by appearance of new digital products, such as crypto assets.

**What is happening in the market?**
BaFin, Germany's financial regulator, and the Deutsche Bundesbank published a joint discussion paper in July 2021 on the use of machine learning in risk models. Leveraging emerging technologies requires comprehensive, high-quality, and timely risk data.[20] But many institutions continue to face challenges in obtaining this data, especially for non-financial risks. Also last year, the Basel Committee began consultation on proposals for the prudential treatment of banks' crypto-asset exposures.

The combination of advanced technologies and stricter risk-related regulations is causing banks to allocate more resources to developing and implementing technological solutions to streamline risk control processes and reduce bias. In particular, robotic process automation (RPA) is set to play a pivotal role in task execution. Combining robotic automation and artificial intelligence, RPA can be programmed to perform tasks that previously required the input of human intelligence to be successfully completed.

This could have a significant impact on banks' compliance activities as RPA can eliminate the need for manual processes associated with know your customer (KYC) and anti-money laundering (AML). Automating significant chunks of these requirements will help to minimize human error, reduce costs and improve the efficiency of the onboarding process for new clients. According to our expert assessment, the impact of this trend will be rather high and mainstream adoption is expected within four to six years. Consequently, preparation is advised.

**Trend Assesment**

**Influence**

very low | low | rather low | **rather high** | high | very high

**Time of Mainstream Adoption**

0–2 years | 2–4 years | **4–6 years** | 6–8 years | 8–10 years | 10+ years

# Legal and regulatory framework for digital assets

**What is it about?**
Crypto-asset markets are evolving quickly. According to the Financial Stability Board (FSB), crypto-asset market capitalization grew by 3.5 times in 2021 to $ 2.6 trillion. The FSB notes that institutional involvement in blockchain-based markets is growing from both investors and service providers. "If the trajectory of growth in scale and interconnectedness of crypto-assets to these institutions were to continue, this could have implications for global financial stability."[21]

However, the share of digital assets is still low in the overall global financial system, and direct connections between crypto-assets and systemically important financial institutions and core financial markets are limited at present.

**What is going on in the market?**
The continued growth and innovation in crypto-assets and related services, coupled with the interest of some banks, could increase global financial stability concerns and risks to the banking system. Therefore, it is not surprising that regulators want to provide legal certainty and investor protection for investments in digital assets.

The EU has published a proposal to address the emergence of crypto-assets, such as bitcoin, and the effect these innovative technologies will have on how financial assets are issued, exchanged, shared and accessed. This Markets in Crypto-Assets Regulation (MiCA) includes mitigating the risks posed by crypto-assets (fraud, cyber attacks and market manipulation).

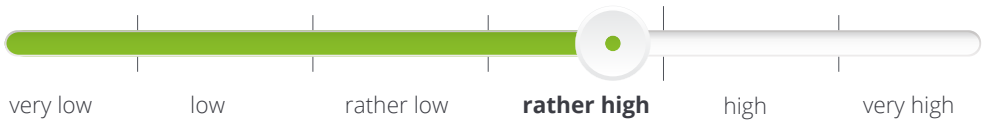
The Basel Committee on Banking Supervision has also published a public consultation on proposals for the prudential treatment of banks' crypto-asset exposures.

The proposals split crypto-assets into two broad groups. One is those assets eligible for treatment under the existing Basel Framework with some modifications. The others, such as bitcoin, would be subject to a new conservative prudential treatment.

Although the expert opinion is that the impact of this trend is some way off, its influence will be rather high. Given this, it is best to prepare.

## Trend Assesment

**Influence**




**Time of Mainstream Adoption**


# Regulation of shadow banking

**What is it about?**

Shadow banks are entities that provide bank services, such as lending, but do not fall under traditional regulation. In 2018, according to one study, shadow banking assets in the euro area amounted to almost € 34.5 trillion – more than 40 percent of financial sector's assets.[22] Total shadow banking assets more than doubled between 2000 and 2008, and a similar boom occurred between 2009 and 2018.

