European banking supervision, global cooperation and challenges for banks

Sabine Lautenschläger
Vice-Chair of the Supervisory Board
Member of the Executive Board

International Banking Federation
18 May 2017
Outline

1. The set-up of European banking supervision
2. Regulation and supervision – The international dimension
3. The challenges for banks
European banking supervision is based on cooperation between the ECB & national supervisors

**Distribution of tasks within the SSM**

- **Direct supervision**: Oversees the system
- **Indirect supervision**: Supports less significant institutions
- **Joint Supervisory Teams**: Supervise significant institutions
- **National supervisors**: Supervise smaller institutions

**Key SSM facts**

1. The Single Supervisory Mechanism (SSM) is one of the largest banking supervisory authorities in the world.

2. Currently **125 banking groups** in 19 countries are under direct ECB supervision. Almost **82%** of euro-area banking assets are under direct ECB supervision.

3. Around **3,200 smaller institutions** are directly supervised by the National Competent Authorities (NCAs), with the ECB being responsible for the system at large.

4. Banking assets under direct and indirect ECB supervision amount to **more than 26 trillion Euros** ⇒ about **2.6 times euro-area GDP.**
## 1.2 The objectives of European banking supervision

### Article 1 SSM Regulation

“This Regulation confers on the ECB specific tasks [...] relating to the prudential supervision of credit institutions, with a view to contributing to the safety and soundness of credit institutions and the stability of the financial system within the Union and each Member State, with full regard and duty of care for the unity and integrity of the internal market based on equal treatment of credit institutions with a view to preventing regulatory arbitrage.”

### Objectives of European banking supervision

<table>
<thead>
<tr>
<th>1. Resilient banking system</th>
<th>2. Financial integration</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Identifying relevant risks</td>
<td>• Developing harmonised supervisory methods and approaches</td>
</tr>
<tr>
<td>• Assessing risks fairly and consistently</td>
<td>• Applying the supervisory framework consistently across all participating countries</td>
</tr>
<tr>
<td>• Intervening timely and resolutely when deficiencies are identified</td>
<td>➔ Creation of a <strong>supervisory level playing field</strong></td>
</tr>
</tbody>
</table>

➔ **Tough and forward-looking supervision** of credit institutions
The Supervisory Review and Evaluation Process (SREP) methodology at a glance: four key elements

1. Business model assessment
2. Governance and Risk Management assessment
3. Assessment of risks to Capital
4. Assessment of risks to Liquidity and Funding

SREP Decision

- Quantitative capital measures
- Quantitative liquidity measures
- Other supervisory measures

Overall SREP assessment - Holistic approach

→ Score + Rationale/main conclusions

- Viability and Sustainability of Business Model
- Adequacy of Governance and Risk Management
- Categories: e.g. Credit, Market, Operational Risk
- Categories: e.g. Short Term Liquidity Risk, Funding Sustainability

Feeds into the Supervisory Examination Programme (SEP)
The main features of the SREP

• **Level playing field:** SREP is being conducted according to… …a common methodology ➔ banks across the euro area are assessed according to the same yardstick.

• **High standards of supervision:**
  • Methods follow guidelines from the European Banking Authority and draw on best practices from across the euro area.
  • Methods are constantly being improved and refined.
  • SREP approach incorporates principle of proportionality.
  • Based on the SREP assessment, supervisors can demand capital add-ons and additional measures tailored to banks’ specific weaknesses (such as additional reporting requirements).

• **Sound risk assessment:**
  • SREP assessment is based on a combination of quantitative and qualitative elements – expert judgement and data analysis.
  • It delivers a holistic & forward-looking assessment of institutions.
1.4 Harmonising supervision – The limits

- Unjustified **regulatory fragmentation** in the euro area ….
  - … runs counter to the idea of a European banking union,
  - … hampers European banking supervision,
  - … creates bureaucracy and increases costs.

