Pre –recording of a speech at the ECB Forum on Banking Supervision: "Bank regulation – moving beyond the post-financial crisis agenda"

Monday, 8 November 2021
18.15

SPEECH

Ladies and gentlemen, good morning.

It's a pleasure to be with you at the fourth ECB Forum on Banking Supervision. Thank you to the ECB for inviting me to speak here today.

During the last 10 years, the agenda for banking regulation and supervision has been dominated by the global financial crisis.

The financial crisis showed that financial regulation was too lax.

So we have spent the past decade bringing in reforms to tighten that regulation.

And this latest crisis prompted by the pandemic showed that the reforms have been effective.

Banks stayed resilient, and they helped deliver some of the public supports to households and businesses.

But we have not yet finished the job. We need to finalise the reforms we decided on after the financial crisis.

And that will let us look towards preparing the banking system for the future.

The reality is that our world is changing fast. If we want banking to benefit from change and not be overwhelmed by it, we need to take action.

With the pandemic came an acceleration in the digitalisation of the financial world.

Finance has also woken up to the urgency of the climate crisis.

The financial system that we see in 10 years' time, even in 5 years, could be very different to the one we have today.

We will not be well prepared for the future if all we do is look towards the past.

Basel 3 and Banking Union

But to move beyond the post-financial crisis agenda, we must first finish what we started.

EU banks are more resilient as a result of post-crisis reforms and of high-quality supervision.

This year, the European Banking Authority is celebrating its tenth anniversary, and the Single Supervisory Mechanism is turning seven.

The EU single rulebook made our bank regulatory framework more robust. We addressed many of the flaws the financial crisis brought to light.

Now, banks are much better capitalised, they have enough liquidity and they are not excessively leveraged.

But there are still some gaps in the rules that we need to close.

The Commission recently adopted a new banking package that addresses some of deficiencies that remain in the prudential framework.

The first part of this proposal implements the final Basel III reforms.

The main element that remains to be implemented is to limit the ability of banks to excessively reduce capital requirements when using internal models.

The proposal aims to increase the comparability of capital ratios across banks.

The reforms avoid a significant increase in the overall capital requirements of EU banks, and the reforms will be phased in over a long period, giving banks time to adapt.

Our proposal is faithful to the Basel III agreement while using flexibility within the international standards.

It includes targeted adjustments to reflect the specific features of the EU banking sector and the EU economy.

In particular it recognises the significant contribution of SMEs, most of which are not rated, to the EU economy.

We are taking into account the fact that European banks finance low-risk mortgages, and keep them on their balance sheets.

We are also taking into account that our banks have an important role in financing big projects and infrastructure.

And EU banks' long-term equity holdings will not be treated as speculative investments.

On top of that, the reforms are proportional and help reduce compliance costs, in particular for smaller banks, without loosening prudential standards.

The second part of this banking package is about making sure that banks are more resilient when it comes to sustainability.

We are introducing requirements for banks to manage ESG risks systematically and consistently. Banks should also set out transition plans.

And we are giving supervisors the tools they need to enforce these requirements.

The third part of the package is a series of measures to strengthen supervision.

One weak point addressed is the rules for non-EU banks with branches in the EU.

These third country branches have a substantial footprint in the EU and they provide important services.

But right now, they are regulated at national level and there is a lack of consistency between the approaches applied by different Member States.

That's why we are proposing minimum standards for the regulation and supervision of third country branches, moving to a more coordinated approach.

And we are also taking this opportunity to respond to some of the lessons we learned in the Wirecard scandal.

Notably, we are clarifying our rules on financial groups headed by a fintech company that have a bank as a subsidiary, so that they are properly regulated and supervised.

We are also proposing minimum requirements on supervisory independence based on international best practices.

So on the prudential regulation side, we are on track to achieve what we set out to do following the financial crisis.

But after the financial crisis, we also decided to build the Banking Union.

The Banking Union was a response to the Eurozone sovereign debt crisis. We realised we needed the Banking Union to back up the Economic and Monetary Union – our common currency, the Euro.

The Banking Union is vital to protect the European banking sector from a future crisis and to safeguard financial stability.

The banking sector has remained stable during this crisis. But if we do not complete Banking Union, we have no guarantee of that stability in the future.

We need to live up to our promises as policy-makers to do all we can to prevent another banking crisis, with all the impact that would have on lives, livelihoods and taxpayer money.

The Banking Union will also provide a strong regulatory framework that can accommodate change.

The financial sector is changing and we need a system that fosters consolidation where scale matters, including across borders.

And we need to ensure that banks that do not adapt can exit the market in an orderly way, without threatening financial stability.

But here we still have a lot of work to do.

We want to strengthen the crisis management and deposit insurance framework.

We know that the cost of a bank failure should be borne primarily by a bank itself.

But when extra money is needed, the common safety net financed by industry should be used and not public funds. If a bank fails, taxpayers should not foot the bill.

We also need to build the third pillar of the Banking Union – a European deposit insurance scheme.

The Banking Union will only be complete once EDIS in place.

Reforms by the EU in this area have already helped protect citizens' money and reduced the risk of bank runs.

But national deposit guarantee schemes can only go so far.

EDIS would make common safety nets stronger and more consistent across the EU. This would make national schemes more resilient to large local shocks.

It would help to maintain the trust of depositors, regardless of where a bank is located. And banks in trouble would be less dependent on national governments.

To start with, EDIS could provide liquidity to national deposit guarantee schemes in need, strengthening depositor confidence and making banks more robust in a crisis.

But the Commission remains convinced that a more ambitious EDIS set-up involving loss mutualisation is needed in the steady state of the Banking Union.

