



**EUROPEAN CENTRAL BANK**

BANKING SUPERVISION

**PENTTI HAKKARAINEN**

ECB Representative

SSM Supervisory Board

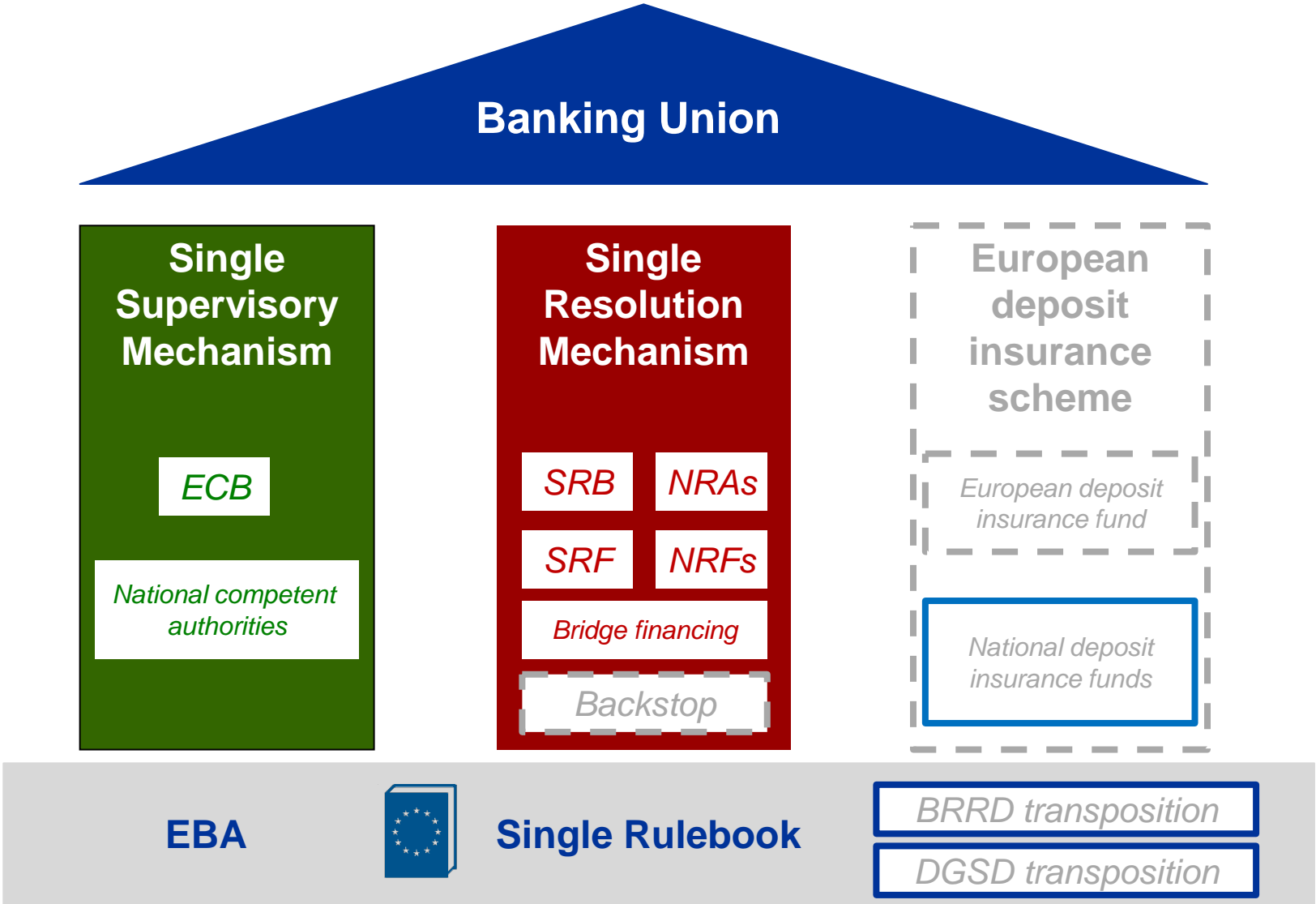
# **Banking union: Prospects for integration and further consolidation**

**SAFE Policy Center Lecture  
Frankfurt, 19 June 2018**

**ECB-PUBLIC**

- 1 European banking supervision
- 2 Achievements of ECB Banking Supervision to date
- 3 State of progress – a strengthened euro area banking system
- 4 The coming consolidation – a boost for financial integration
- 5 Conclusions

