



# AMSTERDAM FINANCIAL FORUM 2011

SHAPING  
THE FUTURE  
OF FINANCIAL  
SERVICES

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# EXECUTIVE SUMMARY

Two years after the inaugural Amsterdam Financial Forum, financial leaders from around the world once again convened in Amsterdam to discuss the future shape of the industry.

There was no question that discussion had moved on from the causes of, and the immediate responses to, the global financial crisis. The tone of discussion was more forward looking, yet it was notable that in many respects the industry is still feeling its way. There was a sense that many institutions currently have less visibility over their future direction than at any time in recent decades; indeed it would be hard for any industry to make sound judgements in the midst of such a period of upheaval. As a result, delegates responded strongly to the historical parallels raised by Simon Schama, and to his call for financial leaders to increase their self-awareness.

The Forum's programme framed the future of the industry in the broadest possible terms, exploring global economics and politics, the future of financial firms and the shape of the global financial architecture. Discussion and debate ranged widely over the course of the Forum's two days, but this paper attempts to summarise key areas of the debate.

For the purposes of this summary, these are further distilled into eight observations:

- The financial industry is operating in a new world. Macro-economic and geo-political factors are shifting rapidly, and there is increasing tension between international economics and national politics.
- The financial crisis has accelerated the evolution of the financial world from a centralised structure towards a more localised, multi-polar focus.
- Governments will be key players in financial services –especially in the banking sector – for many years to come. More intrusive and more assertive regulation will be permanent, not temporary.
- Patterns of customer demands are changing, facilitated by mobile technology. In the long term, the industry needs to enhance its ability to identify and meet customers' fundamental financial needs.
- Many financial institutions' business models are under intense pressure. Some will struggle to attract capital. Firms from developed markets should avoid seeing the emerging markets as a remedy.

- It is hard to avoid the impression that many industry leaders have underestimated public hostility. Banks in particular need to be seen to support economic growth and improve their ethical behaviour.
- In the long term, the financial industry needs to convince its customers to pay a fair price for its services. Only then will it be seen to generate value for investors, customers and society at large.
- The industry's greatest challenge may be in achieving a change of attitude and behaviour, which will take a considerable amount of time and effort.

We hope you find this paper interesting, and would welcome your comments and further contributions.

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## THE WORLD TURNED UPSIDE DOWN

The financial industry's environment has undergone a permanent dislocation

### **The industry's operating environment has been overturned**

The importance of financial services to a modern economy gives the industry good reason – some might say, a good excuse – to portray itself as unique. That may be true, but the sector does not operate in a vacuum. Like any other industry, its world is defined by the forces of macroeconomics and geo-politics.

This environment has changed unrecognisably since 2007. The way that the global financial crisis swept aside old assumptions, some of which seemed unchangeable, was one of the central themes of 2011 Amsterdam Financial Forum. This was no mere historical discussion; the new economic and political realities that financial firms use as a basis for planning were hotly debated. Many speakers warned that the industry is entering a new age of volatility. As Jan van Rutte warned, "Expect the unexpected!"

### **Old macro-economic assumptions have been quashed**

Despite the scale of the financial crisis, speakers and delegates agreed that capitalism (for want of a better term) will remain the dominant force in global economics. Even so, there was recognition



Hans van der Noordaa

**'A EUROPEAN BANK IS FOR US THE WAY TO GO'**

that greed and herd behaviour have shown Adam Smith's 'invisible hand' of self-regulation to be far from infallible in the context of the financial markets.

In macroeconomic terms, there was universal agreement that the crisis had accelerated the southward and eastward shift of global economic power. The growing levels of bilateral trade between emerging economies were also widely discussed, with Abdullah Mohammed Al Awar pointing out that China is now Brazil's largest trading partner. Several speakers stressed that the rise of developing nations was crucial both to global economic recovery, and to redressing the financial imbalances that contributed to the financial crisis.

However, some speakers questioned whether the aftermath of the crisis could see a slowdown in globalisation, defined here as greater economic integration and freer flows of capital. As Philip Middleton commented, "it is not hard to envisage a worst-case scenario in which the Doha round fails and trade barriers increase". Few suggested that globalisation could be halted, but the potential for localised reductions in international economic activity was acknowledged. Powerful political

voices in developed nations could easily lead to protectionism and attempts to prevent jobs from moving offshore.

