Supervisory reforms in Europe

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Outline

1. Introduction

2. Main achievements
   1. Harmonisation of national options and discretions
   2. SREP policies

3. Main challenges
Introduction

• The Banking Union has been a key in restoring confidence in EU banking market

• The creation of the Banking Union – with a common monetary policy – should foster financial integration

• However, financial integration can not be achieved without financial stability
Banking Union

SSM

Single rule book

SRM

Resolution funds

+/-

DGS (missing)
SSM : Main progress

1. Set-up of new authority (SSM) – fully operational – in less than one year since 4/11/2014 after a very short preparatory phase

2. Harmonisation of regulatory framework
   National options and discretions

3. Harmonisation of supervisory practices
   1. SREP (Pillar 2 requirements): policies and implementation
   2. Dividend policies
   3. Recommendation on remuneration
   4. Fit & Proper policies
   5. On-site inspections (methodology)
   6. Model validation (+ forthcoming Target Review of Internal Models)
   7. …..
Harmonisation of ONDs

1. Competent authorities and Member States have heavily used the **flexibility left by the CRDIV/CRR**

   ![Table 1](ond_mapping.png)

<table>
<thead>
<tr>
<th>Mandate</th>
<th>CRR</th>
<th>CRDIV</th>
<th>LCR Delegated Act</th>
</tr>
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<tbody>
<tr>
<td>Competent Authority ONDs</td>
<td>04</td>
<td>16</td>
<td>12</td>
</tr>
<tr>
<td>Member States or national ONDs</td>
<td>20</td>
<td>25</td>
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2. This has led to **important heterogeneities across banks**, leading to the following **adverse consequences**:

   - Impairs comparability of reported figures (eg capital)
   - Lack of consistency with international standards (credibility of EU markets)
   - Uncertainties for market participants as regards actual financial situation of banks (eg capital, DTA,..)
   - Difficulties to harmonise SREP process

3. The harmonisation of national options and discretions will contribute to **foster the development and application of a single rule book** and will **enhance comparability across banks**

4. **General principles in the harmonisation of the ONDs**

   - Sound and prudent prudential standards
   - International standards (Basel, EBA,..)
   - Open and integrated banking market
Impact of the ONDs before SSM

Figure 2
Impact of transitional arrangements on CET1 ratios in the SSM Member States
(Left scale: total impact on CET 1 capital in absolute values – in billion €; Right scale: impact of CET 1 relative to RWA of each MS - in percentage points)

Note: Based on transitional arrangements projected by the banks included in the EBA disclosure template; Calculated based on a fully implemented CRR/CRD IV definition of Common Equity Tier 1 capital including 60% of unrealised gains/losses from Sovereign Exposure in AFS portfolio.
Harmonisation of ONDs

1. Most important ONDs

- Transitional arrangements for capital requirements in CRR
  - DTA
  - Intangible items,…
  - AFS sovereign exposures

- Insurance participation

- Cross borders integration: liquidity and intragroup exposures
  - LCR, intragroup exposures
  - Financial integration vs Financial stability concerns (Unfinished banking union)

3. The ECB is currently finalizing the legal instruments after the public consultation. ONDs should be in place in the course of 2016 (Q2).

4. To ensure the level playing field across institutions, it would be preferable if NCAs would also apply the harmonisation of the ONDs to LSI

5. The ECB will continue to harmonise the regulatory framework and the remaining ONDs in the coming years, although Member State options and different transposition of EU directives will affect this harmonisation
SREP policies

1. Harmonising ONDs is crucial for the coherent application of common SREP policies

2. Main decisions
   - SREP requirements should be covered by high quality own funds: CET1
   - Pillar 2 requirements are below the (macro-prudential) buffers
   - MDA trigger (implication for dividend and remuneration policies, and payment of AT1 coupons)
   - The 2015 decisions led to a general increase in capital requirements of SSM banks (including macroprudential buffer)

3. Main challenges
   - SREP process will be further harmonised in the coming years (ICAAP, Stress test)
   - Interaction between macro- and micro-prudential authorities
   - Level playing field among EU institutions: coherence among the EU authorities
   - Adequacy and consistency in the RWAs
SSM creates important opportunities ....but also challenges

1. It involves a lot of interactions with different authorities (NCAs, macro-prudential authorities, SRB, NRAs). Close cooperation and collaboration is therefore required to ensure efficient supervision.

2. In view of the large number of banks supervised by the ECB, there might be a risk of more compliance-based supervision (vs risk-based supervision).

3. Centralised supervision might create the risk of a “one size fits all” supervision and as a result, a less diversified banking sector.

4. While harmonised supervision might help ensure a level playing field, it could also facilitate – inter alia with the harmonisation of the regulatory framework – financial sector concentration for instance by encouraging M&As and as a result, increase the risk of ‘too-big-to-fail’ institutions, especially in the context of pressures on profitability.

5. Finally, unified supervision enhances the centralisation of capital and liquidity within cross-border groups, without yet having a full banking union, especially a fully implemented Resolution Funds, a common deposit guarantee scheme and a wider fiscal union.
The first year: How the market perceives ECB banking supervision

Overview

- Availability, quality, granularity of data
- Stress testing
- IRRBB
  → Need to invest in infrastructure

- Pillar 2 supervision process unclear
- The “why” of some requirements is not understood
  → Need for change management

Very demanding

ECB-Supervision

Increased supervisory uncertainties

Inconsistent

Culturally challenging

Differences compared to former national supervisory approaches: ECB perceived by some countries to be more direct/more intrusive
- Different governance models in Europe
  → Need to establish SSM-Manager

- Supervisory intensity different I) w.r.t. presence; ii) w.r.t. subsidiaries
- Differences in the national legal requirements
  → Need for cont’d harmonization

Source: KPMG