# Complete the banking union



## Key objectives

### Article 1 of the SSM Regulation

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*“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.”*



### European banking supervision objectives

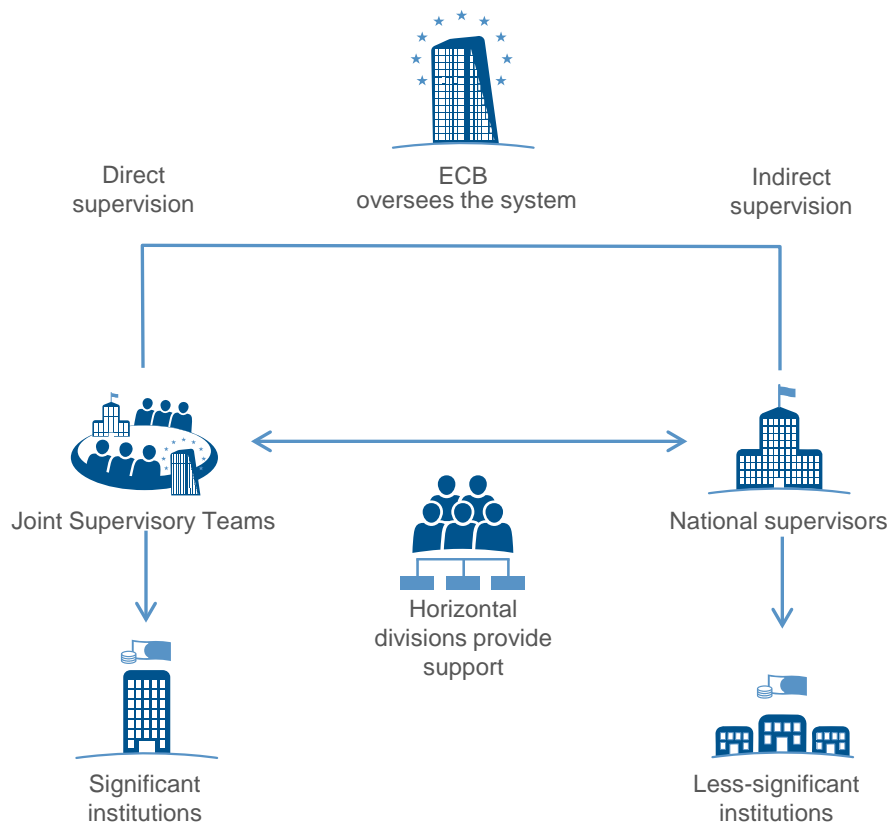
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1. **Financial stability**, i.e. tough and forward-looking supervision of credit institutions
  - Identification of relevant risks
  - Fair and consistent assessment of risks
  - Timely and tough intervention if deficiencies are identified
2. **Financial integration**, i.e. creation of a supervisory level playing field
  - Consistent application of the supervisory framework across all participating countries
  - Development of harmonised supervisory methodologies and standards
  - Quality assurance and benchmarking of supervisory practices to identify best practices and areas for improvement

# 1. European banking supervision

## European banking supervision is an integrated system of national supervisors and the ECB

### Distribution of tasks



### Key facts

1. One of the **world's largest banking supervisors**
2. Currently **around 120 banking groups** in 19 countries under direct ECB supervision – including eight out of 30 global systemically important banks
3. Around **3,500 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 supervision amount to **more than €26 trillion**
5. Supervision is carried out by **several thousand supervisors** – most of whom work for the 26 NCAs that participate in the SSM

## Paving the way to a truly European banking sector

### **Second pillar of banking union**

- Fruitful cooperation between the SRB and the ECB on bank resolution will continue