Shadow banks, therefore, constitute a systemic risk. Their increasing involvement in credit intermediation and capital markets mean they have become more central to the EU financial system, which has the potential to amplify any market-wide shock suffered by the traditional banking sector. It is little wonder that the EU is increasingly seeking to regulate the shadow banking sector.[23]

**What is going on in the market?**

The EBA launched a consultation in 2021 on draft regulatory technical standards (RTS) that set out criteria for identifying shadow banking entities for the purposes of large exposure reporting. The consultation finished in October, and the proposed standards were submitted to the European Commission for endorsement in December.

Special provisions in the draft RTS address funds regulated under the Undertakings for the Collective Investment in Transferable Securities (UCITS) Directive and the Alternative Investment Fund Managers (AIFM) Directive. Money market funds are identified as shadow banking entities and will face increased regulation and supervision. The draft also considers entities established in third countries and distinguishes between banks and other entities.

The experts assess the influence of this last trend in the regulatory and political dimension as rather high and with a recommendation to prepare. Mainstream adoption is expected in four to six years.

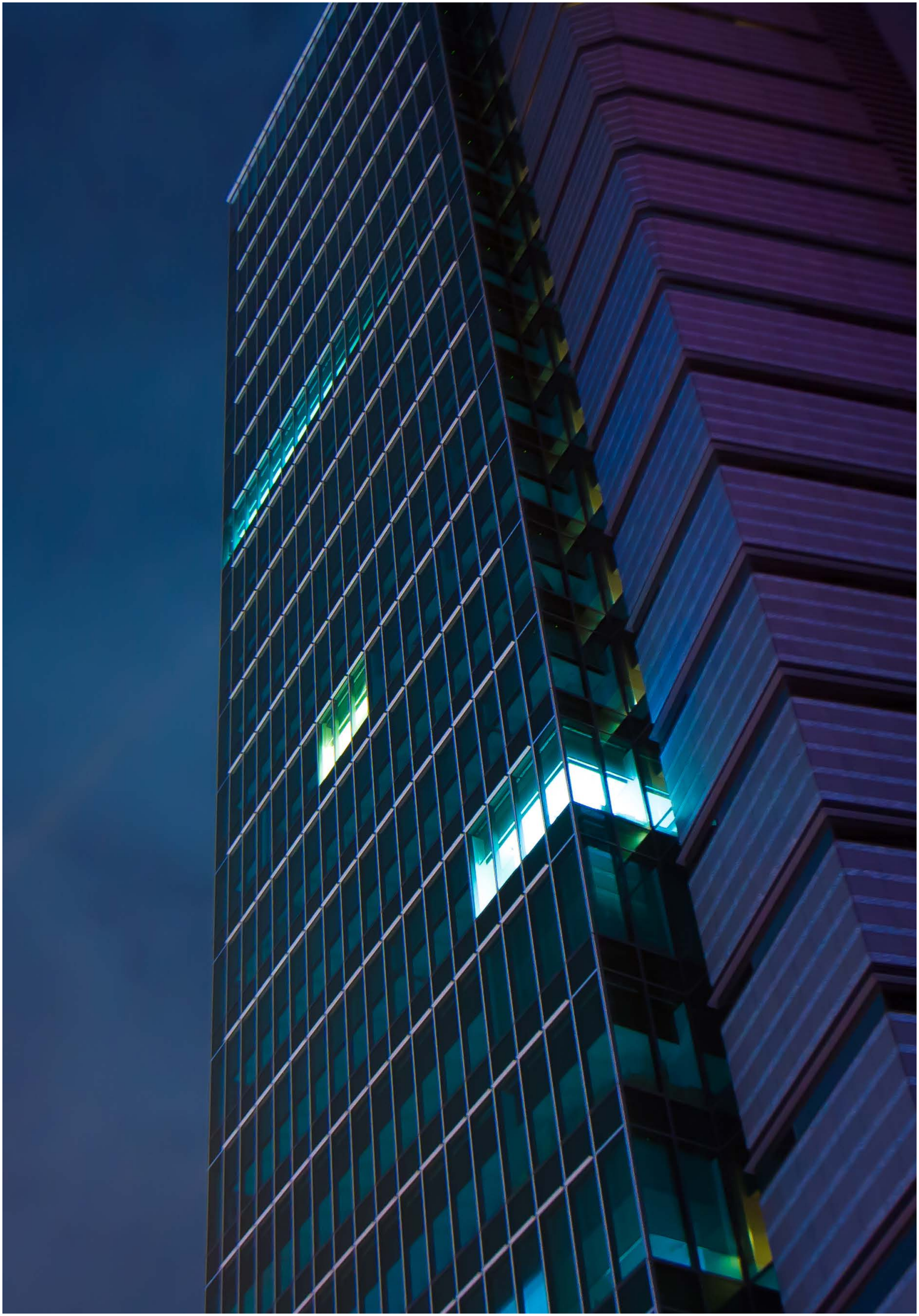
**Trend Assesment**

**Influence**

very low | low | rather low | **rather high** | high | very high

**Time of Mainstream Adoption**

0–2 years | 2–4 years | **4–6 years** | 6–8 years | 8–10 years | 10+ years



# Economics and financial markets trends

The banking sector is heavily dependent on external factors, such as economic conditions and developments in financial markets. Banks must react to changes in the market environment.

Two recent trends include advancements in integrating capital markets or a stronger location competition for financial services in the EU. In addition, technological or financial innovation, like digital currencies, leads to new economic mechanisms that shape the way markets work. Moreover, shifts in society also affect market mechanisms: Younger, more tech-oriented generations, for example, can acquire new information easily and quickly. Therefore, their investment behavior differs from older generations, a trend that influences business models in the financial sector.