Progress on the crisis management framework and EDIS should help increase market integration.

We know that the Home-Host debate is sensitive.

Only when our banks are European in both their success and failure will we reap the full benefits of the Banking Union.

The Banking Union requires making hard choices and reaching difficult compromises. And so far we have not been able to do that.

In short - if we want to successful navigate a changing banking landscape, we first need to complete the post-financial crisis agenda.

But if we want our banking sector to be well positioned to embrace the latest technology and support the green transition, we can and must go beyond it.

Digitalisation

As I mentioned, digitalisation is fundamentally changing the financial landscape.

Technology companies – large and small – are increasingly offering financial services.

This increases competition but it also makes value chains more complex, making it harder for supervisors to have an overview of the risks.

It can fundamentally change banking service supply chains, introducing new critical suppliers and a new category of risks that must be managed.

It also has consequences for the business model of traditional banks. New FinTechs unbundle the full-service model of

traditional banks, and big tech companies enter financial services using data and extensive customer information.

Last year, the Commission put forward our Digital Finance Strategy. We want financial institutions, capital markets, consumers, and the economy as a whole to be able to make the most of new technology, such as blockchain or artificial intelligence, while addressing the risks.

Today I want to focus on how the Commission is addressing cyber risk, which is key to banking supervision.

According to research by the ECB, there was a 54 percent increase in the number of cyber incidents reported to the ECB in 2020 compared with the previous year.

Indeed the financial sector is the sector that faces the most cyber attacks. A digital financial system needs to be resilient to these risks.

The Commission's proposed regulation on digital operational resilience – DORA – defines common rules for all parts of the financial system to ensure that they can withstand all types of ICT-related threats.

The rules we want to put in place are robust, consistent across the financial sector and proportionate.

The draft regulation also addresses the risks of large technology providers that offer ICT services – such as cloud computing – to financial firms.

Third party providers of ICT services should be subject to EU-level oversight.

We are working hard with the Member States and Parliament towards a swift agreement on the new rules.

Making sure banks have the right procedures in place to be resilient to cyber risk must be a top priority for banking supervisors.

Supervisors need to understand the technologies – such as artificial intelligence – that banks are using and monitor the risks they create.

Beyond these new risks, technology could fundamentally change the financial system.

The very nature of money is changing.

Money is increasingly digital, as crypto currency and stablecoins gain in popularity.

But for now, this digital money is private money.

So central banks – including the ECB – have been thinking about central bank digital currencies – whether we need digital money backed by a central bank, in the way that cash is, and how that would be designed.

According to the Atlantic Council, 87 countries – including the United States, China, Japan and the United Kingdom – are at various stages of looking into central bank digital currencies.

7 countries, mostly in the Caribbean, have already launched CBCDs.

In the EU, the ECB has begun the investigation phase for a digital euro.

The Commission is working closely with the ECB to explore what a digital euro could look like and we are carefully considering the potential impact.

A digital euro could bring benefits for citizens.

We already face situations where cash cannot be used, like when making an online purchase – though a digital euro would be a complement to cash not a replacement for cash.

A digital euro would give consumers more choice about how to pay and therefore increase financial inclusion.

People who currently do not have a bank account or have difficulties accessing cash due to bank branch closures could be brought into the financial system.

Beyond the benefits for individuals, the digital euro could also support our ambitions for the EU retail payments market.

It could help private intermediaries develop truly European payment solutions using European infrastructures and standards and it could support instant payments.

It could also help us achieve some of the political goals of the EU, such as support for innovation, supporting the digitalisation of the economy and strengthening the international role of the euro.

But there are big questions to address as well.

What would the impact be on banks?
How do we ensure that privacy is protected?
How would we keep this digital system secure?

Introducing a digital euro would be a big decision – one that we have to get right. And if we decide to go ahead, then the digital euro will have to be well designed.

I look forward to continuing our close collaboration with the ECB on the next steps in this project.

Climate

The other fundamental transformation confronting us is the transition to climate neutrality.

Economy, society, politics – all will need to change.
And to meet our sustainability targets, all of our policies must contribute, including in the area of financial services.
I mentioned earlier that we used the opportunity of a new banking package to ensure that banks take account of ESG risks.

This transformation will not be easy.

That's why the Commission's Sustainable Finance Strategy is so important – it helps all sectors, whatever stage in the journey they are at, to reduce their negative impact on the climate and environment, while managing climate risks.

The ECB's economy-wide climate stress test released this September shows just how important addressing climate risk is – if we do nothing to tackle the climate crisis, we risk knocking 10 percent off European GDP.

We welcome the ECB's climate stress tests.

The climate stress tests by the ECB, as well as those that we in the Commission have mandated the European Supervisory Authorities to carry out, are a key way to figure out where the vulnerabilities in the financial system lie.

We want to know how climate change affects financial institutions – the exposure of banks to biodiversity loss, environmental degradation or extreme weather events.

At the same time, we want to know the impact that financial institutions themselves have on the climate and environment through their financing decisions.

Looking at climate risks from both these perspectives will help us make the financial system more resilient to climate change, and enable it to make a full contribution to the climate transition.

Conclusion

In conclusion, we have not yet finished implementing the post-financial crisis agenda. But we must complete the process, for the sake of financial stability.

And we must finish implementing the reforms for another reason – to allow us move on from the past and look to the future.

There are many challenges ahead – cyber risks and climate risks are just two.

But there are also huge opportunities to build a financial system that delivers for both people and the planet.

As regulators and supervisors, we must help the financial system navigate these choppy waters as we safeguard financial stability.

Thank you for your attention.