The Future of Retail Banking in Ireland

September 2021

Banking & Payments Federation Ireland

In partnership with

EY
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Preface & Purpose: The retail banking sector in Ireland is at a major inflection point

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Banking & Payments Federation Ireland

The Irish retail banking sector[1] is at an inflection point. Rapid technological advances, swiftly changing customer preferences, increasing competition from new technology-based market entrants, a necessity to reduce high fixed costs, extensive regulatory and compliance obligations, high capital requirements, the growing importance of funding the transition to the green economy, and a historically low interest rate environment all continue to contribute to a highly complex sector and the disruption of the traditional retail banking model.

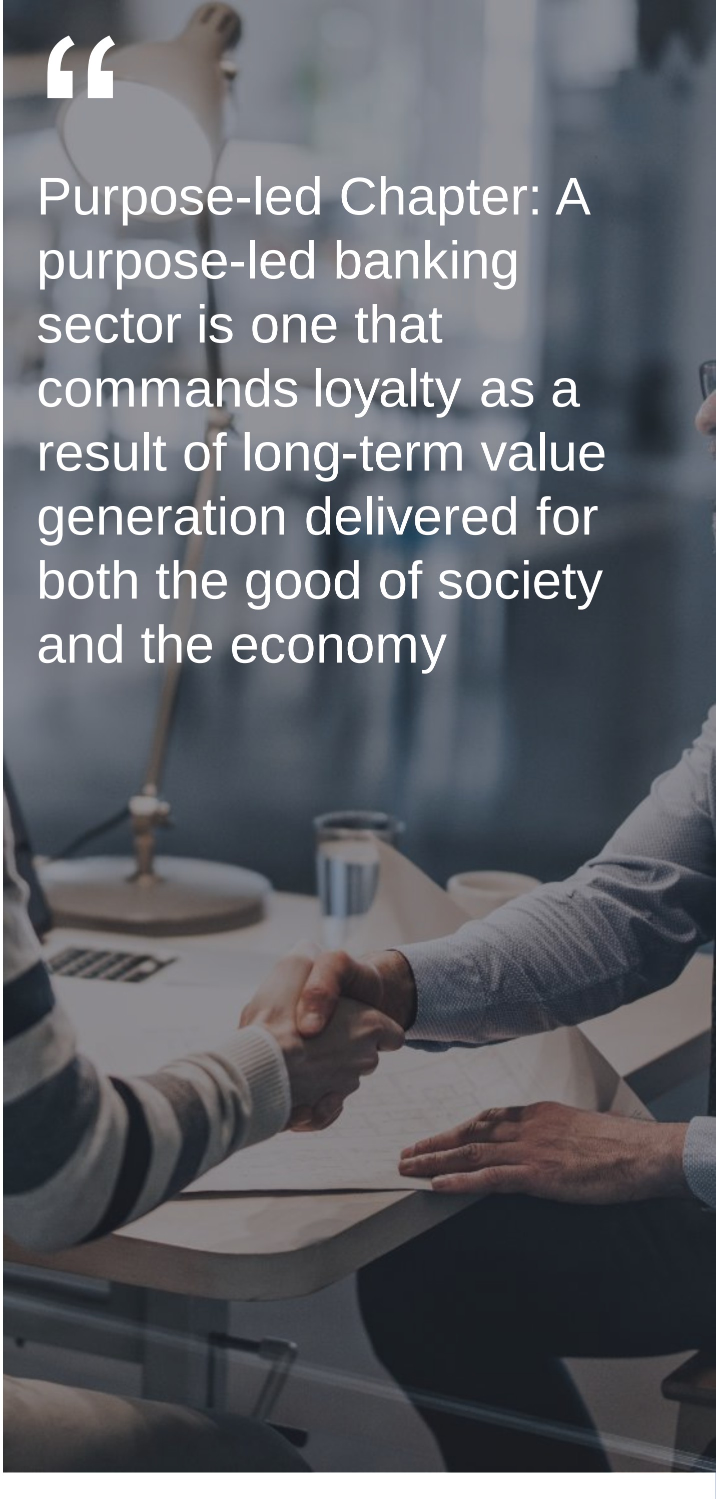
Much change was already underway in the sector prior to the global pandemic; however Covid-19 has accelerated the pace of change. The recent announcement that two significant players intend to exit the Irish retail banking market brought a further spotlight on the sector, triggering a call by many to assess the retail banking environment in Ireland, and its future development.

Purpose: This report by BPFI, supported by EY, seeks to outline the importance of the retail banking sector to Ireland, to identify the key stakeholders within the sector, their competing demands, and to understand the key challenges and opportunities the sector faces framed against a set of four key pillars – a Purpose-led Banking Sector, a Viable Banking Sector, a Safe and Stable Banking Sector and a Progressive Banking Sector.

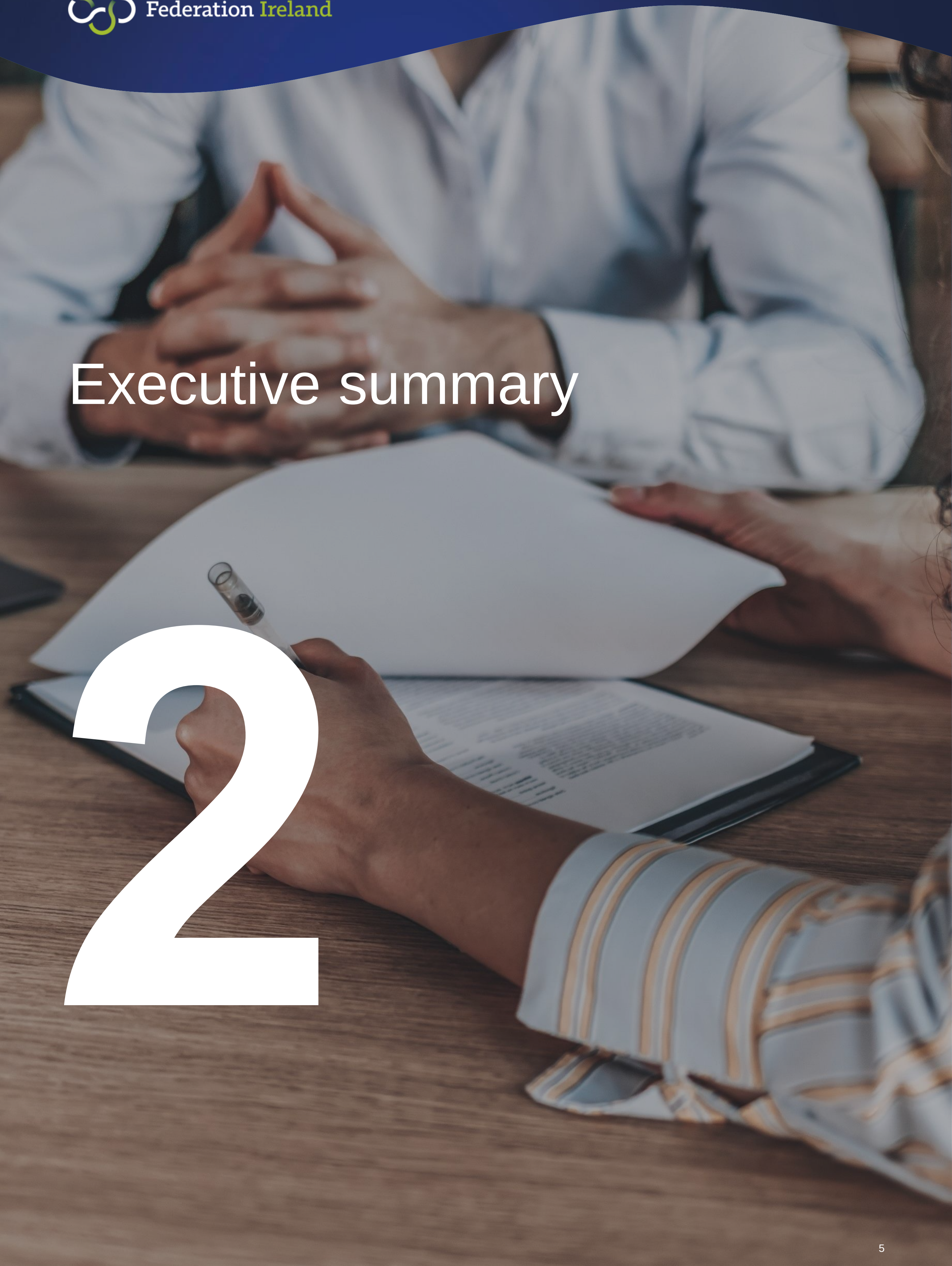
The report has been developed in consultation with a panel of domestic and global banking experts and senior industry representatives. It seeks to provide an overview of the sector as we know it today and to present a framework to facilitate a collaborative and forward-looking discussion.

There are many factors, challenges and opportunities to reflect on as we debate and consider the future of Irish retail banking.

Given the myriad of competing demands, a necessary precursor to a meaningful and outcome-focused debate is a rigorous, informed, and balanced engagement amongst all stakeholder groups.



1 For the purposes of this paper, references to the banking sector is defined as domestically focused retail banks – Allied Irish Bank (AIB), Bank of Ireland (BoI), Permanent TSB (PTSB)



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Executive summary

A stable and viable retail banking sector is a fundamental prerequisite to a well-functioning modern economy and society. Much of the day to day activities and transactions of consumers and businesses would simply grind to a halt without the services provided by retail banks. Businesses couldn't operate without credit and payments services, employees couldn't get paid or deposit salaries in a guaranteed safe place, consumers couldn't spend, and people would face great difficulty buying homes without the full range of services provided by the retail banking sector.

In addition to their key role in underpinning the economy, the Irish retail banks employ approximately 22,000 people[2], and the wider banking sector contributes €1.6 billion directly to the Exchequer[3], and a further €11.6[4] billion to the economy each year.

The retail banks hold €270 billion in deposits for Irish households and businesses and provide loans totalling €152 billion, including over 822,500 mortgages to homeowners in Ireland[5]. The retail banks also play a central role in the functioning of the payments system, processing around 5 million transactions worth €3.7 billion every day[6].

2. https://603101-1952083-raikfcquaxqncofqfm.stackpathdns.com/wp-content/uploads/2021/05/IBCB-eist-2021-report-RS-060521_Final_ONLINE.pdf
3. Sectoral breakdown provided to EY from Revenue across all key tax headings
4. https://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=nama_10_a64_e&lang=en
5. https://www.centralbank.ie/statistics/data-and-analysis/credit-and-banking-statistics/bank-balance-sheets/bank-balance-sheets-data
6. BPFI Payments Monitor

The future of retail banking in this country has been the subject of debate for some time, but the announcement in 2021 of the planned departure of two retail banks, along with the accelerated changes brought about by the pandemic, has given a new intensity to the topic and an acknowledgement of the need for a thorough analysis of Ireland's retail banking environment.

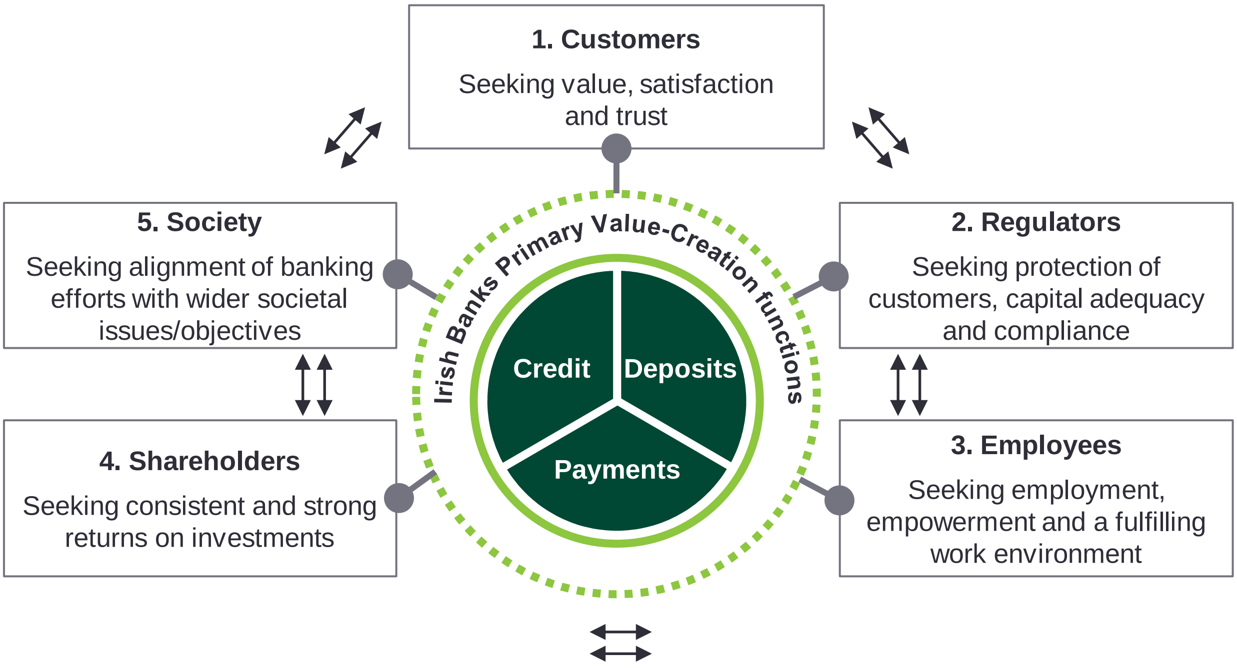
In our view, that analysis needs to consider the competing stakeholder demands within the retail banking sector. For example, financial regulators place a strong emphasis on strength and stability while shareholders will need to focus on sustainable profitability if they are to remain viable and continue to serve their customers and society. These demands and expectations are not necessarily mutually exclusive however there is a need to acknowledge and seek a means to achieve balance between stakeholder demands.

Therefore, the primary challenge for Ireland's retail banking system is to run its core functions effectively and efficiently whilst meeting a diverse set of competing stakeholder needs.

These stakeholders include:

- **Customers** seeking access, value, satisfaction, and trust
- **Regulators** seeking the protection of customers, capital adequacy and compliance
- **Employees** and future talent seeking employment, empowerment, and a strong work culture
- **Shareholders** seeking a return on equity invested and profitability
- **Society** seeking alignment of banking efforts to wider societal objectives

Figure: The primary challenge for Irish Banks - meeting the set of diverse stakeholder needs and objectives



Given the differing perspectives of the various stakeholders, it is essential that any debate on the future of the retail banking sector in Ireland takes account of the framework upon which successful banking sectors globally are based. This report looks at what global experts see as the essential pillars of a healthy banking system and provides an assessment of the Irish retail banking landscape against each of those pillars:

- **A purpose-led banking sector** which seeks to balance the expectations of customers, regulators, shareholders, and society and looks at prioritising long-term customer and societal value.
- **A viable banking sector** which delivers value for customers and is profitable and efficient in doing so.
- **A safe & stable banking sector** which is robust, secure, transparent, and acts in the best interests of the customer.
- **A progressive banking sector** which continuously increases value for the customer and the shareholder through technology, analytics, talent, and other forms of innovation.

Key Findings by Framework Pillar

The four-pillar framework enables a structured appraisal of the industry as we know it today; identifying challenges, opportunities, and potential actions to facilitate a forward-looking discussion.

A Purpose-led Banking Sector

Why it's important: Without purpose and trust, the banking sector loses competitiveness & long-term relevance.

1. Retail banks are vital for Ireland's future economic and social development and will play a leadership role in Ireland's green transition

The climate crisis is the greatest single challenge facing the world today[7] and tackling it will require an unprecedented scale of investment by governments, industries and individuals globally. Banks in Ireland and across the EU will play a critical role in the provision of funding to support that investment. Irish retail banks have developed green products and services to help consumers and businesses transition to a carbon neutral and environmentally friendly economy. Those green products and services will represent a significant growth area for banks in the future.

A review of the leading Irish banks' latest annual reports reveals a shift towards Environmental, Social, and Governance (ESG) that marks them out as industry-leading, with Irish lenders featuring in the top 10%-15% of banks globally in this important area.[8]

2. Continued investment in culture and trust remains a strategic priority within the banks

Improving culture in banking, and repairing trust with the public, continues to be a strategic priority for Irish retail banks. The sector has invested significantly in recent years to create an open, inclusive and growth culture in order to achieve better and fairer outcomes for bank customers and staff. The progress made is reflected in the annual Edelman Trust Barometer survey into public trust in financial services and banking; it has shown an increase of 27% in trust in the period from 2012 to 2020.[9] That progress was further reinforced this year with the announcement by Government of a new individual accountability framework including a senior executive accountability regime (SEAR) which was welcomed by the retail banking sector.

7. 2021 EY Global Climate Risk Disclosure Barometer | EY – Global
8. Article - Irish Banks Leading the Charge: Are banks the new ESG gatekeepers, Goodbody Stockbrokers
9. 2021 Edelman Trust Barometer: Financial Services | Edelman

A Viable Banking Sector

Why it's important: If the banking sector isn't profitable, it can't deliver its core mission.

3. A sustainable retail banking sector is critical to society and the economy, but profitability remains challenging

A viable and profitable retail banking sector is critical to supporting customers and the economy. However, the profitability of the Irish retail banking sector is among the lowest in Europe, measured in terms of return on equity[10], with RoE for Irish retail banks of circa 2.6%[11] versus circa 7.6% for the European average[12] for Q1-21. This reduces the retail banks' attraction to global investors, who have a wide range of alternative investment opportunities, limiting retail banks' ability to raise capital for lending, investment, acquisitions and diversification.

Irish retail banks need to be profitable to generate organic capital that in turn is lent back into the wider economy to support jobs, businesses, and economic activity. This will require new and diversified sources of income as well as further efficiencies in operational costs. A banking sector which isn't viable cannot reinvest profits in the other three pillars of Purpose, Safety, and Progressiveness which are central to meeting the expectations of stakeholders.