### **Tensions between international economics and domestic politics are a major concern**

Speakers at the Forum were not only concerned with changes to the financial industry's economic environment. International politics was also identified as an increasingly important consideration. At one level, speakers questioned the continued spread of democracy and the conventional wisdom of recent years that countries become freer as they grow wealthier. The assumption that individuals' growing economic autonomy is connected with increasing self-determination has been challenged by the strong economic performance of a number of autocratic countries.

More pressingly, delegates and speakers were profoundly concerned about the increasing tension between international economics and domestic politics. The strain is at its most obvious in Europe, where taxpayers have grudgingly accepted the need to bail out domestic financial firms – provided concessions are seen to be made in return – but are not prepared to support their neighbours' institutions. Several speakers highlighted the risk

that any fiscal transfer within Europe could trigger a wave of aggressive nationalism.

### **The direction of financial development is also in question**

Long-standing assumptions about the development of financial services were also brought into question. The belief that economic development leads to financial development was still seen as valid, with increasing per capita output linked to greater demand for deposit taking, credit, insurance and investments. At the same time there appears to be a growing realisation in the industry that countries will not always advance along this curve as far or as fast as each other.

Increasing awareness of the importance of local factors is illustrated by the way that cultural considerations, often overshadowed by economic factors, are moving to the forefront of industry discussion. Delegates were encouraged to avoid viewing Asia or Latin America as faster-growing versions of Europe, and to recognise the huge diversity within each region. Mr Al Awar also pointed to the emergence of new financial hubs with regional expertise, and the gradual erosion of London and New York's dominance, as evidence of greater localism in the financial industry.

### **QUESTIONS FROM THE PUBLIC: THE NEW ECONOMY – SHIFTS IN GLOBAL POWER**

- To what extent will the Basel III reforms negatively affect bank lending capacity to European industry and thus the recovery of the EU economy?
- Should the EU alone set capital standards or should national governments be permitted to judge for themselves the level of capital required for domestic financial stability?
- Can we truly regain trust and take more social responsibility if our future is in the east, where the humanitarian reality and reputation of many of the governments does not fit so comfortably with western ideals of freedom?
- What will be the impact of the recent social unrest in the Middle East on the future economic development of the region?
- How will the world, especially Europe and the US, overcome the huge levels of debt? Is inflating it away a - or the - only solution?
- If we shackle the banks do we have to accept lower economic growth?
- Can the eurozone survive?

## THE SCALE OF THE CHALLENGE

The financial industry is only just beginning to respond to the changing demands of governments and customers

### **The industry needs to get used to government involvement**

In September 2008 the global financial system stood on the brink of collapse. José María Roldán identified excessive leverage, insufficient loss-absorbing capital, moral hazard, massive capital arbitrage and inadequate supervision as some of the contributors to the crisis. Concerns about the stability – and even the survival – of the financial industry led to unparalleled intervention by national governments. National treasuries, central banks and regulators are now more directly involved in the financial industry than at any time in living memory, both as investors and as guarantors.

There was no doubt that governments would like to reverse this support, but no consensus on when and how this will happen. In Europe, concern about banks' exposure to Greek sovereign debt makes the withdrawal of government guarantees look particularly challenging. There was grudging acknowledgement among delegates that public sector involvement in the industry will continue for far longer than either party would wish.

### **Bank regulation and its effects – intended and unintended**

The most obvious result of the financial crisis is a desire to keep the financial industry under tighter control in future. Regulatory regimes are developing with unprecedented speed, leaving the industry struggling to achieve compliance, let alone identify the long-term implications for business models.

The effects of new regulation are being felt across the financial industry, but there is no doubt that banking received the most debate. Nout Wellink and José María Roldán reminded delegates of the key elements of the new Basel Committee rules, namely the amount and quality of capital; lower levels of leverage; additional dynamic capital requirements; surcharges for systemically important institutions; and liquidity measures aimed at improving stress resilience and funding viability.

Discussion about the wider economic consequences of tighter banking regulation was particularly heated. Wellink and Roldán insisted that most of the effects of tougher capital and liquidity ratios are fully intentional, although they acknowledged the danger of a slowdown in maturity and liquidity transformation by the



José María Roldán

**'LEVERAGE WAS  
DISGUISED AS  
FINANCIAL  
INNOVATION'**

banking industry. However, many banking delegates identified a direct conflict between making banks more stable (and, therefore, more cautious) and encouraging a private sector-led economic recovery. Several were openly sceptical of claims that more stringent banking regulation would have a minimal impact on economic growth. There was also concern that tougher bank regulation could lead to a fresh shift of risk towards unregulated shadow banks.