# Actions concerning Capital Markets Union

### What is it about?

Plans for a Capital Markets Union in Europe have existed for over a decade. Its target is to create a single market for capital within the EU. An increase in financial integration promises to improve financial stability, competitiveness, and efficiency. Yet, for the last years, plans for such a Capital Markets Union have largely been left on the shelf, and the eurozone continues to face a fragmented structure.

Therefore, the European Commission is now seeking to hasten the Capital Markets Union plan, including a banking union project and a deposit insurance scheme. The single market for capital will make it easier for businesses to raise money and reduce their reliance on bank funding. This ambition makes the plan the most critical trend in the dimension of economics and financial markets.

### What is going on in the market?

The EU has a long to-do list relating to its proposed Capital Markets Union. Among the items on the agenda are insolvency laws, withholding tax, supervision, investment distribution and disclosure and shareholder engagement.

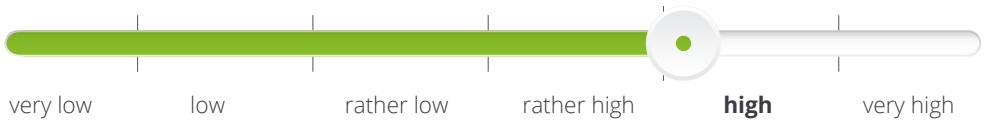
It is expected that the EU will soon begin diligently ticking off items. Also, likely to be tackled are critical topics such as Recovery and Resolution Regulation of Central Counterparties (CCPs). The European Commission states that "CCPs play an increasingly major role in the financial system. They increase market transparency and reduce risks, in particular in derivatives markets."[24]

It also notes that a distressed CCP could pose risks to financial stability. New regulations introduced last year require CCPs to create recovery plans. It also requires banks to review current contracts with CCPs and take a recovery plan into account.

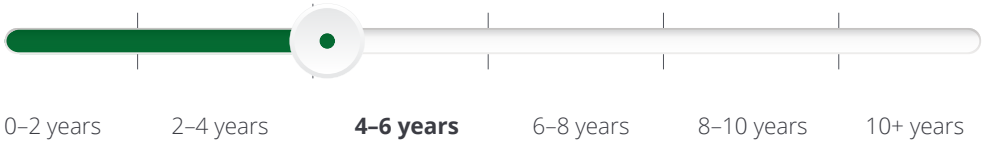
The proposed Capital Markets Union has been around for the best part of a decade, but the project is drawing closer to an end. The expert assessment is that the influence will be high. While mainstream adoption is expected within six years, it may occur in as little as two years. The recommendation is act.