4. Irish retail banks are heavily dependent on interest income

Irish retail banks are far more reliant than their European counterparts on interest income for profits. For 2020, net interest income for Irish retail banks accounted for circa 80%[13] of operating Income versus circa 54%[14] for the EU banking sector, reflecting the fact that fees and commissions are an important source of income across the EU banking sector. In addition, net interest income has been negatively impacted by the historically low interest rate environment which has prevailed for almost a decade now and is set to continue as signalled by the ECB as recently as July 2021[15]. The average loan-to-deposit ratio in Ireland has reduced from 102% in 2016 to 78% in 2020[16], significantly lower than the European average of 107% in December 2020[17]. The combination of low interest rates, one of the lowest levels of customer loan to deposit ratios in the EU, and negative net lending growth has negatively impacted Irish retail banks' profitability.

5. Irish retail banks must hold back an estimated €2.5 billion in additional capital for mortgages, impacting price of products and impacting adversely the share valuation of retail banks

Capital requirements are rules that require a bank to maintain a minimum ratio of capital in relation to its lending. A recent study undertaken by the BPFI revealed that capital requirements for mortgages amongst Irish retail banks are three times the European average, despite the vast improvement in the mortgage book quality over the past five years [18]. This is mainly due to higher Loss Given Default (LGD) levels used in the Risk Weighted Assets (RWA) calculations, much of which is influenced by low recovery rates of security for mortgages under judicial processes, and longer time to recover security and the associated legal costs. This impacts negatively on the pricing of products and services and has an adverse effect on the share valuation of retail banks, again reducing investor interest along with the value of the State's shareholding.

10. https://www.ebf.eu/wp-content/uploads/2020/11/EBF_043537-Banking-in-Europe-EBF-Facts-and-Figures-2020.pdf
11. Interim accounts 2021 for AIB, BoI and PTSB
12. Risk Dashboard | European Banking Authority (europa.eu) (Selection return on equity)
13. Figures compiled from publicly available annual accounts for Irish banks (AIB, BoI and PTSB)
14. EBA Interactive dashboard Q1-21
15. ECB pledges to keep rates low until inflation hits 2% (rte.ie)
16. Figures compiled from publicly available annual accounts for Irish retail banks (AIB, BoI and PTSB)
17. https://www.bankingsupervision.europa.eu/banking/statistics/html/index.en.html
18. Final-BPFI-RWA-Report.pdf

6. Continued divestment by the State of its stake in Ireland's retail banks

While state ownership has been a feature of the Irish retail banking sector for the past decade, the Government's strategy[19] is to return banks to private ownership. State support for the Irish retail banking sector was vital to ensuring the sector could continue to function through the crisis. With returns to date, including current valuations from existing shareholdings, the State's present day recovery value from the three banks is 83% of its original investment. The future sustainable profitability of the retail banks will further increase the return to the State.

A Safe & Stable Banking Sector

Why it's important: Without capital adequacy and controls, the banking sector faces liquidity and sustainability risks.

7. Continued and sustained focus on the regulatory environment

Covid-19 proved to be the most unprecedented test of decade-long regulatory reforms. Financial and operational resilience of retail banks were tested to the core. Thankfully, for the most part, the banking sector found that a decade-long effort, of implementing new business, regulatory and accounting rules and requirements, have allowed retail banks to build a far superior level of higher-quality capital and liquidity, which in turn enabled banks to contribute materially to supporting communities, economies and financial markets, while remaining financially safe and sound. In addition, other regulatory change over the last 10 years, has had a very positive impact in aligning the requirements of customers, regulators and banks, including PSD2 and GDPR amongst others.

Looking ahead, our view is that the regulatory agenda will be sustained, across an increasingly diverse range of priorities including the green agenda, financial crime, operational resilience, as well as traditional focus areas of governance, credit, capital, liquidity and broader prudential reforms through Basel IV. Juggling these competing priorities while striving to achieve committed cost reductions and operating model enhancements will require a fine balancing act.

8. Drive towards scale and consolidation in banking across the EU

The ECB's policy to have a safe and well capitalised banking system, operating to high regulatory standards, is one of the key drivers of consolidation in banking across the EU. Economies associated with scale can help generate the sustainable profits required to improve capital levels and financial stability. Recent ECB research *'What will the banking sector look like in 2030?'* states that if recent trends continue, the EU banking sector in 2030 will likely look different than it does today in that 'it could be smaller, employ fewer people, and operate less via branch networks.'

19. gov.ie - Notes to Editors - Bank of Ireland trading plan (www.gov.ie)

A Progressive Banking Sector

Why it's important: If products and services fail to improve over time in a market economy, incumbents will face challenges in sustaining existence.

9. Rapid shifts in consumer behaviour and technology preferences driving major changes in retail banking

There has been a dramatic and continuing shift in customer behaviour driving major changes in retail banking and payments for some time, while the Covid-19 pandemic has accelerated these trends.

Over the counter transactions in Irish retail bank branches have fallen by over 45% in the past three years.

In contrast, there has been an immense rise in online and mobile banking activity, with overall digital payments rising by a significant 65% during the same period.

These transformative and relentless customer trends are reflected across the entire EU banking sector. The use of cash by European consumers has been diminishing rapidly, in-branch transactions have fallen sharply, while internet banking use has surged. These trends are driving profound changes in the nature and structure of banking. More than 80% of respondents to the World Economic Forum June 2020 research report said they believed banking will become part of a platform of services within a digital ecosystem where the banks will work with bank and non-bank partners to offer their own and third-party services to customers.

10. Increased competition from new entrants targeting segments of the traditional banking market

The traditional model where customers used one bank for all their needs has changed – today, major disruption is underway. Consumers are shopping across the financial services landscape in Ireland with close to 20 different competitors now providing different products and services across the mortgages, personal loans, overdrafts, and payments services market in Ireland. The advent of open banking, coupled with new technologies and heightened customer expectations, has led to products being unbundled from one another. This has created opportunities for specialist niche players to enter the market and compete by choosing to serve certain segments of the retail banking market. This contrasts with the breadth of services that the traditional banks deliver and the costs associated with that.

11. Irish retail banks continue to invest in new technologies and services to meet consumer demand

Notwithstanding the extremely challenging landscape, Irish retail banks have been reorienting their business models and strategically investing to transform, diversify and grow their businesses while managing their costs. They have pursued strategic partnerships with non-banking players and FinTech companies as an avenue for growth, while investing significantly in digitalisation and innovation to meet changing customer needs. BPFI research has shown that Irish retail banks have collectively spent over €3 billion in the last five years on technology and innovation projects[20] to deliver a range of new digital services for customers and transform their businesses in response to a rapidly changing market environment and increasing regulatory demands.

20. Banking-on-Innovation-Report-Final.pdf (bpfi.ie)

12. Challenges in recruiting and retaining talent is more acute than ever

The skills composition within banks is evolving rapidly, with the retail banks needing a range of skills including IT and digital skills to meet evolving consumer and regulatory demands. The ever-increasing demand for talent is a challenge for all businesses, including the retail banks in Ireland, who compete for people with the large international financial services sector, multinational technology companies, the fast-growing FinTech sector, and other corporates nationally and internationally.

However, as a result of the Financial Crisis in 2008-2010, Irish retail bank employees and potential recruits are subject to some of the most restrictive variable pay remuneration conditions in the EU and are clear outliers when compared with graduates and employees not only in financial services but in a range of other sectors. This places Ireland's retail banks at a considerable and growing disadvantage compared to other banks, IT companies, and corporates.

A normalisation of pay and employment conditions at Ireland's retail banks – to allow the banks compete for people on a level playing field with other corporates – is needed if they are to attract the skills and employees that are necessary for their future and for the provision of services expected by Irish consumers.

Looking ahead – potential future opportunities

The Irish retail banking sector can strengthen performance by continuing to manage its challenges and availing of growth opportunities. This report explores in some detail the actions which the banking sector can take to shape its future. These include the continued need to invest in trust and culture, the bedrock on which lasting customer relationships are built; explore inefficiencies in the legal system or asset recovery that are driving higher capital requirements in Ireland; the potential to develop new income streams, diversify into new areas, partner with non-bank players, and explore new business models; develop increased agility and resilience to better manage future risks; restore a level playing field with competitors for recruitment; and continued investment in digital transformation programmes and the development of future talent in order to meet changing customer expectations.

These are among the many potential actions which the retail banks must consider with their stakeholders as they seek to shape the future dynamics of Irish retail banking.

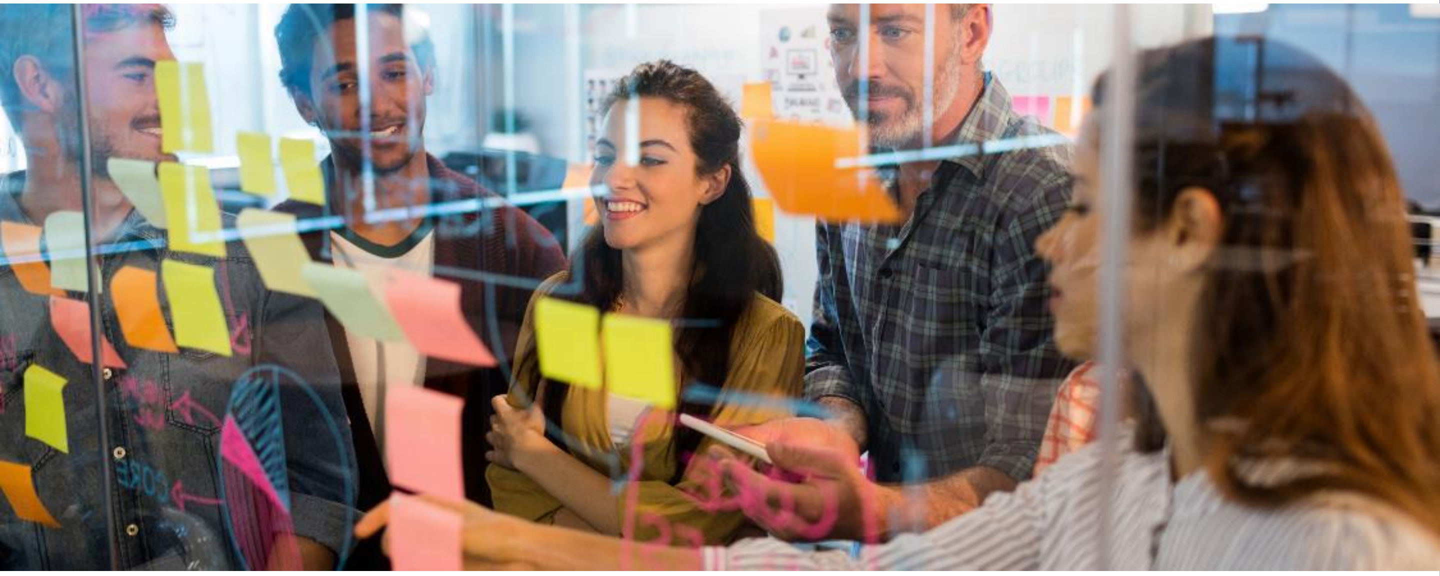


Table: Potential opportunities for the sector for all stakeholders

Irish Banking sector is	Purpose-led	Viable	Safe	Progressive
Topic	Purpose, sustainability, trust, advocacy	Profitability, diversification, effective capital allocation	Customer protection, capital adequacy, resilience, compliance	Innovation, technology, data, talent
Description	**A purpose-led banking sector** elicits trust, loyalty and legitimacy through delivery of long-term value generation in admirable ways	**A viable banking sector** delivers value for customers, shareholders, society, is efficient and diversified in doing so and effective at capital allocation	**A safe and financially stable banking sector** is robust, secure, transparent and acts in the best interests of the customer	**A progressive banking sector** continuously increases value delivered through technology, analytics or other forms of innovation
Key trends/ opportunities include	• Companies across the world are seeing to run their business in a more holistic way which considered their impact on the full range of stakeholders • Rebuilding the economy post-Covid and support for the SME community • Taking a lead role in the transition to a greener and more sustainable economy and society • Promoting financial inclusion, literacy and overall financial wellness • Investing in trust, the bedrock upon which relationships are built and loyalty is obtained	• Leverage Improved economic performance and investments in Private Banking and Wealth to reduce reliance on Net Interest Income • Refine capital requirements to invest in customer led digital transformations to reduce overall cost to serve • Increase operational efficiencies in a hybrid world e.g. reduced property costs • Mature location strategies to enable Improved and consistent use of wider talent pools in Ireland and globally • Creation of shared utilities to further reduce operational costs	• Irish banks working with local and European regulators have made significant progress in terms of capital reserves and asset quality • Looking ahead, there are several opportunities to leverage new and emerging regulation to transform business capability e.g. 1. Basel IV, SRB, IREF and BIRD to transform Finance and Risk Data and Technology capabilities 2. New Financial Crime capabilities enable improved understanding of customer and relationships	• The continued focus on investing in a progressive banking sector will be central to Ireland's economic future • Continued investment in innovation and digital programmes to meet heightened customer expectations and compete with the rising numbers of FinTech • Investing in future talent and workplace models to ensure a sustainable workforce within a changing and more digitised banking sector • Leverage rich data insights to drive more personalised customer services
Competing stakeholder perspectives	Customers | Society | Shareholders | Regulators | Employees			

Source: EY Analysis

We need a viable, safe, innovative, and purpose-led retail banking system that serves its customers, the Irish economy and the wider society. An informed and open conversation by all stakeholders is key to a meaningful and effective dialogue that will shape the future dynamics of Irish retail banking and ensure the sector realises its full potential and continues to play a central role in the Irish economy and society.

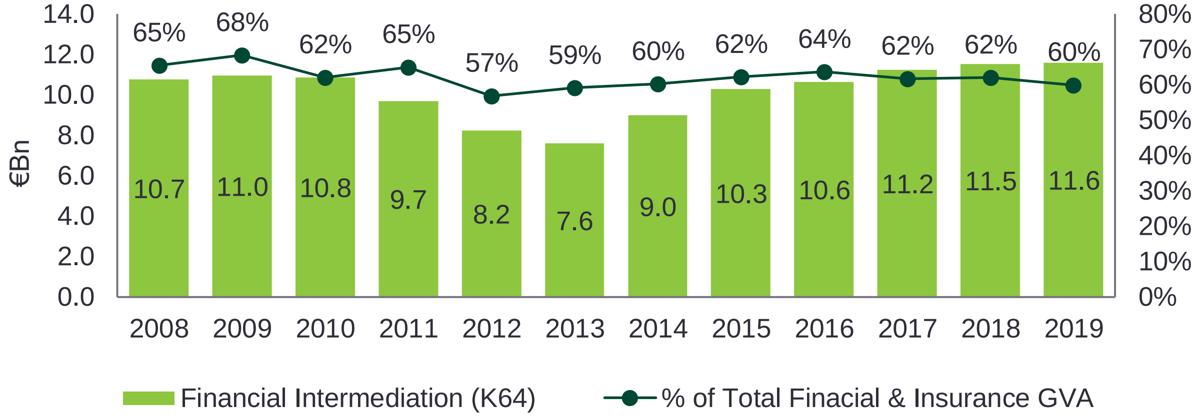
The role and significance of retail banking in Ireland

3

The role and significance of retail banking in Ireland

The Irish retail banking sector plays a critically important role in the economic life of the country. In 2019, the total economic contribution made by the Irish banking sector through operating profits and employee wages stood at €11.6bn[21], representing a GDP contribution of 3.3%[22] compared to a Eurozone average of 2.6% of GDP.