### **Regulators have their own concerns**

#### **– not least, inconsistency**

If financial firms are worried about regulatory overload, the rule-makers themselves are more concerned about under-shooting. Mr Wellink and Mr Roldán both highlighted inconsistent application as the greatest threat to the effectiveness of Basel III, whether between regions or individual countries. National finishes, gold plating and other local interpretations were acknowledged as being unavoidable, but the importance of reasonable global consistency was stressed repeatedly. Mr Roldán highlighted the risk of regulatory arbitrage, while Mr Wellink emphasised his desire to see Basel III's liquidity requirements implemented through the European Union's latest Capital Adequacy Directive.

It is no surprise that consistent international regulation is hard to achieve. As already mentioned, the potential conflict between technocratic international regimes and emotional arguments about national interest was widely discussed. To look at it another way, it is not Basel Committee members but local politicians who will have to pick up the pieces when things go wrong. One of the most-quoted phrases at the Forum was UK central bank governor Mervyn King's dictum that "large banks are international in life, but national in death".

### **More intrusive regulation is the 'new normal'**

Regulatory speakers at the Forum did not stop at urging the consistent application of Basel III standards. They also outlined several other areas where they hoped to see regulation advance its reach. One was the absence – despite the urgency placed on it at the 2009 Forum – of an effective international bank resolution regime. Individual institutions have made progress in setting up their own 'living wills', but there is still no sign of a mechanism that could swiftly implement such a plan on a multi-national basis.

Melanie Howard  
**'IT IS ABOUT  
 UNDERSTANDING  
 YOUR OWN VALUES  
 AND ATTITUDES  
 AS YOU MOVE INTO  
 THE FUTURE'**



A second area of regulatory appetite is the shadow banking sector. Mr Roldán emphasised that shadow banks' escape from Basel III did not mean that their role in the financial crisis had been overlooked. It may have been logical for government agencies to begin by focusing on deposit-taking banks, but with non-bank finance companies luring staff away from mainstream banks, there was a sense that swift action may be needed to stop risk disappearing under the regulatory radar.

Other areas of concern highlighted by the regulators included the ongoing absence of a global insurance regime, the problems of agreeing risk-weightings for banks' complex trading books and – if regulatory arbitrage is to be minimised – the need for more consistent treatment across all sectors of financial services.

Overall, delegates came away with a clear understanding that governments and their agents will no longer give the financial industry the benefit of the doubt. The eternal search for innovative money-making financial products will be accompanied by a continuous process of regulatory adaptation for the foreseeable future. As Mr Roldán stated, "I know that if we have increased

core capital requirements by a factor of seven since Basel I, then we have also increased the incentive for capital arbitrage seven times over."

#### **The nature of customer demand is changing, influenced by technology**

The industry may be fixated on the changing demands of governments and regulators, but delegates at the Forum were also encouraged to pay greater attention to another group of stakeholders – their customers. Evolution in the thinking, requirements and preferences of customers now and in the future was a major theme of discussion. Several speakers emphasised the importance of understanding customers' objectives, not just what institutions hope they will want. Melanie Howard made the point that cultural and social factors tend to evolve more rapidly than commercial organisations, and several speakers stressed that – just as in other areas – the financial crisis only served to accelerate changes in customer demand.

The changing behaviour of retail customers received particular attention. One of the fundamental changes identified by Ms Howard was individuals' growing desire to exercise control over every aspect of their lives. This implies that



Simon Schama

**'I CALL UPON ALL OF YOU TO BECOME SOCIAL PHILOSOPHERS'**

financial performance will come under closer, more frequent and less forgiving customer scrutiny. A connected development widely recognised by delegates was customers' growing ability to identify and act on uncompetitive pricing, however minor. There was also a warning to the industry that the desire for frugality is particularly strong in Asian markets.

Price comparison technology has become a fact of modern life, and there was widespread agreement that technology is helping to shape demand and customer relationships in the retail arena. The evolving need for financial services to be delivered to customers who see their lives through the prisms of mobile technology and social networking was widely discussed. This is not just a phenomenon of the developed world, and delegates exchanged examples of ways in which mobile technology has by-passed traditional infrastructures in a range of financial services markets.