- Additional fragmentation:
  - in the **exercise of supervisory powers** by ECB/national competent authorities
  - in the **supervisory landscape**
<table>
<thead>
<tr>
<th></th>
<th>Outline</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>The set-up of European banking supervision</td>
</tr>
<tr>
<td>2</td>
<td>Regulation and supervision – The international dimension</td>
</tr>
<tr>
<td>3</td>
<td>The challenges for banks</td>
</tr>
</tbody>
</table>
2.1 The international dimension of rule-making and supervision

- **Global level**
  - **G20**
  - **Financial Stability Board (FSB)**
  - **Basel Committee on Banking Supervision (BCBS)**

- **EU level**
  - **European Commission**
  - **European Parliament**
  - **Council of the EU**
  - Ordinary legislative procedure
  - **European Banking Authority (EBA)**
  - Fine tuning

- **Euro area and national level**
  - **National Competent Authorities (NCAs)**
  - **JSTs**

Guidance & Standards

Regulation

Supervision
2.2 Home-host supervisory cooperation – The structure

1. Third country authorities

   **Step-in**
   - Continuity of previous cooperation between euro area authorities and 3rd country authorities is very important for the ECB.
   - ECB proposal to 3rd country authorities to cooperate based on existing MoUs already signed with the authorities in the euro area.

   **MoUs**
   - ECB staff drafted a template MoU negotiated with third country authorities.
   - Negotiations have started with Authorities in: Brazil, Canada, Hong Kong, Japan, Mexico, Singapore, Switzerland, USA.

2. EU Authorities outside of SSM

   **Step-in**
   - ECB cooperates with non-SSM Authorities based on pre-existing MoUs with the authorities in euro area countries.

   **MoUs**
   - The ECB staff is negotiating a template MoU with all non-SSM EU Member States.

3. Supervision within the SSM

   [Diagram showing the structure of supervision within the SSM, including the ECB overseeing the system, direct supervision, indirect supervision, joint supervisory teams (JSTs), national competent authorities (NCAs), and horizontal divisions between significant and less significant institutions.]

www.bankingsupervision.europa.eu ©
Home-host cooperation – The role of the ECB

**Colleges of supervisors are permanent coordination structures that bring together the competent authorities involved in supervising cross-border banking groups.**

**1. As consolidating supervisor**

- The ECB chairs the EU colleges of 29 euro area institutions (8 G-SIBs) under EU law.
- The ECB chairs four international colleges (which do not include European Union participants) of banks headquartered in the euro area which have material cross-border activities within the euro area and outside the EU.

**2. As host supervisor**

- The ECB participates in seven colleges for institutions (one G-SIB) headquartered in non-participating EU member states, under EU law.
- The ECB is a member of colleges of five international third-country institutions (4 G-SIBs) with subsidiaries which are significant institutions in the euro area.
## Outline

1. The set-up of European banking supervision
2. Regulation and supervision – The international dimension
3. The challenges for banks
3.1 The challenges for European banks

Banks have become more resilient, ...

... but still face challenges

CET1 ratio 2012-2016
(Euro area Significant Institutions)

- 9.0%
- 13.7%

- Brexit
- Profitability
- Stronger regulation
- Digitalisation
- Low interest rates
- Non-performing loans
- Overcapacity and fragmentation

Banks have become more resilient, ...

... but still face challenges
The SSM Supervisory Priorities 2017

1. **Business models & profitability drivers**
   - Assess banks’ business models and profitability drivers
   - Brexit preparations – Dialogue with banks
   - Non-bank competition / FinTech

2. **Credit risk focus on NPLs and concentrations**
   - Consistent approach to NPLs/ forborne exp. (e.g. deep dives / OSIs)
   - Evaluate banks’ preparedness for IFRS 9
   - Track exposure concentrations (e.g. shipping/ real estate)

3. **Risk management**
   - Assess compliance with BCBS 239 - principles on risk data aggregation and risk reporting
   - TRIM: Credit risk, market risk and counterparty credit risk models
   - Improvement of banks’ ICAAP and ILAAP approaches
   - Outsourcing

---

1. Thematic reviews are highlighted with dark blue border

Timelines are indicative

www.bankingsupervision.europa.eu ©