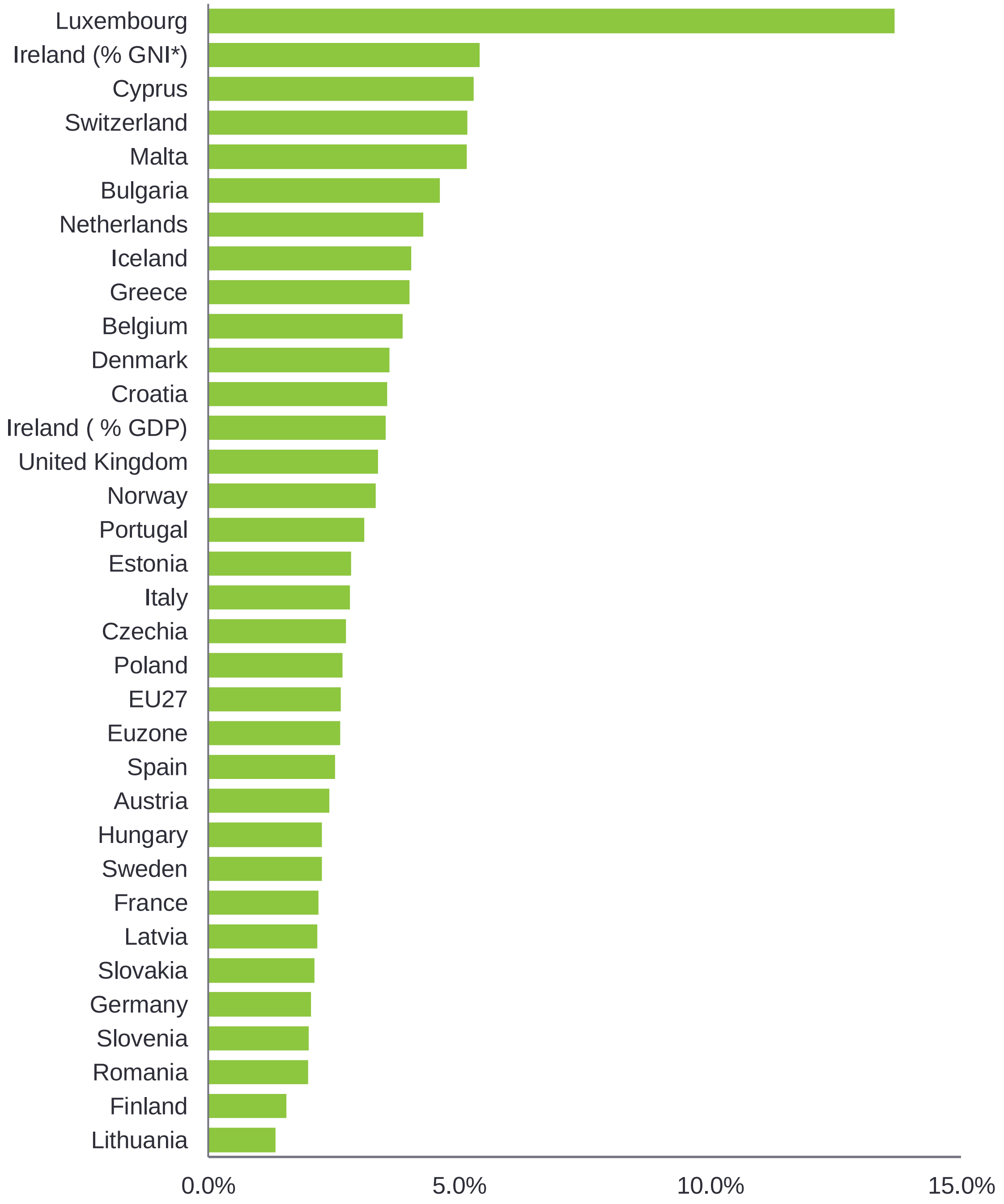
Figure: Irish banking sector GVA (€bn), 2008 to 2019



Source: EY analysis using CSO data (Financial and Insurance Activities Sector - CSO) [23]

21. https://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=nama_10_a64_e&lang=en
22. https://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=nama_10_gdp&lang=en
23. Financial and Insurance Activities Sector - CSO - Central Statistics Office

Figure: Irish Banking Sector GVA Contribution to the Economy, % of GDP- 2019



Source: EY analysis using CSO and Eurostat data

Figure: Irish Retail Banking Sector GVA (€bn) vs other economic sectors, 2019 (excludes industry and ICT)

Source: CSO, National Income and Expenditure 2019 [24]

In addition, Irish retail banks employ approximately 22,000 people[25], and the wider banking sector contributed €1.6 billion[26] to the Exchequer in 2020, including €1.4 billion in income tax and USC –7% of all income tax generated in the Irish economy that year.

Table: Irish Banking Sector Tax Contribution in 2020 (sector K.64)

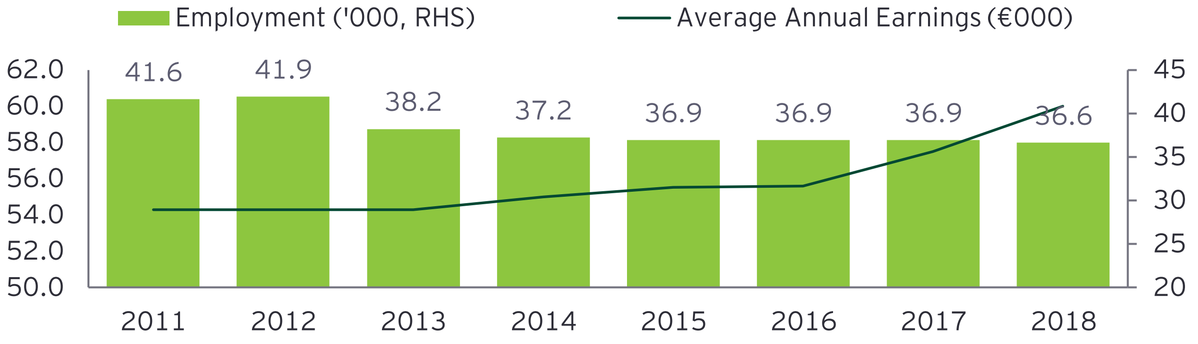
Tax Heading	Income Tax & USC	VAT	CGT & Others	Total
2020 Total (€m)	€1,359	€141	€107	€1,607

Source: Revenue data supplied to EY

The nature and geographic spread of these jobs is also highly significant. Retail banking workers are spread widely across the country and their spending makes a considerable contribution to their local economies. Indeed, the Irish Banking Culture Board Employee Survey from 2018 indicated that across the five largest Irish retail banks, 48% of retail banking roles were located outside of Dublin[27], a statistic which may well grow given changes in the working environment post-Covid-19.

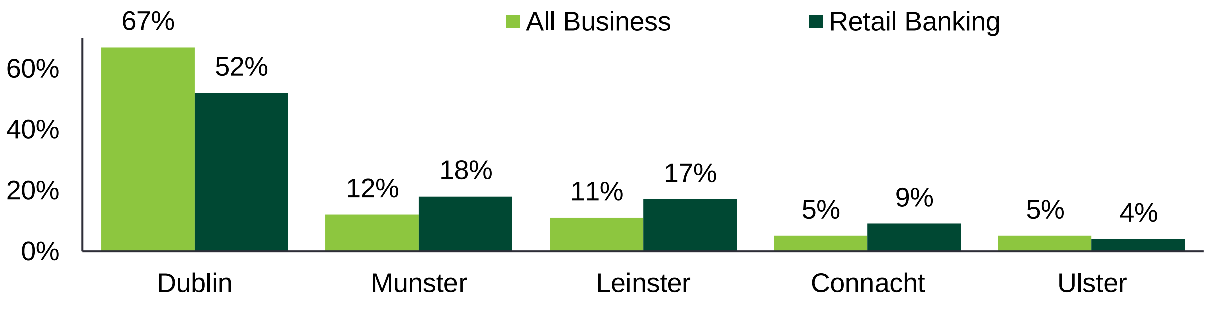
24. https://www.cso.ie/en/releasesandpublications/ep/p-nie/nie2019/
25. https://603101-1952083-raikfcquaxqncofqfm.stackpathdns.com/wp-content/uploads/2021/05/IBCB-eist-2021-report-RS-060521_Final_ONLINE.pdf
26. Sectoral breakdown provided to EY from Revenue across all key tax headings
27. https://603101-1952083-raikfcquaxqncofqfm.stackpathdns.com/wp-content/uploads/2020/03/Irish-Banking-Employee-Survey-2018-summary-report.pdf

Figure: Irish banking sector (K64) employment and earnings, 2011 to 2018



Source: EY analysis using CSO data [28]

Figure: Irish retail banking sector employment by region – 2018



Source: Irish Banking Culture Board

The Irish banking sector is also fundamental to the functioning of the Irish economy and its continued growth and success. The banking system enables the efficient flow of money in the economy and matches savings to investments through its deposit and credit channels.

Irish households and businesses hold €270 billion in deposits in Ireland's banks (Central Bank, July 2021[29]). These deposits enable the banks to provide credit to Irish households and businesses. Banks have a total credit book of €152 billion spanning consumer and business lending including 822,500 mortgage accounts in Ireland.

The retail banks also play a central role in the functioning of the payments system, processing around 5 million transactions worth €3.7 billion every day[30]. These transactions include card payments made by consumers in shops, direct debits, cheques and credit transfers including salary payments, social welfare payments and payments between businesses of all sizes.

These services enable Irish individuals to save money, make payments, manage uncertainty, and obtain credit whilst supporting Irish businesses to start-up, expand, and compete in local and international markets.

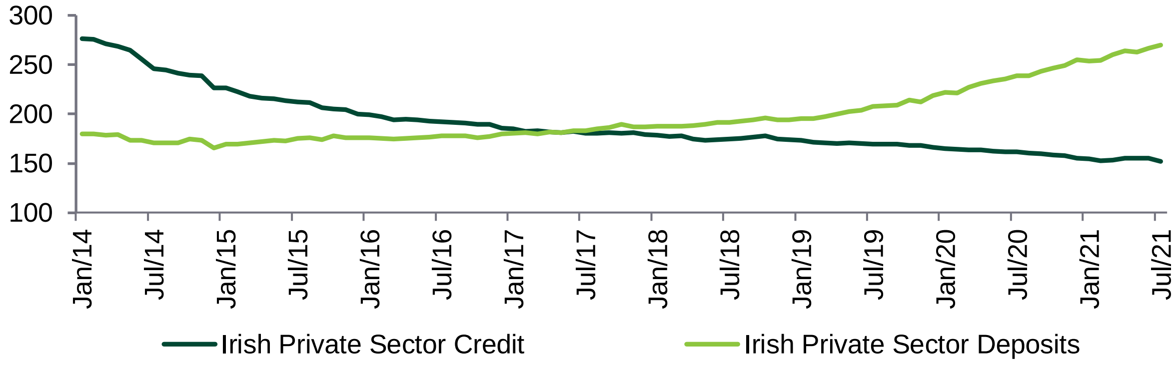
28. https://www.cso.ie/en/releasesandpublications/ep/p-fsina/thefinancialsectorinirelandsnationalaccounts2018/
29. https://www.centralbank.ie/statistics/data-and-analysis/credit-and-banking-statistics/bank-balance-sheets/bank-balance-sheets-data
30. BPFI Payments Monitor

Table: Irish banks drive economic value through three value creation functions

	1. Credit	2. Deposits	3. Payments/Transactions
What individuals and businesses need	• Funds to purchase needs (houses, cars, etc.) • Funds to enable businesses grow	• A safe place to keep savings/surplus liquidity	• Ability to make and receive payments efficiently • Efficient conversion of currency across market
How Irish banks deliver value	• Provision of funds • Effective management of credit risk to protect customers	• Security of individuals/ businesses liquid funds • Access to money market	• Facilitation of payments transfer • Guaranteed security of transactions

Balance sheet business   Fee-based business

Figure: Irish private sector credit and deposits (€bn) – 2014 to 2021 | EY analysis using CBI data



Source: Central Bank of Ireland, Credit, Money and Banking Statistics, Table A.1

Deposits by households have been increasing in the Irish retail banks and particularly during the pandemic have reached new heights. Household deposits increased to €134 billion as of July 2021, from €113 billion in March 2020, whereas credit to households stood at €82 billion as of July 2021. Households and non-financial deposits in the Irish banking system were €209 billion as of July 2021, whereas credit advanced to these two groups was €118 billion in the same month. Deposit amounts in Irish banks have surpassed lending by a significant margin, creating excess liquidity in the Irish banking system. The gap has been widening since 2016 and continues to grow. [31]

31. https://www.centralbank.ie/statistics/data-and-analysis/credit-and-banking-statistics/bank-balance-sheets/bank-balance-sheets-data

Covid-19

The critical role of the banking system was especially highlighted during the Covid-19 pandemic, as the country's retail banks moved rapidly and voluntarily to support impacted customers through the introduction of 160,000 payment breaks[32]. Irish retail banks introduced one of the most wide-ranging and accessible payment break regimes across the European Union.

Logistical support and infrastructural changes were also implemented swiftly, with Working from Home (WFH) arrangements widely implemented at the same time as staff were being redeployed in call centres and across a branch network which needed to be maintained as an essential service.

The vast majority of branches remained open, support units were put in place, and business continuity plans were updated to ensure the continued functioning of the entire payments and banking system. As the pandemic has evolved, banks have been comprehensive in their continued support for customers, extending personal supports on a case-by-case basis and providing vital business supports, particularly through the roll-out and provision of the €2 billion State Credit Guarantee Scheme[33] and other SBCI lending schemes.

The critical nature of the services provided to customers, coupled with the scale of the sector's economic significance, makes clear that a well-functioning and stable Irish financial system is essential to the wider Irish economy. Effective regulatory reforms, progress in cultural change and ways of working reform, and the strengthened capital reserves put in place since the financial crisis, ensured the Irish banking sector was well positioned to support customers through this crisis. Continued responsible banking practices will ensure the industry is similarly well-placed for any future crisis.

Climate

One of the most important contributions that Irish retail banks will make to the economy and wider society into the future is their pivotal role in the country's transition to a low carbon future by 2050. It is recognised by all stakeholders and Governments that the financial system, and banks in particular, will be at the centre of the green transition and will be a major source of the funding required for all of society to make this journey.

Ireland's National Development Plan 2018-2027 envisages €40 billion of sustainable infrastructure investment will be needed, with about €20.2 billion of this to be invested by the State and the remainder to come from private sources. Banks in Ireland, already advanced in their raising of green bonds and the provision of new green products, will continue to play a crucial role by raising money and channelling it to consumers and businesses through an expanding suite of new and innovative green products.[34]

Banks in Ireland are integrating environmental, social and governance (ESG) factors into their organisations, adapting their business strategy and modelling to reflect key sustainability factors. Indeed, Irish banks are now ranked about the top 10% to 15% of banks globally for ESG.[35] Most banks have set a target of aligning customer lending portfolios across all sectors to net zero carbon emissions by 2040. Some banks have already made significant progress in this regard where close to 20% of all new lending is done using green products.

32. http://www.centralbank.ie/statistics/statistical-publications/behind-the-data/covid-19-payment-breaks-who-has-needed-them
33. Covid-19 Credit Guarantee Scheme - DETE (enterprise.gov.ie)
34. gov.ie - National Development Plan 2018 - 2027 (www.gov.ie)
35. Article - Irish Banks Leading the Charge: Are banks the new ESG gatekeepers, Goodbody Stockbrokers

Regulation and Consumer Protection

Banking is one of the most rigorously regulated of all sectors. Every aspect of a bank's operations from the start-up phase through to every single product and service and customer interaction is subject to strictly applied rules, highly complex regulations and authorisations.

Since the global financial crisis in 2009 a raft of legislation and accompanying guidelines have been introduced across the EU and its Member States. The banking regulation model in Ireland moved away from a principles-based to a rules-based approach with the majority of the rules around financial regulation and particularly capital requirements driven by the EU agenda.

The main rules governing banking regulation are the Capital Requirements Directive (CRD) and the Capital Requirements Regulation (CRR). These regulations, extensive in their breadth and their application by national authorities, range from capital requirement calculations to governance and fitness and probity for employees.

With the increased trend over the past decade towards digitalisation and focus on climate related risks as well as new customer demands, the regulatory agenda has deepened and expanded into other spheres, like data protection, cyber, fraud, money laundering and climate related disclosures. In most jurisdictions, financial services – and in particular banking – is shaped by a combination of regulations geared towards specific sectors and those which apply horizontally.

The Central Bank of Ireland along with the Single Supervisory Mechanism (SSM), which is part of the European Central Bank (ECB), supervise banks to ensure they abide by these rules and operate in a safe and prudential manner.

In Ireland, consumer protection in financial services is under the remit of the Central Bank of Ireland. The consumer protection regime in the Irish banking sector is one of the most comprehensive frameworks in Europe, with detailed guidance covering dealings with mortgage and SME customers along with statutory Consumer Protection Codes.

State investment in Irish retail banks

While State ownership has been a feature of the Irish retail banking sector for the past decade, the Government's strategy is to return banks to private ownership over time.

State support for the Irish retail banking sector was vital to ensuring the sector could continue to function through the crisis. Since then, the State has recouped a total of €19.2 billion in fees, dividends and income from disposals in the three retail banks (AIB, Bank of Ireland, PTSB), while the value of its remaining shares totalled €5.3 billion as of June 2021. The State has to date recovered 65% of its original investment in the three retail banks, excluding its €5.3 billion combined shareholding (as at June 2021). The inclusion of the €5.3 billion shareholdings brings the State's present day recovery value from the three banks to 83% of its original investment.[36]

The recent Government announcement of a sale of its remaining shareholding in one of the three main retail banks is a welcome move towards normalisation of the relationship between the Irish retail banks and the State.

36. gov.ie - State's Shareholding in Banks (www.gov.ie)

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Simultaneously meeting a diverse set of stakeholder needs

Banks must run their core functions effectively and efficiently whilst meeting a diverse set stakeholder needs.

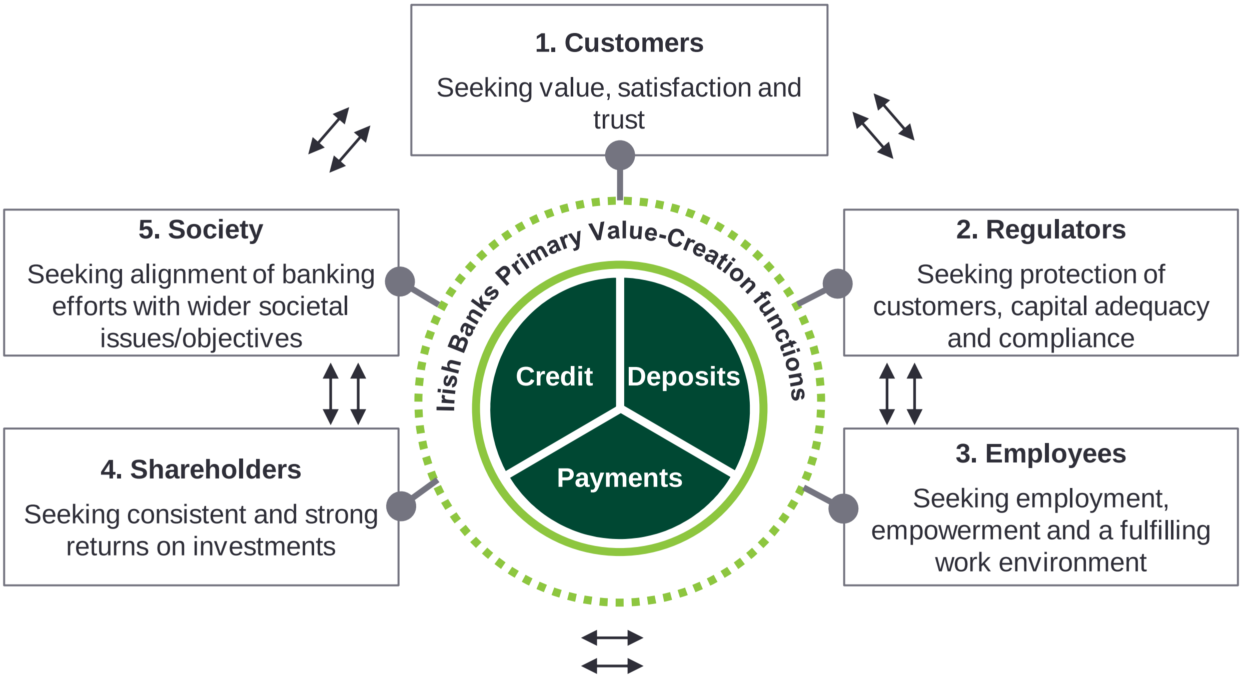
These stakeholders include:

- **Customers** seeking access, value, satisfaction, and trust
- **Regulators** seeking the protection of customers, capital adequacy and compliance
- **Employees** and future talent seeking employment, empowerment, and a strong work culture
- **Shareholders** seeking a return on equity invested and profitability
- **Society** seeking alignment of banking efforts to wider societal objectives

The primary challenge for Ireland's retail banking system is to run its core functions in a way that simultaneously achieves its own objectives while meeting the diverse needs of its stakeholders.