Less positively, the rising influence of websites such as Facebook and Twitter were cited as a multiplier of reputational risk and the power of negative word of mouth. Bad news travels faster than ever and Hans Van der Noordaa pointed out

that financial institutions can no longer rely on maintaining any separation between their internal and external communications.

#### **Understanding long-term customer needs was seen as vital to long-term success**

The long-term evolution of customer demand was, for obvious reasons, discussed in less specific terms. However, one topic kept appearing throughout the debate. This was the way that the financial crisis has accelerated the fiscal tightening in many OECD countries, bringing forward the day when governments will have to address their unfunded welfare and healthcare liabilities. Delegates were also reminded that some fast-growing nations will face their own demographic problems in future.

Several speakers saw a clear opportunity for the financial industry to help customers meet their long-term savings needs, but there was no agreement on what tangible solutions to this problem might look like. Some delegates saw a considerable gap between genuinely innovative products that could help customers manage their lifetime goals, and the repackaged versions of existing products that the industry too often produces. It seems clear that bridging this gap will



Nout Wellink

**'YOUR BUSINESS MODELS SHOULD BE FLEXIBLE AND NOT FINE TUNED TO A CURRENT SET OF REGULATIONS'**

not only require original thinking and significant investment, but also strategic boldness. One problem is that tighter regulation and lower returns on equity are making this a more, not less, difficult task for financial firms to achieve.

### **Business models are coming under strain across the industry**

The changing demands financial firms face from governments, regulators and customers represent a long-term threat to established business models, one that many organisations have hardly begun to address. Profitability is being squeezed by lower leverage, higher finance costs and growing compliance requirements, not to mention weak retail demand and strong competitive pressures.

The overall result is that financial institutions are finding it hard to tell a compelling story to investors, and market analysts expect many firms will struggle to generate value through the economic cycle. Given the inherent riskiness of investing in financial companies, most investors are looking for something more than a return on equity barely higher than the cost of capital. The logical conclusion is that – despite political concerns about the industry's competitiveness – scale economies will drive down the number of

large, listed financial firms. At the other end of the spectrum however, regulation and customer preferences could also lead to a revival of local financial institutions, such as saving banks.

How should individual firms respond to this shifting picture? No one claimed to offer the definitive answer, but several speakers made suggestions. Jonas Ridderstråle felt that organisational flexibility represented the only sustainable competitive advantage for financial institutions, while Melanie Howard called for bolder use of scenario modelling and better integration between long-term planning and annual strategy reviews. Some speakers also warned institutions from mature markets to prepare themselves for intense competition from leading emerging market rivals, both at home and overseas.

## THE MORAL DIMENSION

The financial industry needs to justify its behaviour, role and existence

### QUESTIONS FROM THE PUBLIC: THE FUTURE OF FINANCIAL SERVICES

- Are ethical and sustainable business thinking and capitalism conflicting or can they go hand in hand? Will there - in a fully free market - not always be people going after self interest and short term wins?
- Melanie [Howard] said that "The wiring of human species is not built for long term thinking". If we can also assume that this changes with age, what does that mean for (world) leaders?
- Are we simply doomed to repeat a history that we ignore?
- What will the future bring for male-female dynamics?

### The industry was warned not to underestimate the level of public mistrust it faces

The most profound challenges issued to financial institutions represented at the Forum were not economic, regulatory or structural. Instead they represent what many speakers referred to as 'the moral dimension'. Speakers from inside and outside the sector warned against underestimating the degree of public mistrust towards the industry. Jan Peter Balkenende made a call for the restoration of trust, which he identified as an indispensable component of successful businesses and successful societies. Providing the historical perspective, Simon Schama explained how the banking industry has always walked a tightrope between honourable and profitable conduct. Mr Schama also warned that unwilling taxpayer support for banks is a recipe for discontentment and disorder, commenting that the combination of public subsidy and private profit "carried a strong whiff of the Ancien Regime".

During the Forum itself, delegates seemed willing to accept this message. It is certainly true that the industry is awash with talk of regaining trust, but with public sentiment sometimes bordering on hostility, that sounds overoptimistic at best.