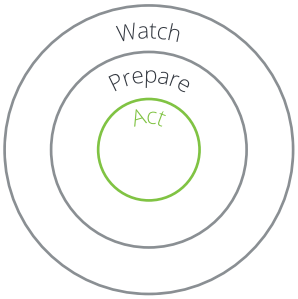
## Trend Assesment

### Influence




### Time of Mainstream Adoption



# Digital currencies

**What is it about?**

The European Union wants its citizens to know it is open to cryptocurrencies, but first rules and functions must be established to plan, test and implement such solutions, and regulations strengthened to prevent fraud.[25] It is only a little over a decade since an anonymous developer created bitcoin, the first decentralized cryptocurrency. By 2021, the global cryptocurrency market was estimated at more than $ 3 trillion.[26] But the rise in the popularity of cryptocurrencies and their adoption by institutions and some governments is meeting pushback.

China banned financial institutions and payment companies from providing cryptocurrency-related services last year. The United Kingdom requires all cryptocurrency firms with either a presence or providing services within the UK market to register with the Financial Conduct Authority.

Europe is more open to cryptocurrencies than China but is concerned criminal organizations and terrorists can exploit the anonymity of networks. It is also aware that cryptocurrencies have the potential to change economies and compete with legal tender.

**What is going on in the market?**

The European Central Bank last year kicked-off a 24-month investigative project on the digital euro. The aim is to ensure consumers' privacy and protect the eurozone from the "threat" of competing cryptocurrencies that could undermine the bloc's monetary sovereignty.[27] The ECB is not alone in investigating central bank digital currencies (CBDC). More than 80 governments are looking at digital currency initiatives.[28]

Given such projects, digital currencies are set to become an increasingly critical part of the investment world. The introduction of CBDCs will force banks to redesign their digital infrastructure and restructure business models. The payment and deposit space, in particular, will be strongly affected. Mainstream implementation of digital currencies is expected in four to six years and the impact will be high, leading to an assessment of prepare.

**Trend Assesment**

**Influence**

very low | low | rather low | rather high | **high** | very high

**Time of Mainstream Adoption**

0–2 years | 2–4 years | **4–6 years** | 6–8 years | 8–10 years | 10+ years

# Intensifying location competition

### What is it about?

With Brexit ticked off, one fear of the critics of the withdrawal from the European Union is being realized: a steady trickling of banking jobs is leaking to the European Union, even if the scale is less than predicted initially. The Brexit decision in 2016 opened up intense location competition, the situation where different geographical units compete to attract companies and, therefore, can provide more jobs and have a larger tax base. Companies base their decision on where to locate on matters such as the cost of wages, taxes/social security payments, regulatory environment, infrastructure and the availability of an educated workforce.

One UK concern is that Brexit risks ending the City of London days as one of the world's preeminent financial centers. A concern on the other side of the English Channel is that a large competitor with more regulatory leeway nearby could spark "a regulatory race to the bottom" that would value competitiveness more than financial stability.[29]

### What is going on in the market?

A year after leaving the EU, Britain's banks face a situation where EU competitors could soon lend to British corporates more cheaply than they can.[30] The decision by regulators to postpone implementation of the final parts of Basel III, the globally agreed capital rules, means EU banks can use less capital when making loans to corporates without a credit rating, which reduces lending costs.