A banking system that creates sufficient financial surplus to continually balance and invest in all these areas is likely to drive a continuous cycle of economic stability, profitability, and growth.

Figure: The primary challenge for Irish Banks - Meeting the set of diverse stakeholder needs and objectives



Given the competing and differing perspectives of the various stakeholders, it is essential that any debate on the future of the retail banking sector in Ireland takes account of the framework upon which successful banking sectors globally are based.

Following a review of the best practice characteristics of banking systems globally[37], we see the future Irish retail banking sector being built on four core and mutually reinforcing pillars:

- **A purpose-led banking sector** which seeks to balance the expectations of customers, regulators, shareholders, and society and looks at prioritising long-term customer and societal value.
- **A viable banking sector** which delivers value for customers and is profitable and efficient in doing so. It inspires trust amongst customers, regulators, shareholders and society that it is efficient at generating the financial resources to further invest in product and service initiatives, crucial talent, proactive compliance and reporting obligations, and innovation.
- **A safe & stable banking** sector which is robust, secure, transparent, and acts in the best interests of the customer. It protects customer interests, complies with regulatory requirements, informs shareholders that there is sufficient capital to protect it against unexpected losses, and enables investment in innovation for future growth and sustainability.
- **A progressive banking sector** which continuously increases value for the customer and the shareholder through technology, analytics, talent, and other forms of innovation. It harnesses that innovation to propel purpose-led initiatives, makes individual banks more competitive, and responds to regulator, customer and shareholder demands in more effective ways.

The importance of each of these pillars is confirmed by existing papers published by economics and banking agencies such as the EBA, the IMF, and the Economist Intelligence Unit.

37. Review scope includes interviews with local and global banking sector experts as well as literature review on the topic of ways to improve functionality of national banking sectors

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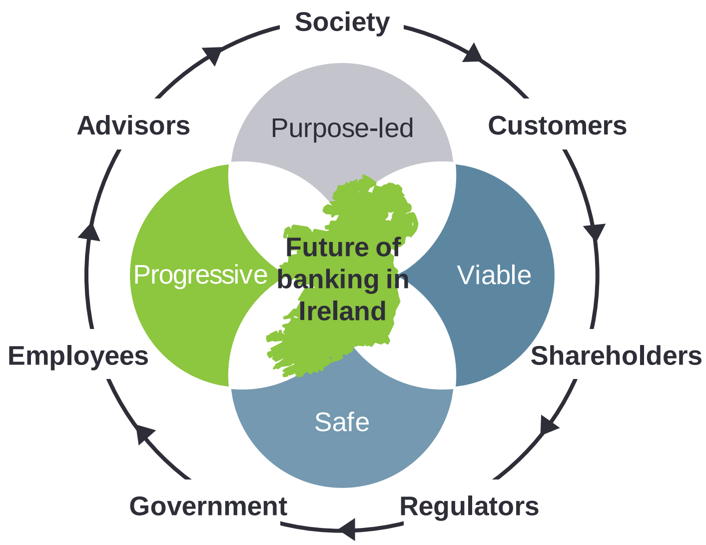
Figure: A new set of performance parameters that meet all stakeholder needs



Irish Banking sector is	Purpose-led	Viable	Safe & Stable	Progressive
Description	**A purpose-led banking sector** elicits trust, loyalty and legitimacy through delivery of long-term value generation in admirable ways	**A viable banking sector** delivers value for customers, is efficient and diversified in doing so, and effective at capital allocation	**A safe & stable banking sector** is robust, secure, transparent, has adequate capital, and acts in the best interests of the customer	**A progressive banking sector** continuously increases value delivered through technology, analytics or other forms of invention
Why	Without purpose and trust, the banking sector loses competitiveness and long term prospects	If the banking sector isn't profitable, it can't deliver its core mission	Without capital adequacy and controls, the banking sector faces liquidity and sustainability risks	If products and services fail to improve over time in a market economy, incumbents will face challenges in sustaining existence
How addresses all stakeholder needs	**A purpose-led banking sector** reassures customers, regulators, shareholders and society that the bank is prioritising long term customer and societal value ahead of short term gains	**A viable banking sector** inspires trust amongst customers, regulators, shareholders and society in that it is efficient at generating the financial resources to re-invest in purposeful initiatives, proactive compliance and innovations	**A safe banking sector** protects customer interests, provides comfort to the regulator and shareholders that there is sufficient capital to not have to draw down on this in times of need	**A progressive banking sector** will leverage its innovations to focus on purpose-led initiatives, make banks more competitive and respond to customer and shareholder demands in more effective ways

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The Irish retail banking Sector as "Purpose-led"

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We see purpose and trust being a core pillar underpinning the future of banking in Ireland

A Purpose-led retail banking sector

In compiling this report, we sought the views of a number of local and global industry experts on what exactly it means to be truly “purpose-led”. There was broad agreement that a purpose-led banking sector is one that commands loyalty as a result of long-term value generation delivered in admirable ways.

In being purpose-led, the banking sector:

- **Defines success over the long term:** Puts purpose and values at the centre of strategy, defining success not just in purely monetary terms but in the context of supporting longer-term sustainable performance and social value for customers, employees and society as a whole.
- **Elicits trust and belief:** Stakeholders trust and believe that the banking sector has the capability, capacity and conduct structures in place to do the right thing on behalf of customers, colleagues and the nation at large.

Why it’s needed

Companies across the world are seeking to run their businesses in a more holistic way which considers their impact on the full range of stakeholders [38]. This is at least in part a response to the increasing calls from individuals, shareholders, regulators and the public, for businesses of all types, including banks, to commit to a purpose that advances the wellbeing of consumers and society as well as of shareholders.

There are also sound business reasons for the move. Research carried out by Harvard Business Review Analytic Services in association with EY has found that organisations that operate with a clear and driving sense of purpose, beyond the singular goal of generating profits, outperformed the S&P 500 by a factor of 10 over a ten-year time frame as a result of increased customer loyalty, employee retention and investor confidence [39].

38. https://www.ey.com/en_ie/purpose/why-business-must-harness-the-power-of-purpose
39. https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/digital/ey-the-business-case-for-purpose.pdf

Against this backdrop, we see purpose and trust being a core pillar underpinning the future of banking in Ireland. Successful banks will be seen as partners who are trusted to do what is right for their customers and Irish society generally. Purpose and trust will also enable the banking sector to be competitive, enhance customer loyalty and ultimately, protect its long-term sustainability.

ESG focus

In recent years, Irish banks have increasingly come to recognise the importance of their social role, as evidenced by the growing emphasis on environmental, social and governance (ESG) factors. This is being driven further by the practical expectations of regulators and policy makers, alongside a greater understanding of long-term environmental risk factors, as well as by an increasing public understanding of the need to create a more sustainable economy.

A review of the leading Irish banks' latest annual reports reveals a shift towards ESG that marks them out as industry-leading, with Irish lenders featuring in the top 10%-15% of banks globally in this important area.[40] This focus extends beyond core products and services and includes targeted investment across a range of strategic initiatives related to climate action, economic inclusion and workforce diversity, with Irish banks committing billions of euro in Green Finance Funds in recent years.

Sustainable Finance and Green Lending

Irish retail banks have taken a leading role in supporting Ireland's ambitious target of achieving net-zero carbon emissions by 2050. This has led the sector to deliver a suite of accessible and attractive green products for customers.

Irish banks have also been proactive in publicly committing to their sustainability journeys, with a number signing the Low Carbon Pledge in 2018, and others going further in pledging to make their operations carbon neutral by 2030.

Through engagement with Business in the Community (BITC) on the Low Carbon Pledge, all Irish retail banks have committed to a sustainability strategy that includes the need to take account of the carbon emissions of their clients[41]. Irish banks will drive the green transition beyond financial services and across the entire economy.

Growing public awareness of climate change-related risks and shifting generational preferences are contributing to a changing social culture in which all finance will ultimately be Green Finance. This transition is already happening at pace for Irish banks, with the estimated 2021 supply of ESG issuance running at twice the 2020 rate in order to feed the increasing demand for such investments.

Irish banks will continue to reduce the direct impact of their own activities on the environment and will contribute to a more sustainable society through the provision of support and financial solutions for environmentally sound projects and companies. In addition, the wider Irish Financial Services Sector has a huge opportunity to make a significant contribution in supporting the Sustainable Finance market, as a hub for European and international finance.

40. Article - Irish Banks Leading the Charge: Are banks the new ESG gatekeepers, Goodbody Stockbrokerss
41. The Low Carbon Pledge (bitc.ie)

Building A Healthy Culture in Retail Banking

Irish retail banks have been investing significantly in their organisations and people to create an open, inclusive and growth culture. Diversity is celebrated, Speak Up Programmes for employees are now a major feature of how banks work, and culture is a strategic priority, making it an area of heightened focus for senior management and all colleagues.

Reflecting the many positive steps taken by banks to drive cultural change to achieve better and fairer outcomes for bank customers, the Irish Banking Culture Board's (IBCB) 'éist' survey of Bank Culture among bank staff shows progress is being made on cultural change across all IBCB member banks in the period since 2018.[42]

The findings, published earlier this year, clearly demonstrate a strong emphasis on the customer across all the retail banks while there has been a material improvement in employees' confidence levels in 'speaking up', which is core to an effective culture.

Staff across the sector reported improvements in how their organisation does business, with 85% considering that in their bank, people do business in an ethical manner, nine percentage points higher than the global financial services benchmark.

Customer trust is the bedrock upon which relationships are built, loyalty is obtained, and long-term performance is sustained. Recent external surveys have shown that the Irish banking sector has taken positive steps in terms of regaining the trust of the public. The annual Edelman Trust Barometer survey into public trust in financial services and banking has shown an increase of 27% in trust in the period from 2012 to 2020.[43]

An IBCB survey on Public Trust in Banking shows that 42% of those surveyed said they believed banks will play a critical role in Ireland's post-pandemic economic recovery, with further positive findings on trust levels in areas such as staff competency, handling of customer data, and the continuation of product services during Covid-19.

When it comes to the perception of their own individual bank, based on their personal experience, customers have a positive view. The average customer satisfaction rate across the industry is over 50%, with customer complaints trending significantly downwards.

This was reflected in industry research undertaken during the pandemic which saw the banks further build on customer satisfaction as a result of high levels of support for their personal and business customers. Consumer research carried out by BPFI during the first lockdown in May 2020 showed that a significant 57% of bank customers who said they had made contact with their bank in the early stages of the pandemic, stated that they were satisfied with the response from their bank.

Throughout the pandemic and beyond, the banks have continued to make investments in supporting their most vulnerable customers through initiatives like mortgage payment breaks. This was reflected in the CXi report which demonstrated that the financial sector's quick response to the Covid-19 crisis had had a very positive impact on its "I Trust You" score which increased by 12.3%, and its "You Fix Things" score which increased by 5.4%.[45]

Such findings reflect the banks' continued prioritisation of culture, trust and customer support in their day-to-day operations and strategic goals.

42. IBCB éist 2021 Survey of bank culture - Irish Banking Culture Board
43. 2021 Edelman Trust Barometer: Financial Services | Edelman
44. IBCB-2021-eist-Public-Trust-in-Banking-Survey-ONLINE-v2.pdf (irishbankingcultureboard.ie)
45. The CX Company - The CXi Ireland Customer Experience Report 2020

Governance & SEAR

Since the global financial crisis there has been a significant overhaul of the entire regulatory framework for banking, aimed at addressing past failings.

These key reforms, which include new rules and requirements in the area of governance and disclosures, have played an important role in improving transparency and accountability with regard to the decisions and actions of senior management, and their impact on the behaviour and culture across the entire organisation.

Substantial work has already been undertaken by Irish retail banks on standards, culture, governance, and individual accountability for staff and senior management, through the Fitness and Probity Regime, and by way of their own initiatives and prioritisation of culture and trust within the banks, as outlined earlier in this chapter.

The retail banks welcomed the Government's recent announcement on the introduction of an individual accountability framework including a senior executive accountability regime (SEAR).

The banks fully support the introduction of an individual accountability framework as part of a wider goal to develop the highest possible standards of conduct and culture across the banking sector. A similar framework in the United Kingdom shows how a regime of this type can operate effectively.

Cultural transformation takes time to achieve but the process of reform is well underway in Irish banking. The findings of the various reports reflect the efforts being made by the industry to effect cultural change in order to achieve better and fairer outcomes for bank customers and staff thereby repairing trust.

What trends will shape the future?

As we emerge from the Covid-19 pandemic, society faces fundamental questions regarding how we want to live in the future, how we want to rebuild our economy, and what kind of world we want to live in.

The banks play a vital role in recovering from the economic impact of Covid-19, contributing to Ireland's future economic growth, and in the transition to a greener and more sustainable environment.

A sustainable future includes addressing issues around climate, delivering an inclusive financial infrastructure, and supporting all customers at the critical stages throughout their life and business cycles.

The Opportunities and Challenges

Irish banks have demonstrated responsiveness and flexibility in support of the SME community during Covid-19 lockdowns via the provision of close to 40,000 payment breaks to Irish SMEs.[46] As we enter the post-pandemic phase, with State supports coming to an end, many SMEs will continue to be impacted by the after effects of the crisis and will require ongoing support.

The banking sector continues to work closely with those SMEs impacted by the pandemic, while also providing finance, lending and advisory services to sectors and businesses adapting and investing in order to secure growth opportunities.

The important mission to decarbonise the Irish economy and society is another area where banks will play a leading role. A wide range of regulatory and societal factors are prompting a re-evaluation of what is and is not a sustainable investment, resulting in a shift away from businesses engaged in heavy emissions activities and towards those that can help in the decarbonisation of the Irish economy.

Accessible green financing is a prerequisite for Ireland to meet its green targets, and banks in Ireland are already experienced in large-scale financing of renewable energy, the creation of innovative products to encourage green building and retrofitting, and the development of socially responsible investment funds.

Financial inclusion, financial literacy and overall financial wellness continue to pose challenges for Irish society. Just 55% of Irish people are deemed to be financially literate compared to 66% in Germany, 67% in the UK, and 71% in Sweden[47]. Moreover, the latest data from the CSO reveals that over four in ten Irish workers have no occupational or personal pension coverage to support them in retirement[48].

The Irish banking sector will continue to play its part in addressing these challenges and are already deploying their expertise to help educate and assist people in improving their financial literacy and overall financial wellbeing. An opportunity exists to not only improve the financial wellbeing of customers, but also of colleagues, and of small businesses which have a substantial impact on the ability of local communities to thrive.

46. https://bpfi.ie/publications/bpfi-payment-breaks-update-december-2020/
47. S&P Global FinLit Survey | Global Financial Literacy Excellence Center (GFLEC)
48. https://www.cso.ie/en/releasesandpublications/ep/p-syi/statisticalyearbookofireland2020/soc/pensioncoverage/

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The Irish retail banking sector as "Viable"

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The profitability of the Irish retail banking sector is among the lowest in Europe, measured in terms of return on equity, with Irish retail banks reporting an ROE of circa 2.6% for the first half of 2021 compared to a European average of circa 7.6% for the first quarter

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Ireland needs a viable retail banking sector

A viable banking sector is one that serves the core needs of the economy and is profitable while doing so. A viable banking sector delivers value to existing and potential shareholders while meeting customer demand and growing business. A viable retail banking sector must deliver products and services efficiently, optimally allocate capital to maximise return on investment, and generate income from a diverse range of sources.

Ireland needs a profitable banking sector which can fulfil its core mission of providing a wide breadth of credit, deposits and payments services to Irish business and society. A banking sector which isn't viable cannot reinvest profits in the other pillars of Purpose, Safety, and Progressiveness which is central to meeting the expectations of stakeholders.

Irish retail banking sector performance

Return on Equity (ROE) is the measure widely used by banks and shareholders to assess profitability. In general, it is agreed that an ROE of around 10% is a desirable return for investors in the global banking industry.