### **Third pillar of banking union**

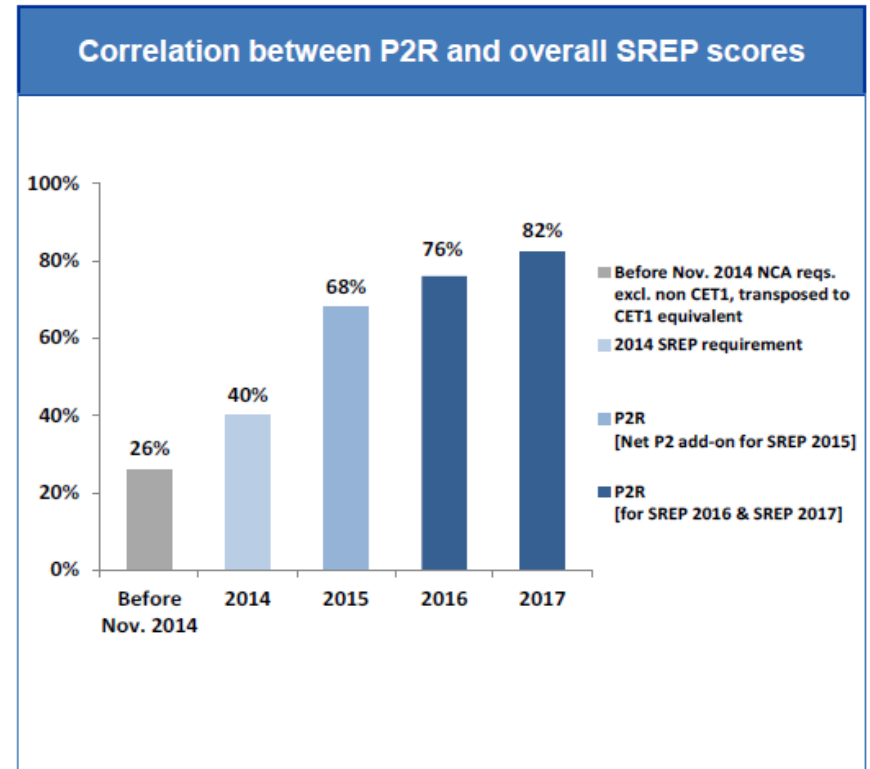
- The European Deposit Insurance Scheme (EDIS) will gradually help share risks more efficiently across the euro area, after a parallel risk reduction
- It will also align liability and control between the national and the European level
- The European Commission's proposal for EDIS foresees an asset quality review when moving from re-insurance to co-insurance

### **A truly European banking sector**

- Once the banking union is complete, the euro area will become even more of a single jurisdiction
- This will make it easier for banks to do business across borders, and for the sector to consolidate

# Initiatives to foster supervisory harmonisation and convergence

- ✓ Comprehensive assessment
- ✓ Supervisory Manual
- ✓ SREP
- ✓ Harmonising options and discretions
- ✓ Guide to fit and proper assessments
- ✓ On-site inspection methodology
- ✓ Internal capital and liquidity assessment (ICAAP and ILAAP)
- ✓ Recovery planning
- ✓ Involvement in EBA and global regulatory fora
- ✓ NPL guidance



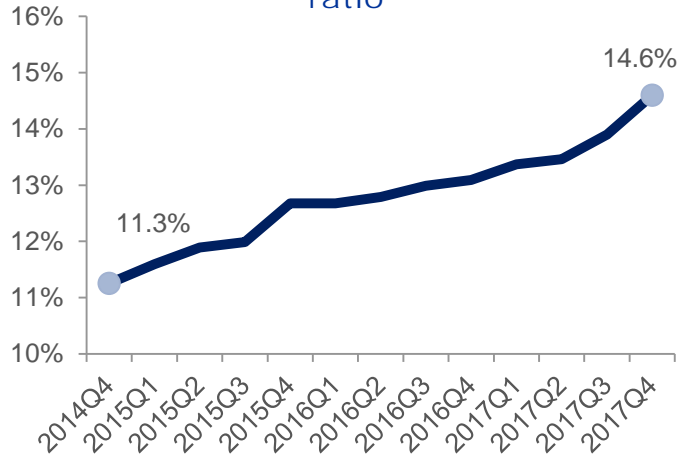
Based on banks with a final SREP 2017 decision as of 30 November 2017

Note:  
Correlation cannot reach 100% due to the facts that risks can also be addressed by other measures e.g. qualitative measures

Source: SSM SREP Methodology Booklet, 2017 edition.