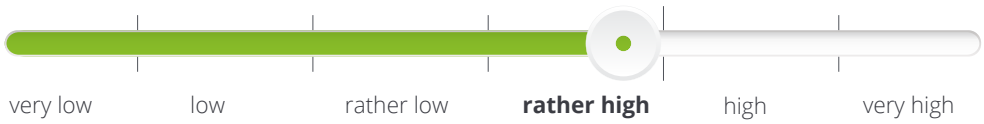
Corporate lending is just one area where the post-Brexit paths of the EU and the UK are diverging. Both jurisdictions are revamping market regulations. However, the dominance of the UK remains unchallenged. For example, 90 percent of euro-denominated clearing volumes still take place in the UK.[31]

Yet, Brexit not only sparked location competition between the EU and UK but also between the financial hubs of continental Europe. Rivals to London's financial crown like Amsterdam, Dublin, Frankfurt, Madrid, Milan and Paris have been jostling to attract jobs leaving the British Isles.

The expert recommendation is to prepare as the influence of this trend will be rather high. However, it could be mainstream in as little as two years to six years, depending how factors play out.

## Trend Assesment

### Influence




### Time of Mainstream Adoption


# New investment behavior

**What is it about?**
During the COVID-19 crisis, the number of young people investing in securities rose significantly. With time on their hands and greater access to market information via new apps and platforms, millennials (those born 1981 to 1996) and Generation Z (those born later) caused a spike in new accounts at online brokers.[32] In Germany alone, almost 600,000 young adults ventured into the stock markets in 2020 – an increase of 67 percent and the single greatest surge in any year in the country.[33]

Numerous factors shape investment behavior, for example, demographics, risk appetite and awareness. Investment behavior can also be shaped by behavioral biases, such as attitudes to risk. With a significant demographic shift looming to a more tech-savvy generation, one of the critical questions is: How has the pandemic shaped their investment behavior?

**What is going on in the market?**
Dabbling in stocks used to be for older generations with savings. But the combination of cabin fever from lockdowns plus user-friendly trading platforms has attracted new generations to invest. Last year's short squeeze on certain stocks by younger investors and fueled by social media that spiraled into a frenzied rally is now notorious, but it indicates that a profound shift is ahead.

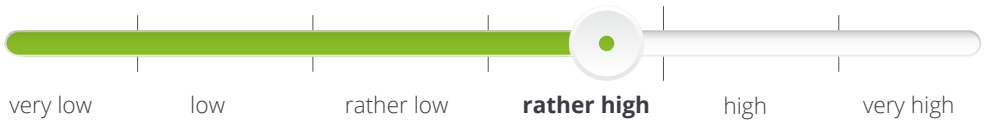
Millennials currently hold a tiny fraction of total wealth, but savings and inheritances mean their share will grow quickly. It would be a mistake to assume they will invest as their parents did. A Deloitte survey found some 87 percent believe corporate success should be measured by more than financial performance, and this is seen in their strong support of sustainable investing.

They also welcome technology that enables them to exert more direct control over their assets. Generations raised on smartphones are adept at using technology to directly buy and sell shares and bonds. Their affinity with technology also means they are ready to embrace technology-based investments, such as cryptocurrencies and non-fungible tokens. "Robo-advisers," programs that automatically allocate invested assets across low-cost index funds based on age and risk preferences for a low fee, are increasingly popular.

This all implies a dramatic shakeup of the investment world. The influence of the trend will be rather high, with the expert opinion being it is best to prepare as the impact will be increasingly felt within four years.