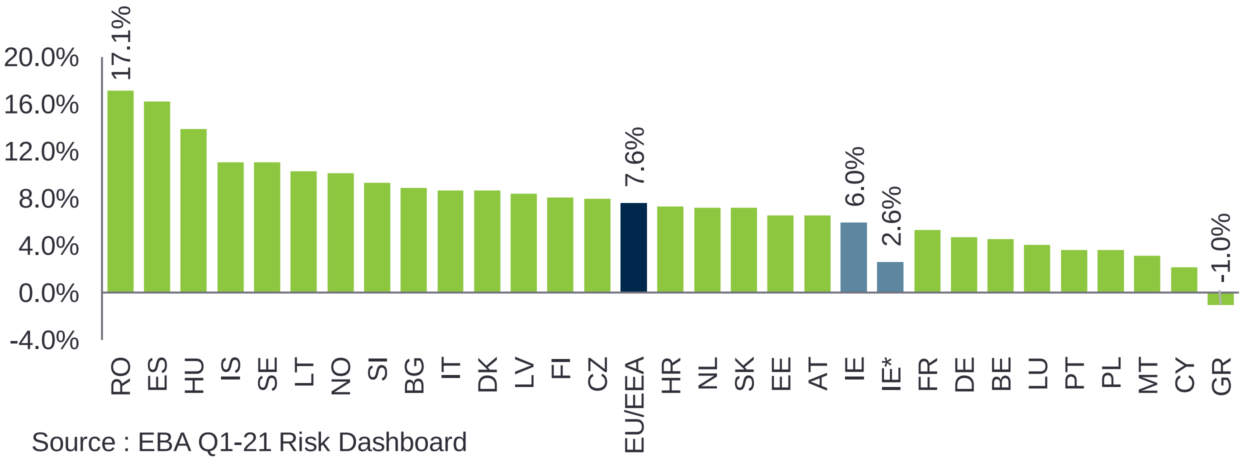
European and Global Profitability Trends

Worldwide, the average ROE for the top 50 global banks ranged between 9% and 12%[49] over the last decade with Canadian banks, for example, ranging between 13% and 19% in 2019[50].

At the European level, average profitability in the banking sector has been under pressure in recent years but there are significant variations between countries. The latest report by the European Banking Authority (EBA)[51] shows that average ROE in the EU banking sector was 7.6% for the period ended March 2021 but it ranged from a high of 17.1% to a low of -1.0%. Banks in Ireland, within the EBA coverage reported an ROE of 6% in Q1-21. However, the EBA study includes some of the international banks located in Ireland and supervised by the ECB SSM. Publicly available data from the Irish retail banks show that average ROE was only 2.6% as of first half of 2021.

The figures for Q1-21, show improvements versus 2020 but are heavily influenced by reduced impairment charges and in some cases write backs following significant impairment provisions during 2020.

Figure: EU Banking sector – Return on Equity for the period ended Q1-21



Source : EBA Q1-21 Risk Dashboard

IE includes international banks located in Ireland, supervised by the ECB SSM, and domestic retail banks
*IE is AIB, BoI and PTSB and is based on H1-21 publicly disclosed data.

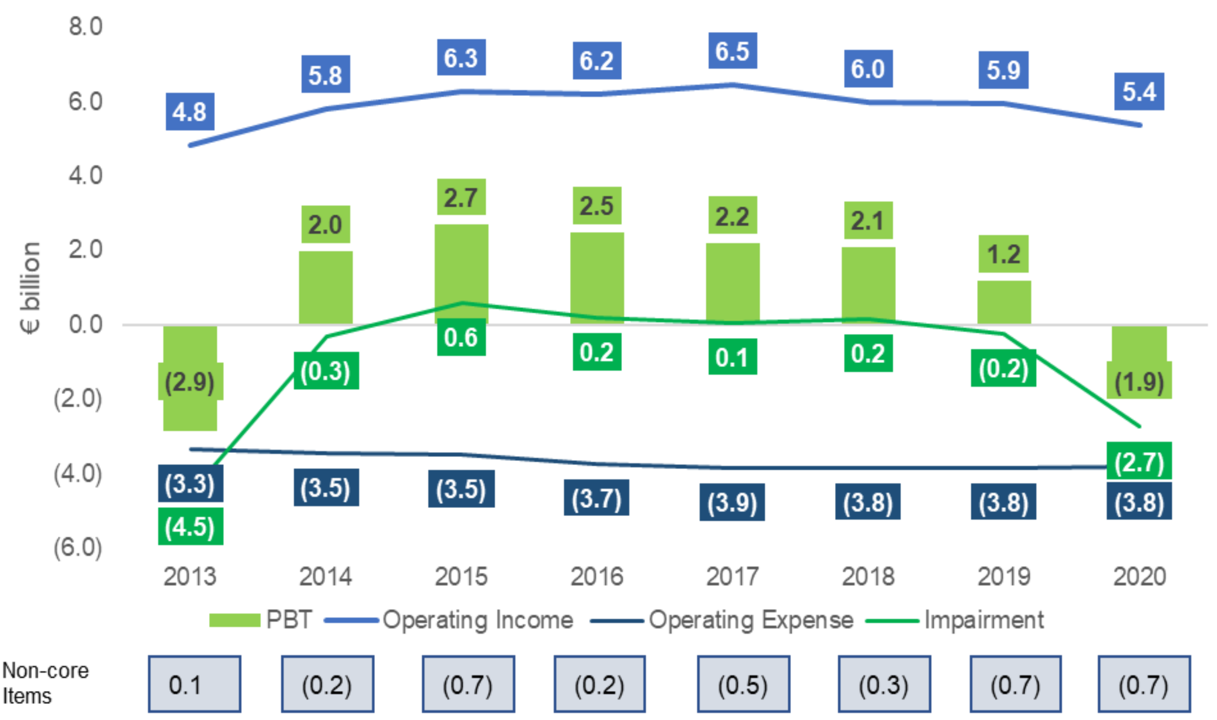
49. Why global banking profitability will remain a challenge in 2020 | EY Ireland
50. Canadian banks' return on equity (thomsonreuters.com
51. Risk Dashboard | European Banking Authority (europa.eu) (Selection return on equity)

Irish retail banking sector profitability trends

Between 2014 and 2019, Irish retail banks reported single digit ROE, averaging c.7%[52], which was above the European average of c. 5%[53] for that period. The ROE improvement for the Irish banks in the early part of that period, until 2016, however, was largely attributable to lower impairments, write backs and one-off events.

From 2016, low interest rates, declining loan portfolios and increased competition combined to then reduce profitability while operating costs remained high. Over the last two years, the continuing decline in operating income, high operating costs and additional impairments have contributed to a further deterioration in ROE in Irish retail banks.

Figure: Trend in profitability of Irish retail banks, 2013 to 2020



Source: EY calculations based on annual reports for AIB, BoI and PTSB.

Note: The operating income and expense reported above, are underlying figures. Any non-core items for each period are reported separately below the graph.

52. Figures compiled from publicly available annual accounts for Irish retail banks (AIB, BoI and PTSB)
53. https://www.ebf.eu/wp-content/uploads/2020/11/EBF_043537-Banking-in-Europe-EBF-Facts-and-Figures-2020.pdf

Turning to the exceptional year of 2020, Domestic Irish retail banks' ROE fell to a low of c.-7%[54] due to ongoing structural profitability challenges as well as impairments linked to the Covid-19 crisis. We have seen improvements in the first half of 2021 with the ROE recovering to 2.6%[55]. A main driver of the improvements in 2021 being a reduction in the size of the impairment provision recognised.

Key drivers and trends impacting retail bank profitability in Ireland

The main factors affecting income and costs in the Irish retail banking sector are:

1. Income drivers
2. Risk cost drivers including capital requirements
3. Operating expense drivers including regulatory costs, labour costs and IT investment

1. Income drivers

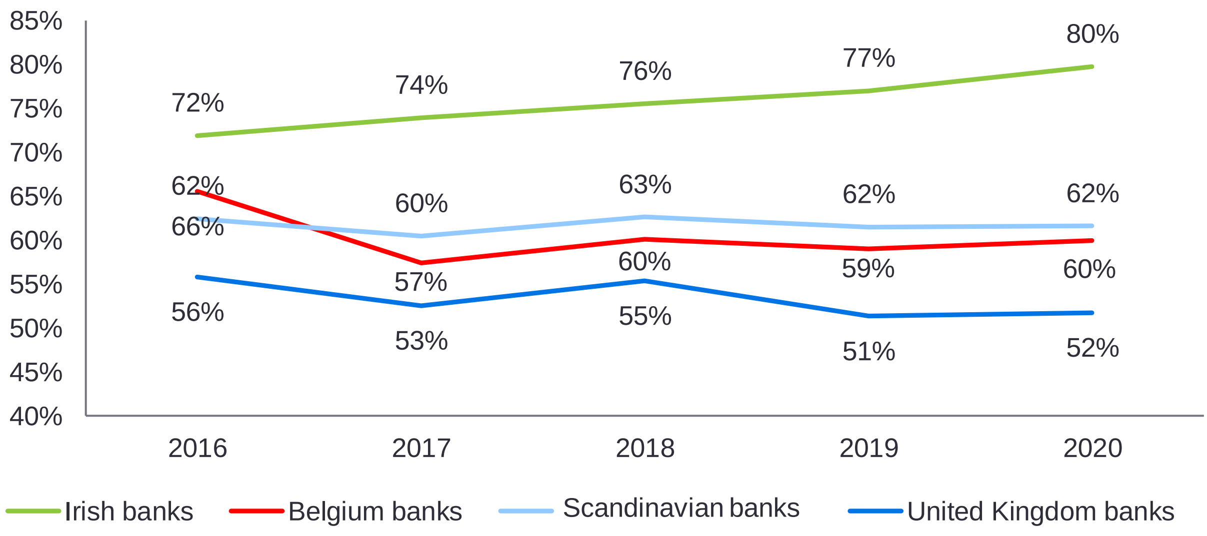
a. High dependence on Net Interest Income as a source of Income.

Irish banks are heavily dependent on interest income for their profitability, and this has been negatively impacted by the historically low interest rate environment which has prevailed for almost a decade now.

Irish banks have a far higher dependence on Net Interest Income (NII) than their European peers. On average in the EU banking sector, Net Interest Income accounts for 54%[56] of total operating income compared to 80% for retail banks in Ireland. Looking at banks within similar sized countries such as Belgium and some Scandinavian countries the figures are c 60%[57].

EU banks rely more on Other Income as a source of revenue, including fees to customers and trading income.

Figure: NII as a % of Operating Income, 2016 to 2020



Source: S&P Global data for Non Irish Banks and published financial figures for Irish retail Banks

54. Figures compiled from publicly available annual accounts for Irish retail banks (AIB, BoI and PTSB)
55. Interim accounts 2021 for AIB, BoI and PTSB
56. EBA Interactive dashboard Q1-21
57. Source: S&P Global as of 6 May 2021

b. Low Interest Rate environment and increase in liquidity.

Central bank monetary policy is one of the most significant influencing factors on different interest rates in the market. In general, central banks use interest rates in order to manage inflation and growth. In the case of the ECB, its main objective is price stability. In response to exceptionally low inflation, the ECB cut interest rates to zero in 2012 and since June 2014 the rate on the deposit facility has been negative[58]. Any excess funds the banks have, are placed with the ECB at the prevailing negative rate.

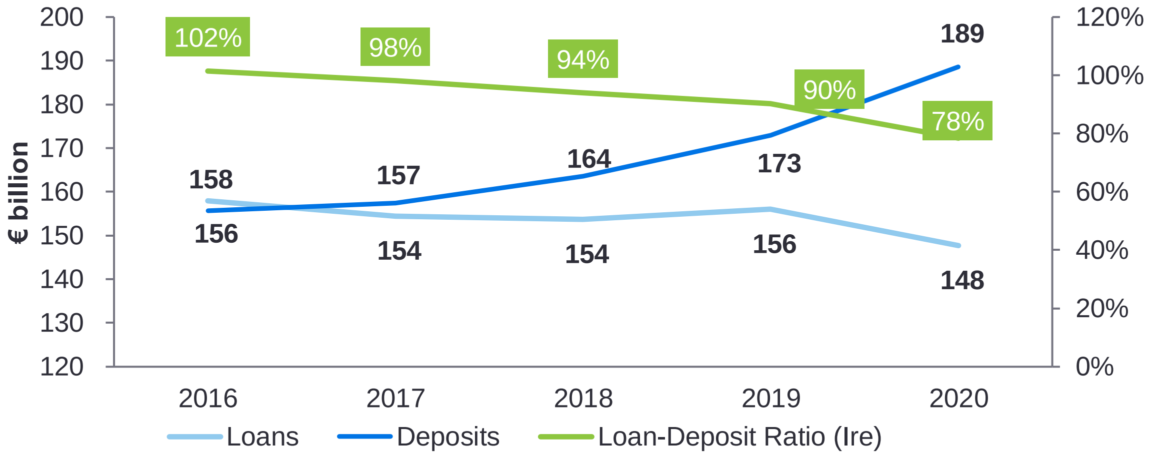
While the negative rate policy has been in place for the past seven years some Irish banks have only recently passed on negative rates to their own customers meaning this additional cost was absorbed by the retail banks to that point. According to official comments, which were reported on in May and August of this year some Irish retail banks have indicated that negative rates will apply to all deposits with balances in excess of €1 million[59] from 2021. On the other hand, in other European jurisdictions, banks start charging negative rates at much lower levels of deposits. Almost all banks in Denmark charge a negative interest on retail deposits over a certain threshold, which is around €34,000. Recent Standards and Poor analysis show that between 40% to 50% of retails deposits in Denmark are subject to negative rates[60]. In November 2020, Starling Bank became the first UK bank to introduce negative interest rates for Euro denominated personal accounts, on balances over €50,000[61]. Around three hundred banks in Germany charge negative interest rates, with the most common type of accounts showing balances above €100,000[62].

Also, during the pandemic, Irish retail banks recorded significant growth in their customer deposits. This has created excess liquidity (cash) in the Irish banking system. Due to muted demand for new credit, Irish banks were not able to turn this excess liquidity into viable lending propositions which has in turn caused the Irish retail banks to increase the amount on deposit with the ECB at negative rates of return. This has been highly costly for Irish retail banks. The increase in household deposits in Ireland was, on a proportional basis, among the highest in Europe.

In addition, redemptions of existing loans outpaced the demand for new credit. As a result, the average loan-to-deposit ratio in Ireland has reduced from 102% in 2016 to 78% in 2020[63], significantly lower than the European average of 107% in December 2020[64].

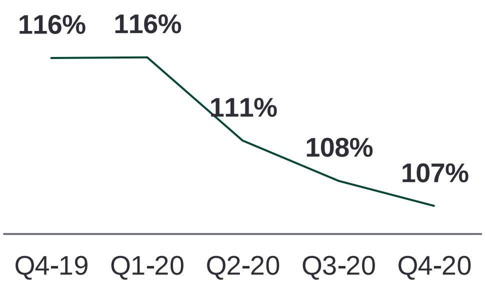
58. Key ECB interest rates (europa.eu)
59. RTE article 4th August 2021 - AIB Irish Times article May-21- BoI
60. https://www.spglobal.com/- Negative Interest rates in Denmark Banking sector
61. Thisismoney.co.uk - Starling the first British bank to charge negative interest rates
62. FT Article – Negative rates on Corporate clients in Germany (Jan 29th 2021)
63. Figures compiled from publicly available annual accounts for Irish retail banks
64. https://www.bankingsupervision.europa.eu/banking/statistics/html/index.en.html

Figure: Trend in customer loans, deposits and loan-deposit ratio, Irish retail banks, 2016 to 2020



Source: EY calculations based on annual reports for AIB, BoI and PTSB

Figure: A similar trend emerged in Europe regarding the loan-deposit ratio during 2020