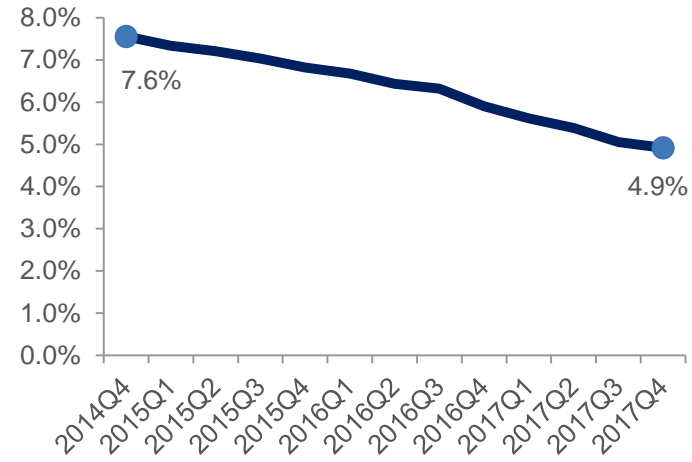
### 3. State of progress – a strengthened euro area banking system

Evolution of fully loaded CET1 ratio



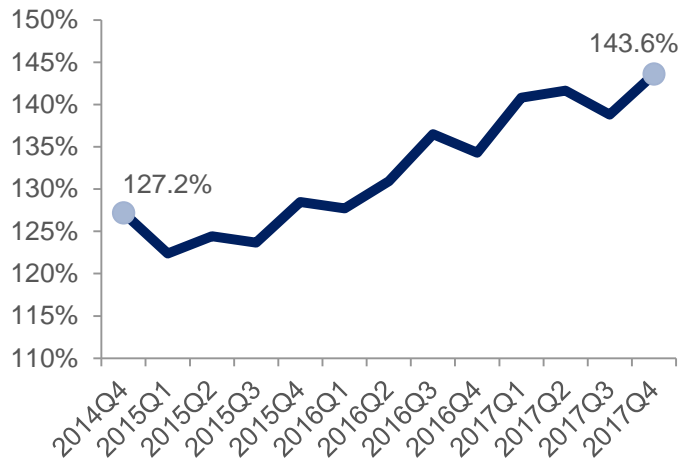
Source: COREP, ECB calculations.

Non-Performing Loans ratio



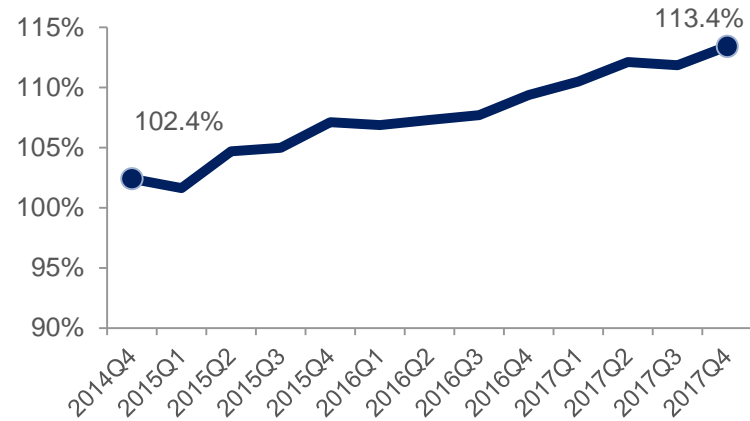
Source: FINREP, ECB calculations.

Liquidity coverage ratio



Source: COREP, STE data, ECB calculations.

Net stable funding ratio



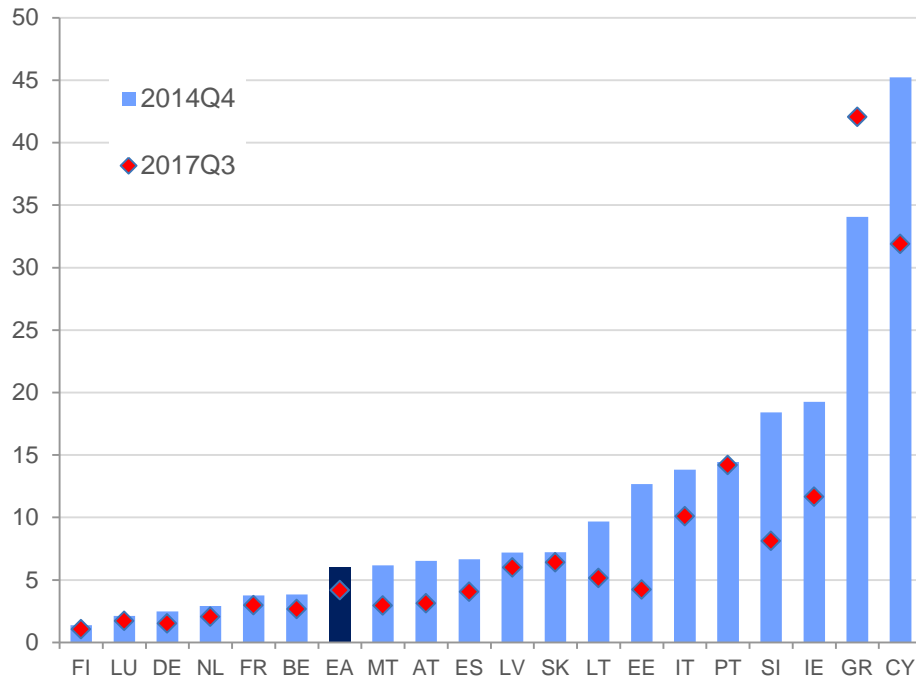
Sources: STE data, ECB calculations.