Jan Peter Balkenende  
**'I THINK THAT TRUST  
 CORPORATE  
 RESPONSIBILITY AND  
 GOOD GOVERNANCE ARE  
 PART OF THE FUTURE  
 OF THE FINANCIAL  
 INSTITUTIONS'**



### **Banks in particular need to improve their public perception quickly**

The global crisis made it clearer than ever that a stable and financial sector is central to every successful economy. Governments and their agents have, quite rightly, been careful to manage their rescue-driven investments at arms' length. At the same time, few credible alternatives have emerged to challenge the industry's large incumbents. Add to this the perception that many firms, after vigorous but brief restructuring, have appointed new leaders with fresh mandates to prioritise top-line growth. Discussion at the Forum suggests that financial institutions – especially banks – should take care to actively integrate moral and ethical considerations into their strategic planning processes.

There was general agreement that the first steps financial firms need to take towards regaining customer trust is to improve the ethics of their behaviour. At its most basic, this could be illustrated by common sense steps such as asking “would I sell this product to a friend?” There was a growing realisation that customers no longer view strictly ethical behaviour as a luxury; it is an expectation. No one questioned the laudability of such aims, but speakers conceded that it is hard to

achieve consistent improvements in behaviour without changing underlying organisational cultures.

### **In the medium term, the industry needs to demonstrate its value to customers**

Moving beyond the short term, speakers identified a need for the financial industry to go back to basics and convince society at large of its worth. This means providing services that customers perceive as being genuinely valuable.

This may be a greater challenge than it sounds, because it is closely linked to the need to convince customers to pay a full price for the services they receive. Too many customers, both personal and institutional, are not accustomed to paying the cost of financial services. The UK retail market is an extreme but not unique example, with customers used to receiving checking accounts (from banks) and financial advice (from independent advisors) that appear to be free at the point of delivery.

In fact, arrangements such as this have led to hidden costs, concealed conflicts of interest and, all too often, misinformation or mis-selling. Ironically, persuading customers to pay a fair price for financial services would be the best way to

eradicate mis-selling, and would improve the industry's image. In the current environment of customer scepticism however, that will be a difficult challenge.

#### **Looking further ahead, the industry needs to be seen as socially useful once more**

As well as rebuilding trust and a sense of value, speakers at the Forum stressed the need for the financial industry to go further and, in the words of FSA chairman Lord Turner, ensure they are 'socially useful'. Simon Schama recalled the importance of co-operation and social obligation to the financiers of seventeenth century Amsterdam, and Jan Peter Balkenende stressed that the industry needs to support the public if it wishes to receive their support in future.

This could be demonstrated through philanthropy, but if the industry is to attract consistent public support it needs to be seen as socially useful in its core activities. The chance to help customers address their long term savings needs was seen as such an opportunity to do just that. If the financial industry can take a lead on issues such as this, it will benefit both socially and financially. Conversely, an indifferent attitude towards social goals could carry significant risks.

#### **Changing organisational culture may be the industry's greatest challenge**

Whatever the moral or ethical improvements targeted by financial firms, many delegates saw the human tendency to forget the lessons of history as a stumbling block. On the positive side, Simon Schama pointed out that institutional responses to crises can achieve lasting benefits. The creation of the US Federal Reserve and the passing of the Glass-Steagall Act, both in response to financial disasters, were cited as examples.

Set against this, other speakers emphasised that changing organisational cultures is more important than changing the regulation or structures of an industry. John Liver gave his view that behaviour is equally as important as rules in the effort to avoid the recurrence of past mistakes.

That may be true, but there was widespread agreement that achieving a genuine change in culture is one of the toughest challenges any financial organisation can face. Melanie Howard was not alone in pointing out that organisations full of habitual risk-takers will always tend towards risk-taking. The keys to lasting cultural change were seen as including more self-critical leadership, altered approaches to recruitment and

reward, more diverse workforces and radically different working practices. Of course, none of these are easy to achieve. Above all, they take time. It remains to be seen how far institutions can change themselves, and how quickly.

#### QUESTIONS FROM THE PUBLIC: THE FUTURE GLOBAL FINANCIAL ARCHITECTURE

- This morning Hans Hagebaar mentioned that countries in the EU are ring fencing liquidity more since the crisis. Is this a temporary phenomenon or are we moving back to more local markets rather than an open European market with free flow of capital/funding?
- Intended change in business models: is a viable (profit making) banking business still possible?
- Is there a global level playing field? Are European banks not disadvantaged compared to the US where banks supported by the government were allowed strengthen their position during the crisis, whereas in Europe, they are being weakened by measures taken by the EU?
- Do you expect convergence between banking and insurance regulation? If not now, when?
- Will increased capital arbitrage, when successful, ultimately result in more institutions or companies being put under supervision of financial authorities?

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