Source: ECB Supervisory Banking Statistics

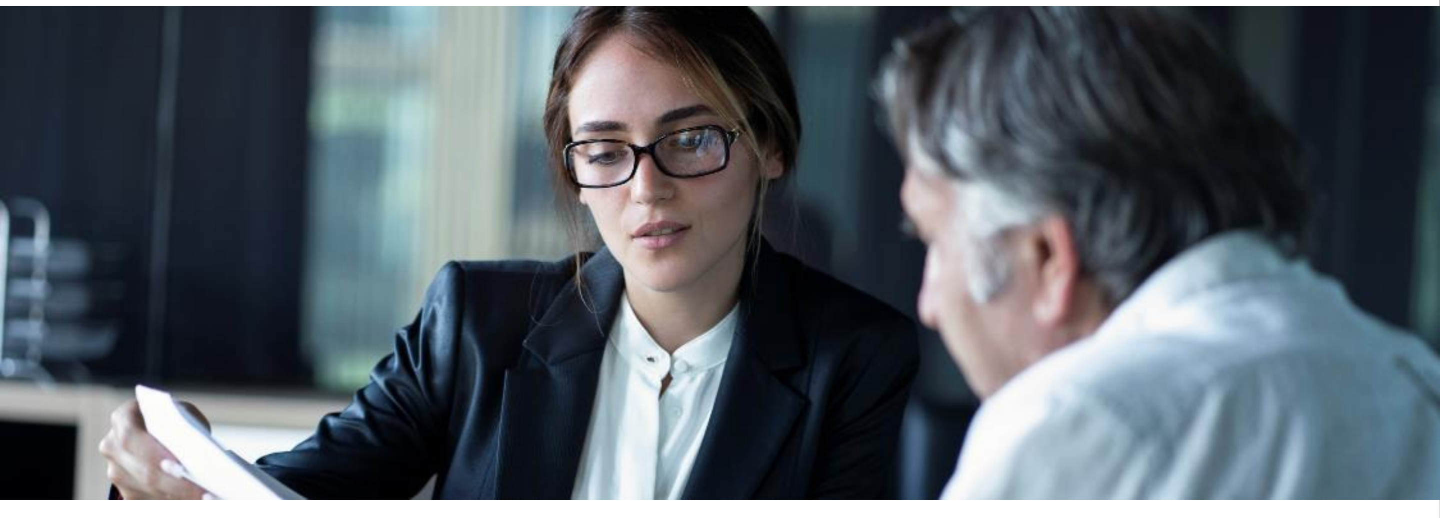
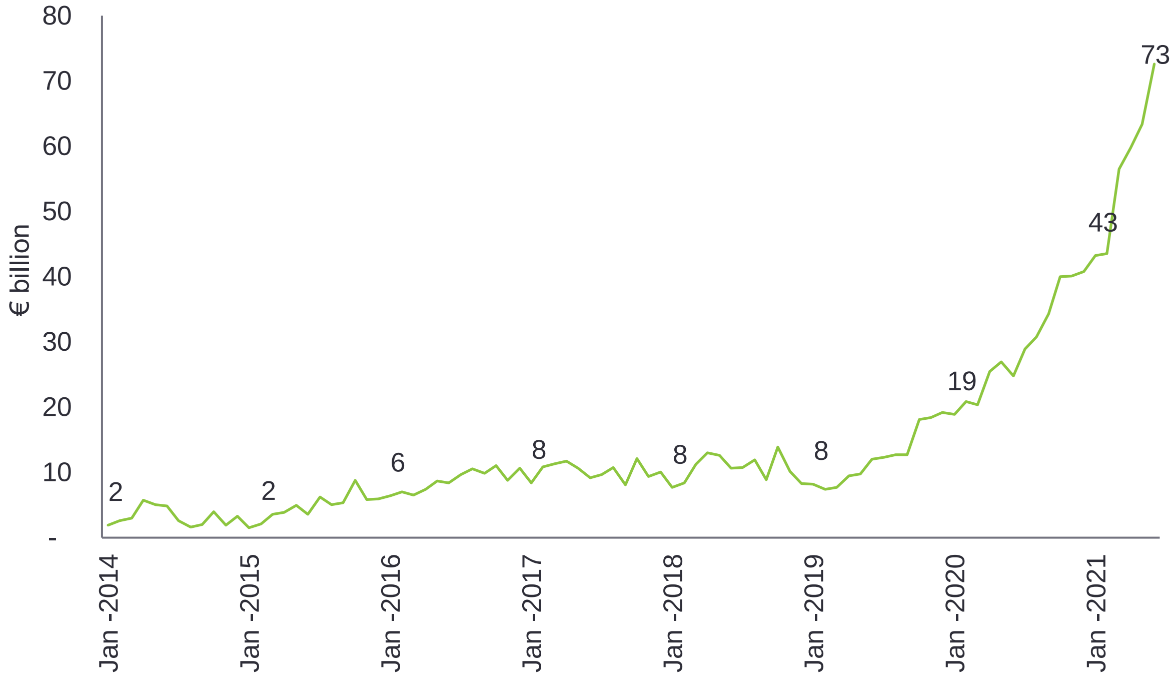


Figure: Deposits of Banks Serving the Domestic Irish Market with the Eurosystem, 2014 to 2021



Source: Central Bank of Ireland, Credit, Money and Banking Statistics, Table A4.1

c. Increased competition from non-traditional players

The emergence of digital banking and FinTech competitors in addition to non-bank lenders have changed the banking landscape. We have also seen a major change in the holistic approach to banking as niche players enter the market and we see the unbundling of what were traditionally 'bank only' services and products.

In the mortgage market, there is growing competition from new entrants such as Finance Ireland, Dilosk, and Avant Money. In addition, some Credit Unions plan to enter the mortgage market subject to regulatory approvals and limits.

There has also been increasing competition in the payments services, with new FinTech possibly moving into the space of personal lending and credit cards. For example, in June of this year, EMI Revolut announced plans to offer credit cards and loans to Irish customers by the end of the year, possibly in partnership with other financial providers as it applies for its banking licence in Ireland.

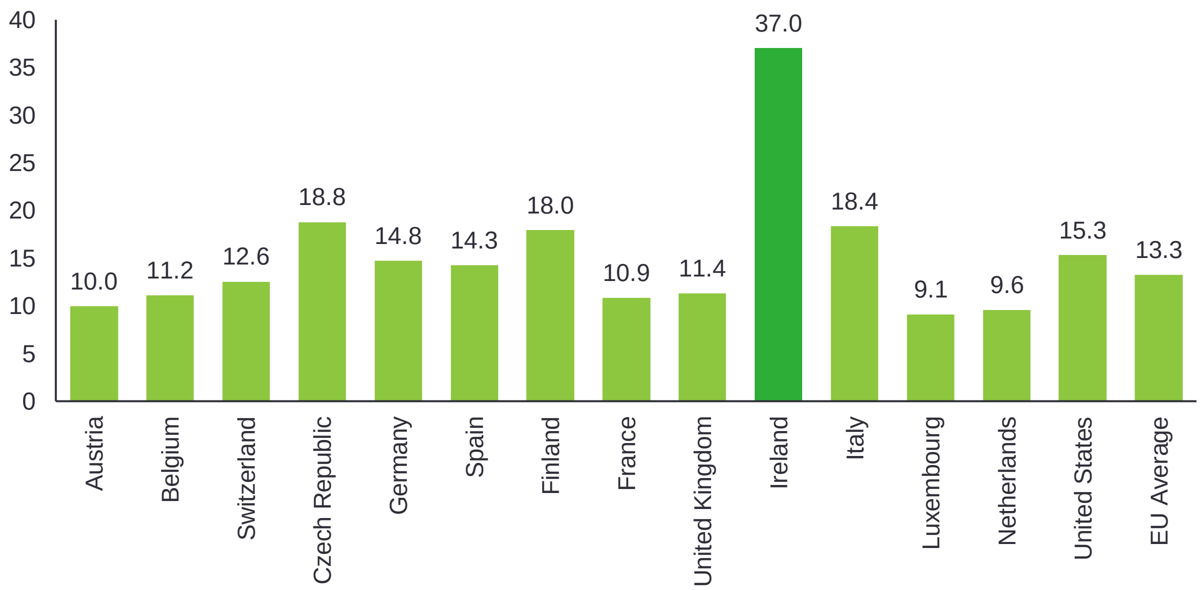
2. Risk Cost Drivers

a. Capital Requirements

Irish banks face more onerous capital requirements than their European counterparts particularly for mortgage lending resulting in higher costs for these products. Capital requirements are rules that compel banks to maintain a minimum ratio of capital to assets. In other words, banks need to hold a certain amount of capital for each loan they issue so that they can sustain unexpected losses in the event that the loans are not repaid.

Figure: IRB RWA Density % - 2020 Q1/FY 2019

Comparable Banking Sectors Residential Mortgages (2020 Q1/FY 2019)



Source: BPFI report - Irish Mortgage RWA Density Analysis Project January 2021

A recent study undertaken by the BPFI[65] on Irish Mortgage RWA Densities revealed that capital requirements for Irish banks are three times the European average. This represents a €2.5 billion additional equity requirement for unexpected losses in mortgages amongst Irish banks, compared to EU averages.

This extra capital held by the Irish retail banks is an additional cost factor which impacts banks' pricing of products and services. In addition, as this extra level of capital is seen as "trapped capital" by investors, it is likely to have a negative effect on the share valuation of retail banks, where the State still has significant ownership.

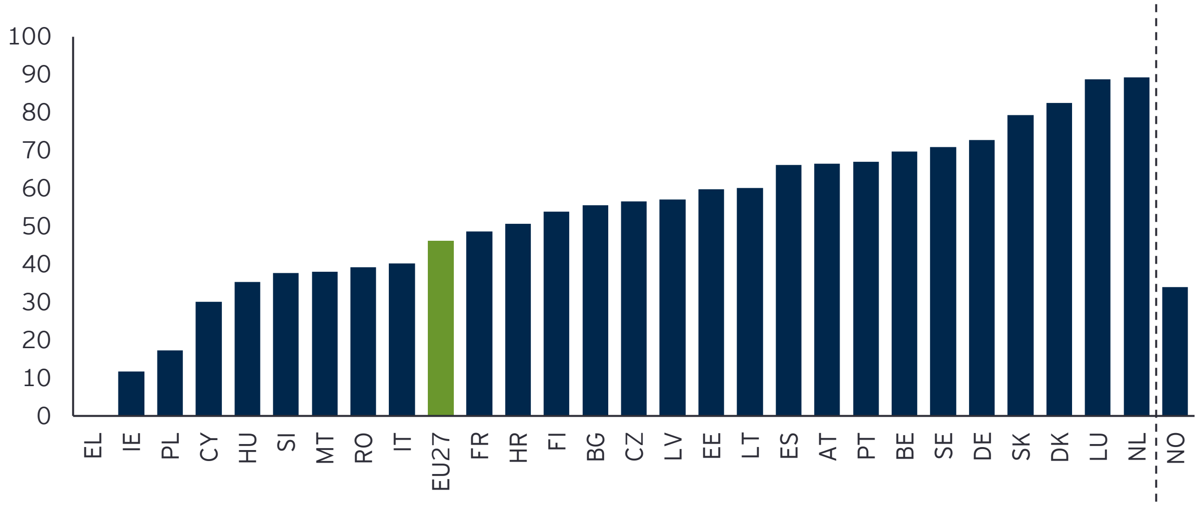
65. BPFI RWA report "Irish Mortgage RWA Density Analysis Project Report"

b. Restrictive enforcement of security compared to EU countries

It remains extremely costly, and takes a disproportionately long time, to repossess a property in Ireland where borrowers have not met their contractual mortgage arrangements over a prolonged period.

Recent research by the EBA confirms that Ireland has one of the lowest rates in Europe for the recovery of security for mortgages under judicial processes, at just 11% compared to a European average of 46%. The combination of legal costs, time to recover repossessed properties, and lack of success in securing collateral plays a key role in driving up the level of capital required for unexpected losses in the Irish mortgage pool. This ultimately drives up the cost of Irish mortgages for both the banks who supply mortgages and the borrowers.

Figure: EU benchmark, gross recovery rate (%), simple average for each EU Member State – Residential Real Estate Loans



Source: European Banking Authority, Report on the Benchmarking of National Loan Enforcement Frameworks

3. Operating Expense Drivers

In the face of income challenges as mentioned earlier in this chapter, Irish banks, as has been the case in banking across the EU, have focused on reducing operating expenses as a means of improving profitability in recent years. However, analysis from a sample of Irish banks reveals that costs, as a proportion of income, have actually risen year on year between 2016 and 2020.

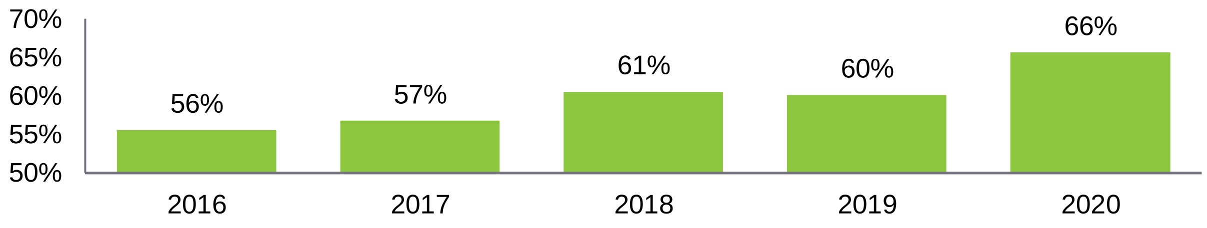
Although the increase was primarily driven by downward pressure on income due to lower interest rates and surplus liquidity in the system, operating expenses, excluding exceptional items, showed little change over the past three years, ranging from an increase of 0.1% to a decrease of 0.6% per annum as shown in the graph on Irish retail banks Operating expenses 2016 – 2020 below.

Banking sectors across the EU moved to reduce the main component of their operating costs (i.e., staff and number of branches), however on average, the decrease in these costs was lower in Ireland than in other EU countries, as outlined below.

In addition to traditional operating expenses, banks have also been investing significantly in IT, innovation and FinTech collaboration, in order to meet customer demands for digitalisation, compliance and reporting requirements, and to meet head on competition from new entrants into an increasingly diversified financial services market.

The sheer scale and weight of the operating costs for Irish retail banks including regulation, innovation/IT and labour costs relative to the size of the market in which Irish retail banks operate are having major impacts on the profitability of Irish banks, an impact deemed to have influenced the decision of two retail banks in early 2021 to depart the retail banking market. In essence, such high levels of fixed costs have impacted Irish banks profitability, their return on equity to shareholders and the effectiveness of their return on capital held.

Figure: Underlying Cost Income Ratio for Irish retail banks, 2016 to 2020



Source: EY calculations based on annual reports for AIB, BoI and PTSB

Figure: Operating Expenses of Irish retail banks, 2016 to 2020

Source: EY calculations based on annual reports for AIB, BoI and PTSB

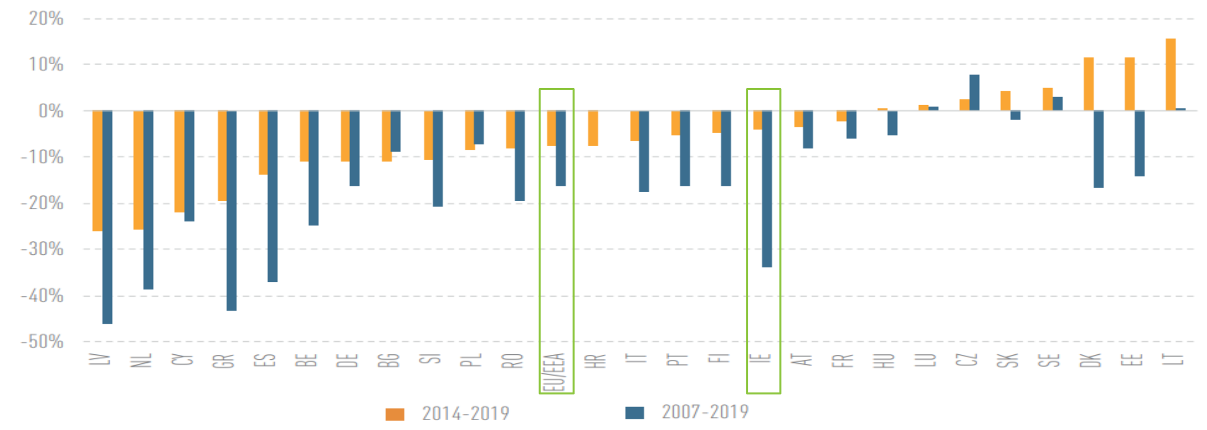
Headline operating expenses are reported as part of the consolidated financial statement Underlying costs exclude any exceptional or non-core items.

a. Labour Costs & Branch Network

The main component of operating expenses involves labour costs, typically representing over 50% of total operating costs in European banks. Although significant reductions in staff volumes were seen amongst Irish banks following the financial crisis, further reductions have been limited between 2014-2019. Overall, there was a reduction in staff numbers of around 3% in Irish banks within this timeframe compared to a European average of approximately 7%[68].

The reduction in the number of branches has also been below the European average during the same period. In Ireland, the number of branches reduced by 11%, while in Europe the average was just under 20%[66].

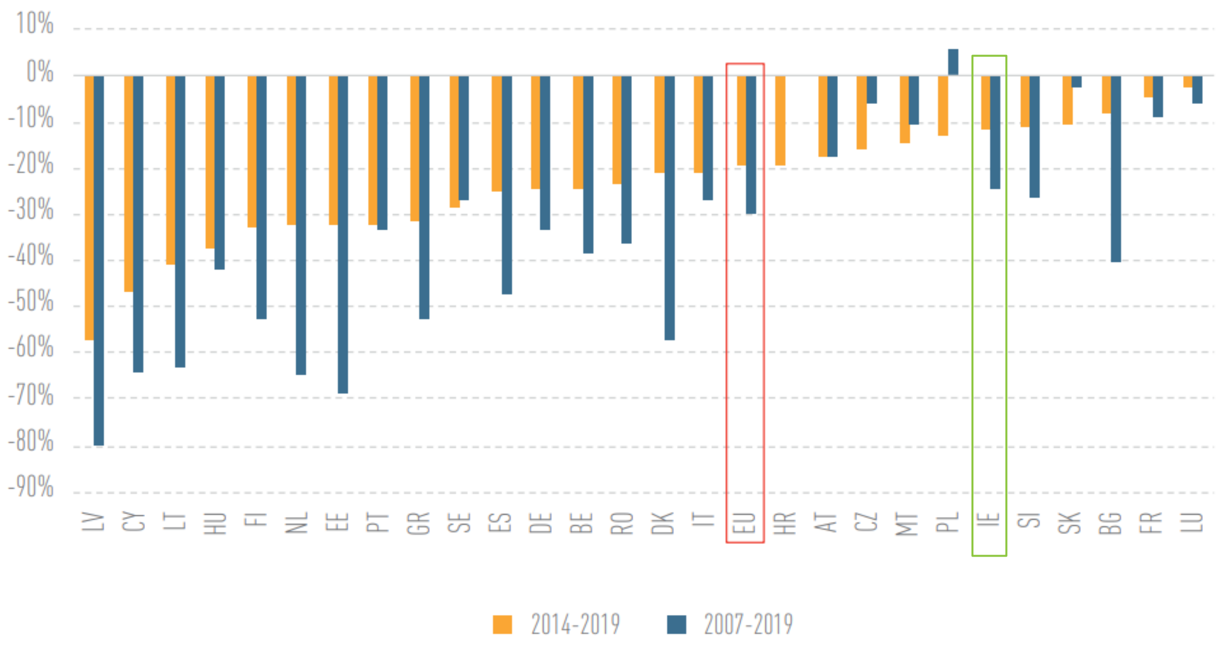
Figure: Variation in number of bank employees by European country, 2014 to 2019



Source: EBA publication Risk Assessment of the European banking system Dec-20

66. Risk Assessment of the European Banking System - December 2020 (europa.eu)

Figure: Variation in number of branches by European country, 2014 to 2019



Source: EBA publication Risk Assessment of the European banking system Dec-20

b. Regulatory costs

The European banking sector has become increasingly costly to operate in, particularly when it comes to compliance and reporting activities. In addition, Irish retail banks incur an annual CBI Funding Levy, which is paid by regulated financial service providers to fund the cost of financial regulatory and supervisory (compliance and reporting) activities. Other fees for the retail banks include an annual contribution which funds the Deposit Guarantee Scheme (DGS)[67] as well as the Single Resolution Fund, which together, protects depositors if the bank fails and ensures the stability of the financial system.