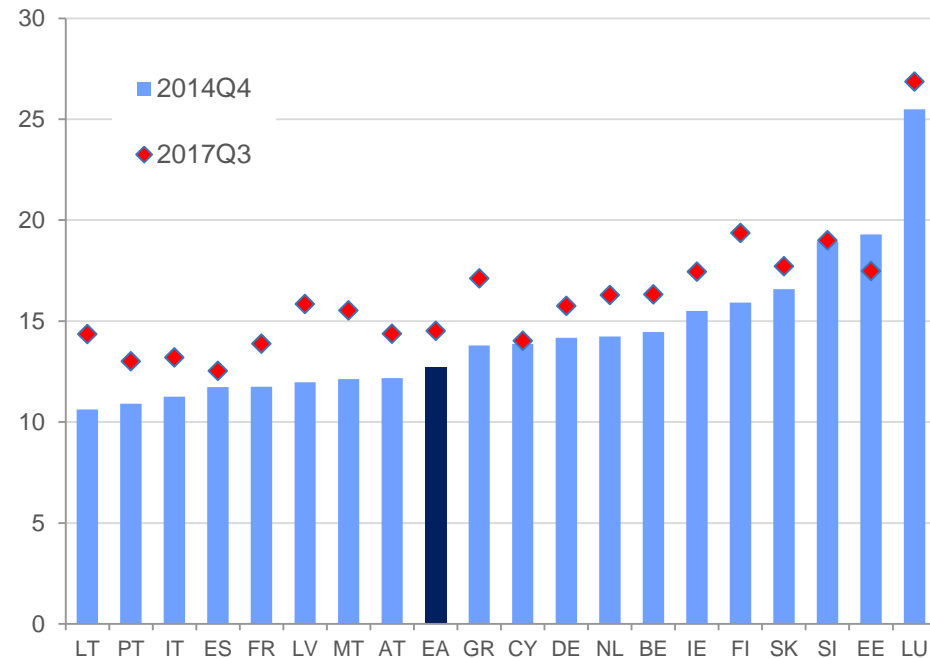
### 3. State of progress – a strengthened euro area banking system

## Capital adequacy and asset quality (2014 and today)

Gross non-performing exposures  
(percentage of total debt instruments)



Common Equity Tier 1 ratio  
(percentages)



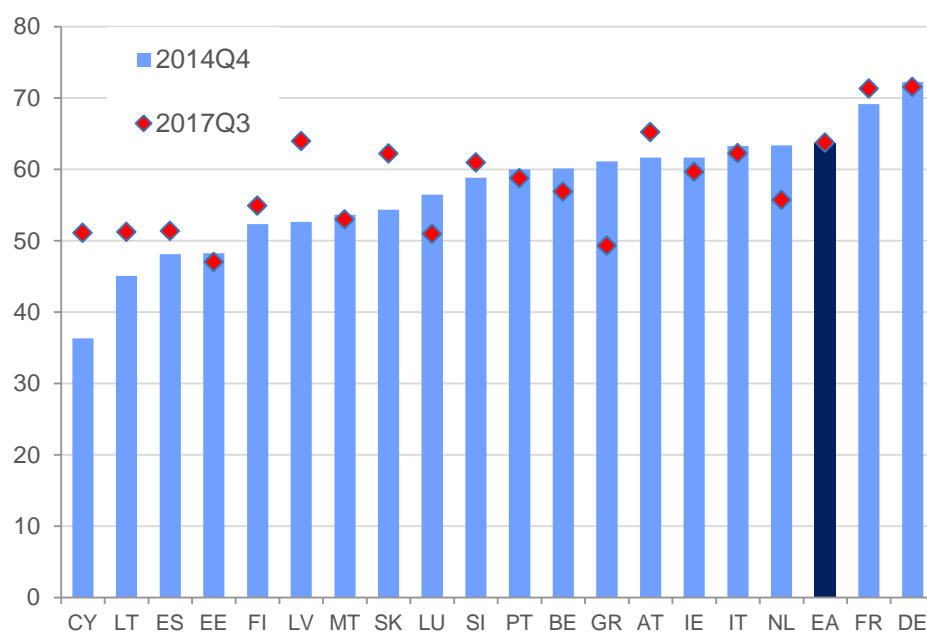
Source: ECB consolidated banking data.