## Trend Assesment

**Influence**



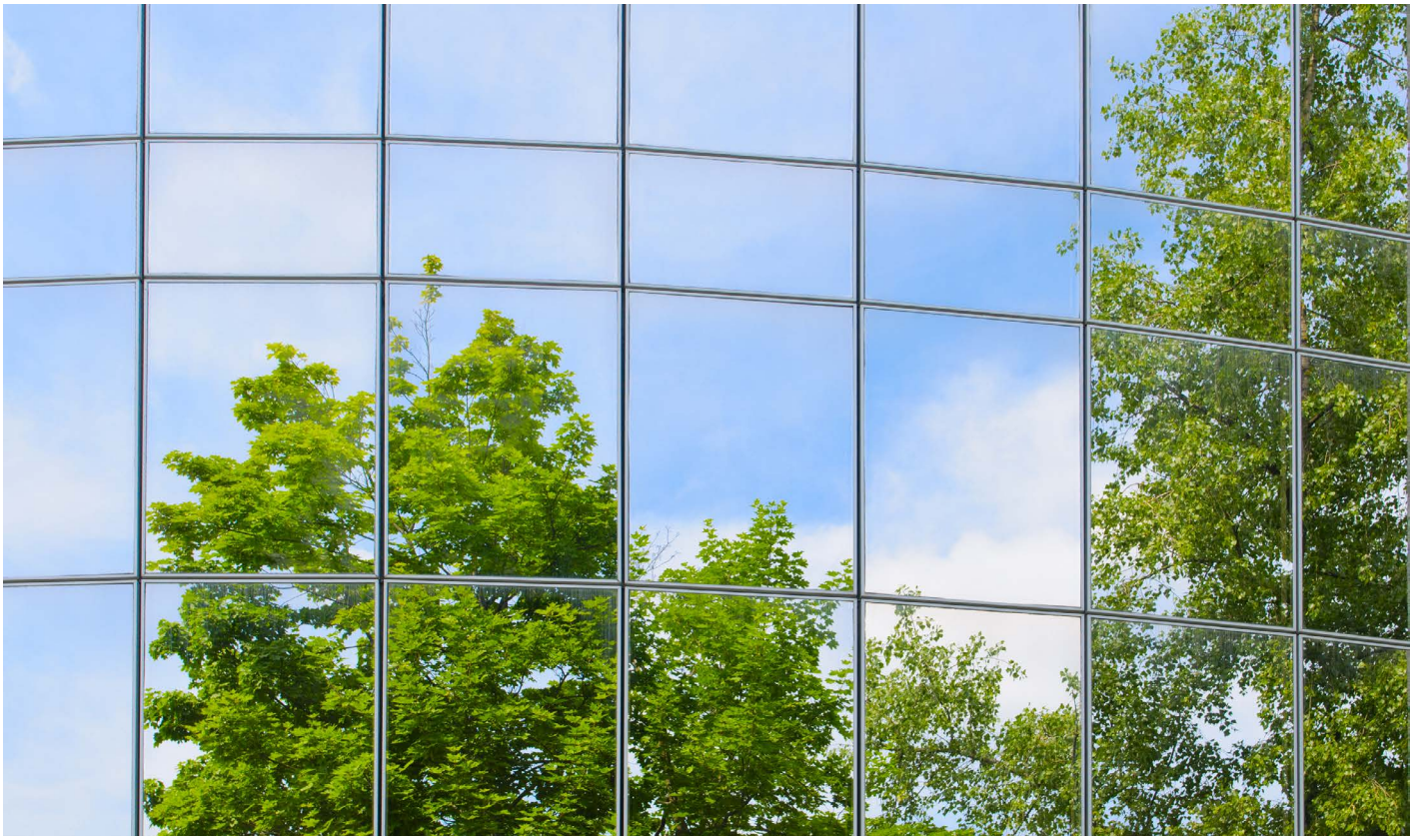

**Time of Mainstream Adoption**


# The way forward

The climate emergency has become a catalyst for changes in the banking industry. It is driving a shift away from measuring corporate performance solely based on shareholder returns. Institutions in Europe are increasingly signaling that monetary policy and bank supervision will be used to fight climate change – a change banks need to anticipate. Companies will need to be more responsive to ESG criteria, be more transparent and provide better disclosures regarding carbon emissions and governance matters in general.

This shift, combined with the increasing prominence of new generations in the workforce, creates the conditions for significant disruption within the sector. It is essential that banks remain aware of the trends covered in this report, monitor their development and draw the correct conclusions.

While the first report in this series dealt with trends in the client dimension, this one tackled ESG, regulatory & political, and economics & financial markets dimensions. The third and final report in the series will look at how the COVID-19 pandemic has accelerated the technology changes that were transforming the banking sector. It will also examine the dimension of the corporate organization.



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Issue 07/2022