There are a number of regulatory frameworks that Irish retail banks, given their product suites, must operate under and these are explored further in Section 6 – Safe & Financially Stable.

67. Deposit Guarantee Schemes data | European Banking Authority (europa.eu)

What trends will shape the future viability of retail banks?

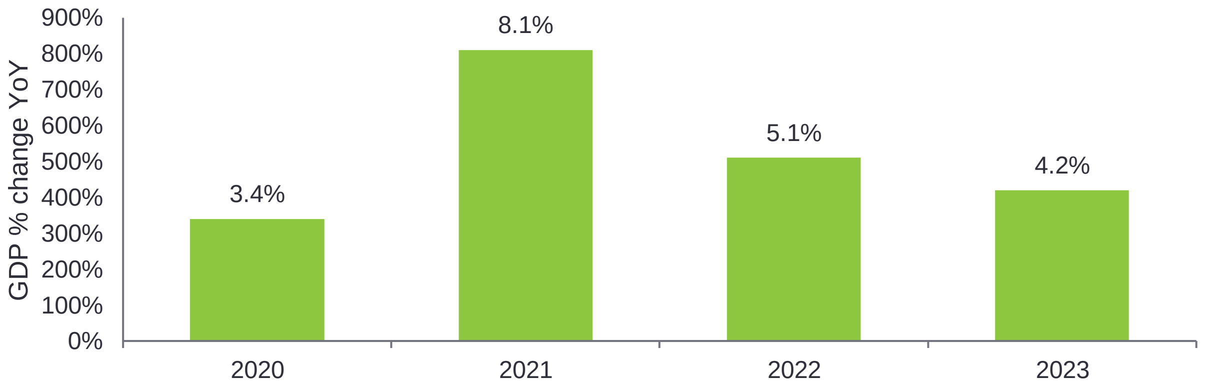
As we shift our attention to the future, we see a number of trends that will shape the viability of the banking sector in Ireland. These include but are not limited to; Ireland's macroeconomic outlook, the interest rate environment, shifting competitive dynamics and accelerated technology disruption.

a. Positive macroeconomic outlook paving the way for an economic recovery

As we look ahead towards 2021 and beyond, the viability of Ireland's banking sector is dependent on the country's broader macroeconomic outlook. The pandemic remains the key determinant of this outlook and similar to the rest of the Euro area, progress on vaccinations offers hope of a return to normality and an associated recovery in economic activity.

EY's own macroeconomic forecasts are based on restrictions being lifted across the country by the end of 2021 and remaining so into 2022. On this basis, GDP is forecast to grow by 8.1% in 2021, followed by growth rates of 5.1% and 4.2% in 2022 and 2023 respectively, fuelled by a strong export sector, the re-opening of the economy and significant accumulated private sector deposits supporting strong consumer growth[68].

Figure: EY growth forecasts (GDP), Republic of Ireland, 2020 to 2023



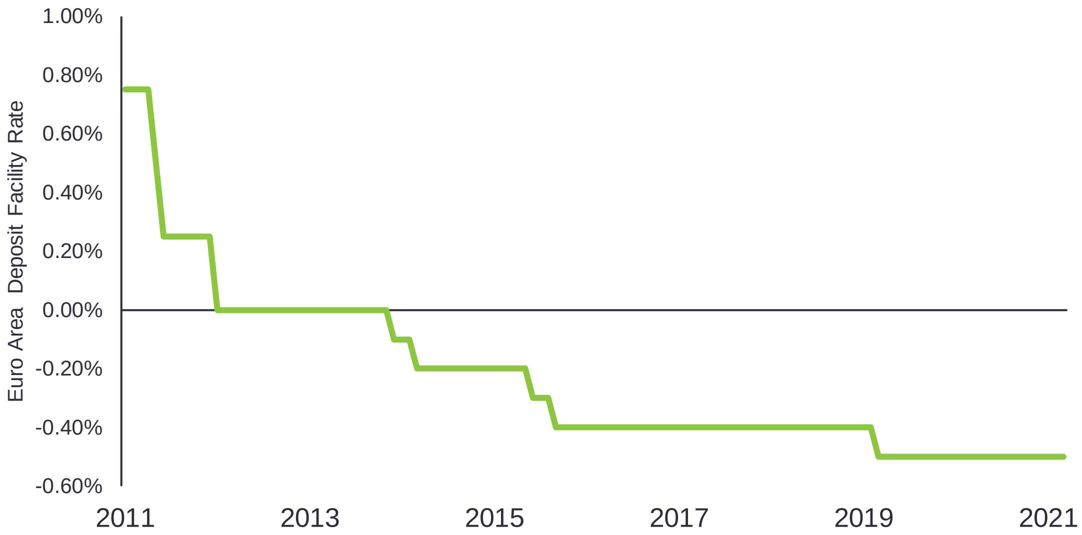
Source: EY Economic Guidance Team

b. Continued low interest rate environment sustaining margin pressures

The response of central banks to Covid-19 will likely involve prolonging ultra-low or negative interest rates. This will fuel further margin compression in the short to medium term, requiring Irish banks to increase investment in cost reduction measures, digitalisation and productivity improvements as well as investing in diversification in order to maintain margins and profitability. At the end July 2021, the ECB made clear that it would continue its negative interest rate policy into the future, with expectations that this could now run for some years to come.

68. EY Economics Guidance team – Autumn Forecast 2021 (Unpublished as at 22/09/21)

Figure: Euro area Interest Rate trends, 2012 to 2021



Source: European Central Bank via Trading Economics

c. Continued new sources of competition

The growing suite of banking regulation and associated cost of compliance has increased the overall cost differential between regulated and unregulated capital in recent years. This has resulted in a significant competitive advantage for non-traditional providers of credit both globally and locally, in contrast to the all-embracing model of the traditional retail banks.

We expect this trend to accelerate as the rebuilding of the Irish economy post-Covid-19 will require fresh sources of credit. For the pillar banks, the rise of alternative capital providers brings into question a number of issues: their position as credit providers rather than intermediaries; the manner in which banking business and funding models will evolve in the future; and the overall question of how banks will compete in the broader financial services ecosystem.

Figure: Analysis of the competitive landscape

Source: EY analysis

d. Retail banking business model evolving and changing

Banking in Ireland has traditionally been a vertically integrated business, whereby the pillar banks have distributed their products through their own channels and have fulfilled all transaction and support services in-house.

Up to now, the majority of Irish banks have focused on improving and digitalising these services and products in order to improve the customer experience, decrease costs and manage risks.

Disruptive trends such as the entry of niche players to the market, the advent of new technologies such as cloud computing, and the introduction of open banking requirements have led to the unbundling of banking products and services as well as core value chain components such as product development, distribution, operations.

This has resulted in more and more players specialising in individual product areas, customer segments and service offerings. This trend in specialisation is expected to accelerate due to the scale and scope it offers, thereby requiring a reassessment of the once traditional universal banking model for Irish retail banks.

Opportunities and challenges for Irish retail banks

This changing landscape brings many challenges and uncertainties, but it also presents a unique opportunity for our banks to transform themselves and ensure the ongoing viability of their business models and operations. An opportunity to become leaner and grow at the same time. An opportunity to collaborate and pursue partnerships as an avenue for growth. An opportunity to connect more deeply with customers via new product sets and offerings.

There are two key areas where banks can improve their viability: (1) cost reductions and (2) income growth and diversification.

1. Cost reduction

The scale of the challenges being faced means banks need to think differently about cost transformation and consider what their entire future cost base might look like across their core business and operating models.

This should be looked at in terms of operational and structural cost reductions.

(a) Operational Cost reduction

Operational cost reductions include the actions banks can take to optimise their current cost structures across existing operations. The shift to remote and flexible working and the changes in customer behaviour brought about by the pandemic may provide the basis for cost reductions in terms of cuts to property overheads and so on.

The new flexible working model can also position banks to better match future customer and work demands, while retaining a competitive edge in the talent market.

Covid-19 has accelerated longstanding consumer and business shifts away from the branch and toward digital channels. Digital will become the default channel for most customers. The dramatic decline in customer demand for cash facilities and the increased demand for online and mobile banking is likely to lead to branch networks evolving to serve customers' more complex needs.

(b) Structural Cost reductions

This is the set of cost transformation actions banks can take to fundamentally alter how their services are delivered.

The banking sector may also consider the establishment of cross-sector utilities as a way to achieve cost efficiencies at scale. Deploying shared utilities and services, in areas that do not provide a material competitive advantage, such as anti-money laundering (AML) or know-your-customer (KYC) checks, for example, offers an opportunity to both reduce costs and achieve greater scalability.

(2) Expansion and diversification opportunities

The extent of sector disruption will compel incumbent banks to reassess their business models, making strategic decisions about what set of products and services they will offer in the market to generate value for customers and expand their own income sources. This would help address the over dependence on Net Interest Income (NII) for the Irish retail banks as discussed above.

The wealth management and private banking space presents strong income expansion potential. We have already started to see some significant activity in this space in recent months, with AIB announcing the acquisition of Goodbody, and Bank of Ireland announcing an agreement to acquire Davy Stockbrokers (subject to regulatory approval). We expect this type of activity to continue with the aim of portfolio diversification and reducing Irish banks' current high dependency on interest income.

In seeking out expansion and diversification opportunities, banks will need to play to their strengths whilst availing of the opportunities that specialisation and partnerships offer. We see a number of new and distinct banking business models emerging, with banks shaping their income generation choices around two key dimensions: customer access and the value chain.

Banks can differentiate themselves through effective customer access across the customer interface and distribution process and can achieve a competitive advantage through specialisations and efficiencies across key sections of the banking value chain.

7

The Irish retail banking sector as "Safe & Stable"

> "The regulatory agenda will be sustained, across an increasingly diverse range of priorities including the green agenda, financial crime and operational resilience

Ireland needs a safe and stable retail banking sector

A safe banking sector is one that is robust, secure, transparent, and acts in the best interests of the customer. This means that it:

- **Has adequate capital** to protect against unexpected events and liquidity risk as well as the credit risk that banks are exposed to in the normal course of their business
- **Protects customers** against threats such as credit risk, financial crime, cyberattacks, data breaches, etc.
- **Is resilient** in the face of economic, operational and third-party shocks
- **Meets all regulatory obligations** in a proactive, compliant and efficient manner

Banks need to anticipate and manage risks to ensure a safe and financially secure banking environment for their customers, shareholders, the economy, and society at large. Capital is a key ingredient underpinning effective risk management across the banking sector. Capital acts as a cushion against losses in the event of an economic shock. It enables banks to use their own resources to absorb the losses, continue to operate and serve their customers.

What progress have Irish retail banks made up to now?

Irish banks have made significant progress in terms of capital reserves and asset quality in recent years. The Common Equity Tier 1 (CET 1) ratio for Irish banks, a measure of banks' ability to remain solvent during a financial crisis, stood at 18.8% as of fourth quarter 2020 according to ECB data. This is above the European average of 15.62% and is fourth highest of the EU countries surveyed[69].

Irish retail banks have also shown significant improvement in terms of both the level of capital held and sensitivity of this capital to various macroeconomic changes under stress scenarios, as evidenced in the results of the EBA stress test carried out. The outcome of the EBA stress test does demonstrate the resilience of the Irish retail banks capital levels (CET1 ratios) to a significant negative scenario[70].

This strong capital position enabled the Irish banking sector to continue lending activity to support the economy during the pandemic.

However, while capital plays a critical role in the stability of the banking system, particularly at a time of economic crisis, excessively high capital requirements can and do impact the costs of providing credit to customers. This is seen clearly in the case of the mortgage loan book, where banks in Ireland have a much higher risk weighted asset base particularly for residential mortgages, which further increases the amount of capital to be held against these products.

69 .https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.supervisorybankingstatistics_fourth_quarter_2020_202104~5f2a05de9f.en.pdf
70 .EBA publishes the results of its 2021 EU-wide stress test | European Banking Authority (europa.eu)

Table: Total capital ratio and its components by country – Q4 2020
(EUR billions; percentage)

Country (Q4 2020)	Total risk exposure amount	Total Capital [2]		Tier 1 [2]		CET1 [2 3]	
		Amount	Ratio	Amount	Ratio	Amount	Ratio
Belgium	185.28	41.84	22.58%	37.91	20.46%	35.83	19.34%
Bulgaria	c	c	c	c	c	c	c
Germany	1,193.29	238.17	19.96%	206.03	17.27%	189.43	15.87%
Estonia	14.45	4.22	29.17%	4.21	29.14%	4.21	29.14%
Ireland	225.01	50.41	22.40%	45.13	20.06%	42.47	18.88%
Greece	165.38	27.71	16.76%	25.01	15.12%	25.01	15.12%
Spain	1,381.08	230.43	16.68%	199.67	14.46%	178.30	12.91%
France	2,588.18	504.17	19.48%	438.74	16.95%	412.01	15.92%
Croatia[1]	—	—	—	—	—	—	—
Italy	1,013.39	197.98	19.54%	172.95	17.07%	157.06	15.50%
Cyprus	19.32	3.79	19.61%	3.60	18.61%	3.25	16.80%
Latvia	c	c	c	c	c	c	c
Lithuania	8.98	1.94	21.55%	1.90	21.21%	1.90	21.21%
Luxembourg	62.91	15.31	24.34%	11.82	18.80%	11.56	18.38%
Malta	8.46	1.87	22.10%	1.60	18.96%	1.60	18.96%
Netherlands	648.87	148.40	22.87%	123.67	19.06%	110.53	17.03%
Austria	271.39	51.84	19.10%	44.05	16.23%	38.89	14.33%
Portugal	114.75	19.45	16.95%	17.26	15.05%	16.12	14.05%
Slovenia	c	c	c	c	c	c	c
Slovakia [1]	—	—	—	—	—	—	—
Finland	216.54	46.36	21.41%	42.10	19.44%	39.12	18.07%
Total	8,145.85	1,589.66	19.51%	1,381.09	16.95%	1,272.69	15.62%

Source: ECB Banking Supervision, Supervisory Data

A recent BPFI report suggests that there is an argument to attaching a greater weight to significant improvements in underwriting quality, the macroprudential robustness of the mortgage system, and the success of forbearance measures, when calculating capital requirements for bank mortgage books across Europe[71]. In short, the regulatory and supervisory system must strike the right balance in assessing the optimal amount of capital banks must hold to mitigate against potential losses, whilst maintaining the availability of credit in normal times.

Irish banks have also made significant investments in meeting increasing and indeed expanding regulatory obligations. These obligations are vast, ranging across conduct, customer interaction, GDPR, sustainability, payments modernisation, open banking, credit risk, financial crime and anti-money laundering legislation, amongst many others.

These investments are safeguarding customers' interests and the ongoing viability of the banking sector as a whole. It must be recognised that there are significant levels of resources, investment and costs required to continually meet and try to anticipate regulatory, compliance and capital requirements at the same time as investing in product innovation, transformation efforts, and cost containment in order to regain profitability[72]. Again, the size of the retail banking market in Ireland, versus the scale of what is required in resources from a regulatory perspective brings a sharp focus to the environment in which the retail banks operate and the challenges that are presented.

71. BPFI RWA report *"Irish Mortgage RWA Density Analysis Project Report"*
72. Supervisory data (europa.eu)

Broadly speaking, the global regulatory frameworks which banks must operate under can be broken down into the following areas:

Bank specific regulations	
Prudential regulations	Covering capital and liquidity requirements to ensure firms resilience to external shocks in the economy, prudent risk-taking behaviour and robust risk management.
Sustainable Finance	Rules focussing on activities related to environmental, social and governance (ESG) and management of ESG risks along with disclosure and scenario analysis requirements for these risks.
Financial stability	Rules focussed on the systemic importance of key institutions (e.g., macro-prudential rules and extra capital buffers), along with rules on recovery and resolution in the event of failure.
Conduct and customer protection	Standards on banks' and employees' internal and external conduct, selling practices, pricing, fair treatment of customers, and market integrity.
Horizontal financial services regulations	
Data Protection/ digitalisation	Standards on data security, data sovereignty, management (collection, retention etc) and cross-border exchange or interoperability. On top of this, banks in the EU also must adhere to rules relating to payment accounts for customers and allowing access to payment systems by non-banks (e.g. PSD2).
Anti-money laundering	Rules requiring firms to perform adequate due diligence and know-your-customer processes, manage AML risks and prevent fraud and economic crimes.
Taxation	Corporate and individual taxation, alongside specific levies on the banking system and higher income taxes for certain bank staff.
Disclosures/ reporting	To support increased transparency, banks are required to publicly disclose capital adequacy, loan losses, investment products, levels of climate sustainability.
Stress testing/ supervisory reviews	Regular internal and external exercises aimed at analysing a firm's ability to withstand stressed economic conditions, and overall functioning of the business.
Cybersecurity/ operational resilience	Requirements on the digital security, third-party risk, monitoring and risk assessments, testing on the resilience of IT infrastructure, reporting of incidences to competent authorities.
Corporate governance	Standards and rules on board of directors and senior managers, including around conflict of interest.
Competition/Price regulation	Rules around collusion and cartels, market dominance, merger and acquisitions and intellectual property. In Ireland, there is also price control regulations relating to customer fees/charges, which do not apply in other EU Member States.

Outlook for the future

Beyond 2021, the banking supervisors and policy makers will also be implementing new regulatory rules and requirements. These include the forthcoming finalisation of Basel III reforms, which needs to be implemented by 2028, and a raft of new and increasingly complex regulations relating to risk management of climate change including ESG reporting. As a result of these new Basel reforms we can expect further changes to rules relating to capital requirements, conduct risk, digitalisation, operational risk and resilience, data protection, cybersecurity, and financial crime[73].

Such regulatory obligations and requirements continue to be part of EU central banks' overall ambition to have a highly safe and solid banking sector, albeit at a high operational cost to European banks.

This ambition is therefore likely to lead to increased consolidation in banking across the EU, as scale can generate sustainable profits for banks, which in turn can improve capital levels and financial stability. Recent ECB research 'What will the banking sector look like in 2030?' states that if recent trends continue, the banking sector in 2030 will likely look different than it does today in that 'it could be smaller, employ fewer people and operate less via branch networks'.

73. https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/banking-and-capital-markets/ey-global-regulatory-outlook.pdf

The Irish retail banking sector as “Progressive”

8

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Irish banks have collectively spent over €3bn on transformation programmes over the past five years

A progressive retail banking sector

The continued focus on investing in a progressive banking sector will be central to Ireland's economic future. Such a focus will ensure that Irish retail banks will increase long term value to customers, the Irish economy and society by investing in talent, technology, analytics, and other critical forms of innovation.

Why its important

Significant disruptive trends are shaping the future of the banking industry domestically and globally. Banks must continue to adapt, invest, recruit new skills, innovate and create new products and services in order to grow and develop new and diverse sources of revenue. It is also fundamental to their ability to compete in a market that is experiencing disruption and witnessing many new entrants seeking to capture different segments of the banking market. Without that ability to grow and adapt, banks risk losing market share, customers, revenues, and capital investment, all of which are key to their future growth, financial performance, attractiveness to future investors and return on investment made by the state in Irish banks.

Rapid and disruptive change is well underway in banking, with technology and digitalisation acting as a major driving force in the evolution of the sector. There has been an unrelenting shift in customer preference for digital banking over several years, with the Covid-19 pandemic accelerating even further the consumer shift towards digital and mobile banking that was well underway globally, and in Ireland.

The use of cash by European consumers has been diminishing rapidly over the past decade with EBA research showing cash used for purchases falling from as high as 38% in 2010 to just 13% in 2020. Furthermore, European Banking Federation (EBF) research shows that over-the-counter cash transactions in bank branches fell from 18.4 million in 2018 to 10.4 million in 2020, a decrease of over 43% in just two years[74].

It is no surprise that the number of bank branches in the EU continues to shrink, with this trend tracking the increasing use of digital banking; close to 60% of customers were using internet banking in 2019, up from just 25% in 2007[75]. Digital wallets are now the most popular payment method in the EU.

The trends across European retail banking are also reflected in Ireland. There has been a dramatic and continuing shift in customer behaviour in the areas of retail banking and payments for some time, and the Covid-19 pandemic has accelerated these changes.

Over the counter transactions in Irish retail bank branches have fallen by over 45% in the past three years, while overall digital payments have risen by 65% during the same period.

The changed competitive landscape along with the rising number of FinTech entering the market is heightening customer experience and expectations in relation to ease of use, speed, and personalisation of financial services.

The Economist Intelligence Unit has also noted the rapid change; its latest survey in 2021 shows almost two-thirds (65%) of banking executives saying the branch-based model will be utterly changed within five years[76].

This trend has been well established for more than a decade and is likely to continue in the future with digital becoming the main channel for service provision with consumer demand for physical branch networks reducing as a consequence.

74. CBI Payments Statistics and BPFI Payments Monitor
75. EBF_043537-Banking-in-Europe-EBF-Facts-and-Figures-2020.pdf
76. New Economist Intelligence Unit Report: Branching Out (temenos.com)

According to the Economist Intelligence Unit's (EIU) 'Forging new frontiers' 2020 report, two thirds of banking executives said new technologies will continue to drive trends in global banking for the next five years. Meanwhile, the World Economic Forum found more than 80% of respondents to its June 2020 research saying they believed banking will become part of a platform of services in a digital ecosystem that will see banks partnering with banking and non-banking third parties offering their own and third party products and services to customers. In this light, the banks of the future are unlikely to bear a close resemblance to the ones we know today. Indeed, they may well have changed out of all recognition[77].

New technologies and data solutions such as cloud computing, microservices, and advanced analytics are creating numerous opportunities to transform banking solutions and processes. Central to banks' ability to meet customer needs and adapt and excel in the fast-changing environment in which they operate are the human skills and resources which are absolutely vital to their future success, innovation and growth.

The Irish retail banking sector will undoubtedly face challenges in sourcing that talent. At least 20% of recruitment in Ireland's retail banks over the past three years involved roles in technology and digitalisation. Retail banks expect that at least 20% of recruitment in the next three years will also be in these areas. However, recruitment challenges are very real, with a recent CIPD Labour Market Survey finding that 83% of Irish organisations face skills shortages[78], particularly across the domains of technology. Financial services organisations, similar to other sectors, are particularly affected by skills shortages in light of the fact they must compete with large multinational technology companies investing and expanding in Ireland.

Progress to date

In response to disruptive trends faced across the sector, Irish retail banks have been investing in innovation and technology, and have collectively spent over €3bn on transformation programmes over the past five years[79]. These programmes have been aimed at improving and digitising end to end processes and customer experiences across key systems and services. They have included the transformation of domestic and international payment platforms, upgrades or replacement of core accounting systems, new and enhanced digital channels, various Open Banking projects, and migration of services to the cloud. These investments have also supported evolving regulatory reporting and compliance requirements.

The investments have delivered tangible benefits to customers, with the pillar banks' reporting improved customer satisfaction scores across specific product and customer segments over the past number of years. In 2020, the CXi Ireland Customer Experience (CX) report ranked the financial sector third out of the ten sectors surveyed for customer satisfaction, marking its highest ranking since the survey began in 2014[80].

77. New Economist Intelligence Unit Report: Branching Out (temenos.com)
78. HR Practices in Ireland 2020 | Surveys | CIPD
79. Innovation in retail banking – A BPFI Survey of Irish Banks
80. The CX Company - The CXi Ireland Customer Experience Report 2020

What is shaping the future?

Talent

Data analysts, AI specialists, digital engineers and technologists will become critical roles within a changing and more digitalised banking sector. Banks must be able to attract the necessary people and skills, already in high demand by other sectors and competitors not only in Ireland, but globally, if they are to deliver the change in banking services being demanded by customers and the demand regarding regulatory compliance and data requests. Talent is also central to the bank's future growth and viability.

The skills composition within banks is evolving rapidly, with the retail banks needing a range of skills including IT and digital skills to meet evolving consumer and regulatory demands. The ever-increasing demand for talent is a challenge for all businesses, including the retail banks in Ireland, who compete for people with the large international financial services sector, multinational tech companies, the fast-growing FinTech sector, and other corporates nationally and internationally.

However, as a result of the Financial Crisis in 2008-2010, Irish retail bank employees and potential recruits are subject to some of the most restrictive variable remuneration conditions in the EU and are clear outliers when compared with graduates and employees not only in financial services but in a range of other sectors. This places Ireland's retail banks at a considerable and growing disadvantage compared to other banks, IT companies, and corporates.

A normalisation of pay and employment conditions at Ireland's retail banks – to allow the banks compete for people on a level playing field with other corporates – is needed if they are to attract the skills and employees that are necessary for their future and for the provision of services expected by Irish consumers.

New Working Landscape

The outlook for every sector of the economy has fundamentally altered as a result of the Covid-19 crisis with many large employers taking a more permanent approach towards continued remote working. Banks, in conjunction with staff unions, are assessing future workplace models and are considering several options across a spectrum from entirely on premises to entirely off premises and hybrid models in between. The 2021 EY Work Reimagined Employee Survey revealed that more than half (54%) the employees surveyed from all sectors around the world would consider leaving their job post-pandemic if they are not afforded some form of flexibility in where and when they work[81].

In response to this trend, retail banks are already offering hybrid models of work in order to facilitate workplace flexibility and have been very strong in their commitment to employees in this regard.

We also expect changes to occur across talent sourcing models, with banks expected to increasingly move from traditional to contingent workforce models in order to achieve more flexibility in their resource capability and meet the changing desires of a workforce who want increasing autonomy and flexibility over how and when they work.

81. https://www.ey.com/en_gl/news/2021/05/more-than-half-of-employees-globally-would-quit-their-jobs-if-not-provided-post-pandemic-flexibility-ey-survey-finds

Table: Future workplace models across banking sector

Work as a Place	Work as Anchor	Work as Connector	Work as Magnet	Work as an Activity
The Office' is work', but more people do some 'from home'. more regularly	The Office' is central to work and organisational effectiveness, with greater degrees, and different types, of remote work in place	The Office' optimally connects different modes of work, and employee segments, to each other	The Office' is not central to work, but is at the centre of organisational development and regularly draws people together	The Office' is not an important part of work. Space is fluid and virtual effectiveness is everything
• Large centralised office or campuses synonymous with brand and able to cater for all employees. • Co-location is the dominant way work is undertaken with limited (1-2 days) of working from home' permitted within policy and managerial bounds.	• Centralised or connected office or campuses able to cater for substantial portions of the workforce at the same time. • Co-location is the dominant way work is undertaken for most, but not all, with a combination of those working some of the time from home and others (particularly non- client serving or administrative) primarily or full time remote.	• Office(s) located & sized for combination of client and on premise work/teaming. Scheduling to manage space optimally combined with shared offices for project based needs. • Co-location is a strong, but not dominant component of working experience for a range of employee segments with different forms of relationships to office. Not all reside in commutable range.	• Office(s) located & sized for combination of client and on premise work/teaming. Scheduling to manage space optimally combined with shared offices for project based needs. • Regular Co-location is considered important but a minority aspect of the working experience. Most employees are primarily remote with some segments full and distant.	• No (or very small) offices. Shared offices or venue hire when required and all work full remote with employees working from anywhere if legal/tax compliant. • Co-location is the exception. Full range of flexible work options by policy/per role including job sharing.

Future of work spectrum

Entirely on-premises ← Hybrid Models → Entirely off-permission

Opportunities for Irish retail banks

As we emerge from the Covid-19 crisis, it is clear that the Irish retail banks are availing of the opportunity to develop a unique employee value proposition which reimagines the workforce, the workplace, and ways in which their people work. They are redefining talent sourcing models and thinking more creatively about recruitment and retention incentives.

Remote and blended working environments are fast becoming a core component of the overall banking sector employee value proposition which provides staff with the option of remote working whilst supporting sustainable regional development. This will see a redefinition of employee cultural norms and ways of working in line with a work model that supports creativity, accountability and flexibility, at the same time as reducing the physical banking sector footprint thereby supporting profitability aims.

However, all this hinges on the banks' ability to attract, source and retain the right skills and talent as well as their ability to generate the investment capacity to transform workplace structures in a way that is seamless and sustainable. The banks will need to work collaboratively with stakeholder groups to critically assess the talent constraints and their root causes in order to develop the sustainable long-term solutions required to support a truly progressive and competitive banking sector.

Conclusion

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Purpose and approach

This report by BPFI, supported by EY, seeks to outline the importance of the retail banking sector to Ireland. The report also identifies the key stakeholders within the sector, the competing demands and seeks to understand the key challenges and opportunities framed against a set of four key pillars.

It has been developed in consultation with a panel of domestic and global banking experts, as well as thorough discussions with key senior industry representatives. It seeks to provide a balanced overview of the sector as we know it today and to present a framework to facilitate a collaborative and forward-looking discussion.

Role and significance

The Irish banking sector plays a critically important role in the economic life of the country. In 2019, its total economic contribution stood at €11.6 billion, representing a GDP contribution of 3.3% compared to a Eurozone average of 2.6% of GDP.

Irish retail banks employ approximately 22,000 people[82] and the wider banking sector contributed €1.6 billion payable to the exchequer in 2020. They hold €270 billion in deposits and have a total credit book of €152 billion spanning consumer and business lending as well as 822,500 mortgage accounts.

The services provided by the retail banking sector enable Irish individuals to save money, make payments, manage uncertainty, and obtain credit whilst supporting Irish businesses to start-up, expand, and compete in local and international markets.

The stakeholders and the pillars

The primary challenge for the banking system is to run its core functions in a way that simultaneously achieves its own objectives while meeting the diverse needs of its stakeholders including customers, regulators, employees, shareholders, and society.

In meeting this challenge, the Irish banking sector will be viewed through four core mutually reinforcing pillars and what global experts see as the essential pillars of a healthy banking system: 'Purpose-led', 'Viable', 'Safe & Stable', and 'Progressive'.

This report by EY and BPFI provided an assessment of the Irish retail banking landscape against each of the four pillars. It examined the challenges facing the banks, the trends emerging in retail banking across the EU, the opportunities that lie ahead, and the key changes and investments that will be necessary to ensure the future viability and stability of Ireland's retail banking sector.

Summary of the findings

Purpose-led: A purpose-led banking sector is one that commands loyalty as a result of long-term value generation delivered for both the good of society and the economy. We see purpose and trust being a core pillar underpinning the future of banking in Ireland. Continued investment in culture and trust remains a strategic priority within the banks. The progress made is reflected by the annual Edelman Trust Barometer survey into public trust in financial services and banking has shown an increase of 27% in trust in the period from 2012 to 2020.

Viable: The profitability of the Irish retail banking sector is among the lowest in Europe, measured in terms of return on equity, with RoE for Irish retail banks of circa 2.6% versus circa 7.6% for the European average for Q1-21. Irish banks are heavily dependent on interest income for their profitability. This contrasts with many EU banks who draw more revenues from fees and charges to their customers. The interest income model remains impacted by the historically low interest rate environment and is set to continue, as signalled by the ECB as recently as July 2021. A banking sector which isn't viable cannot reinvest profits in the other pillars of Purpose, Safety, and Progressiveness which is central to meeting the expectations of stakeholders.

82 https://603101-1952083-raikfcquaxqncofqfm.stackpathdns.com/wp-content/uploads/2021/05/IBCB-eist-2021-report-RS-060521_Final_ONLINE.pdf

Safe & Stable:

Implementing new business, regulatory and accounting rules and requirements, have allowed retail banks to build a far superior level of higher-quality capital and liquidity, which in turn enabled banks to contribute materially to supporting communities, economies and financial markets, while remaining financially safe and sound. In addition, other regulatory change over the last 10 years, has had a very positive impact in aligning the requirements of stakeholders including customers, regulators and banks, for example PSD2 and GDPR amongst others.

Looking ahead, our view is that the regulatory agenda will be sustained, across an increasingly diverse range of priorities including the green agenda, financial crime, operational resilience, as well as traditional focus areas of governance, credit, capital, liquidity and broader prudential reforms through the Basel III reforms. Juggling these competing priorities while striving to achieve committed cost reductions and operating model enhancements will require a fine balancing act.

Progressive:

The use of cash by Irish and European consumers has been diminishing rapidly, in-branch transactions have fallen quite precipitously, while internet banking use has been rising quite sharply. These trends have been driving profound changes in the nature and structure of banking. Consumers are shopping across the financial services landscape in Ireland with close to 20 different competitors now providing different products and services across the mortgages, personal loans, overdrafts, and payments services market in Ireland. The advent of open banking, coupled with new technologies and heightened customer expectations, has led to products being unbundled from one another. This has created opportunities for specialist niche players to enter the market and compete by choosing to serve certain segments of the retail banking market. This contrasts with the breadth of services that the traditional banks deliver and the costs associated with that.

There has been a dramatic and continuing shift in customer behaviour driving major changes in retail banking and payments for some time, while the Covid-19 pandemic has accelerated these trends.

Over the counter transactions in Irish retail bank branches have fallen by over 45% in the past three years. In contrast, there has been an immense rise in online and mobile banking activity, with overall digital payments rising by a significant 65% during the same period.

To meet these changing demands Irish banks have been investing significantly in digitalisation and innovation and have collectively spent over €3bn on transformation programmes over the past five years. The digitalisation of banking means that the skills composition within banks is also evolving rapidly and will soon more closely resemble that of technology companies. However, the unique remuneration restrictions placed on the Irish banking sector place it at a marked disadvantage in recruiting and retaining such talent in the face of competition from international banks and large multinational technology firms operating in Ireland.

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Potential future opportunities

Notwithstanding these challenges, which are considerable, the changing landscape offers opportunities for Irish retail banks to further pursue their diversification, innovation and sustainable finance agenda and to play an even more central role in Ireland's economic and social progress in the coming years.

There is a once in a generation opportunity for banks to transform and grow while becoming leaner, to pursue strategic partnerships with non-banking players as an avenue for growth and to provide robust, trusted, professional service to their customers.

They will leverage those connections to differentiate themselves and will achieve competitive advantage through specialisations and efficiencies across key sections of the banking value chain.

They will adapt and revise their business models in anticipation of further changes to the operating environment with banks choosing to major on experience; acting as marketplaces and service providers.

There also exists a unique opportunity for the banking sector to become a key enabler of Ireland's post-Covid economic recovery, and to play a central role in meeting some of Ireland's most pressing macroeconomic and societal challenges including the rebuilding of the SME community; decarbonising the economy; and supporting financial wellbeing and inclusion for all.

Foundation for the debate

This EY/BPFI report provides a comprehensive fact-based assessment of the complex range of issues impacting on the Irish retail banking sector and the factors that will determine its future direction. It provides a solid foundation of research for stakeholders assessing the future of retail banking in Ireland and the journey of transformation that is now well underway.

Any cross-stakeholder debate on the future of the retail banking sector in Ireland, must be based on rigorous, informed, and balanced engagement. We believe this paper provides an important and evidence-based contribution to such a conversation.

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Notes

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