Note: Data exclude subsidiaries and branches of foreign banks.

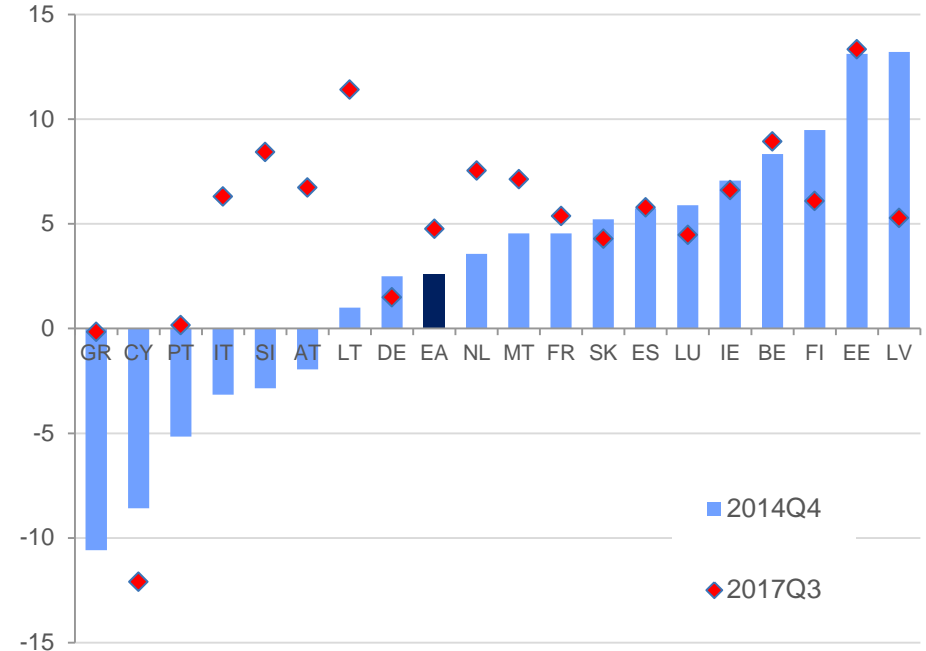
### 3. State of progress – a strengthened euro area banking system

## Profitability and cost efficiency (2014 and today)

Cost-to-income ratio (percentages)



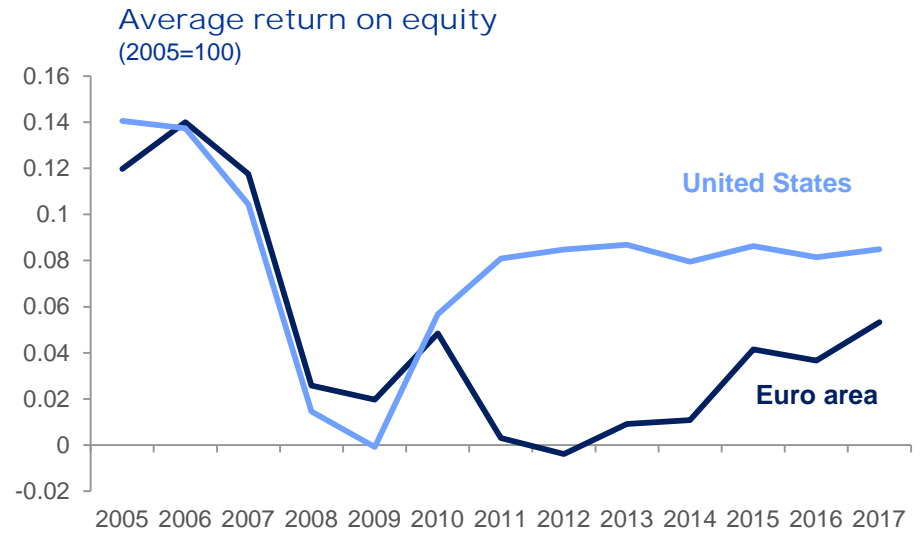
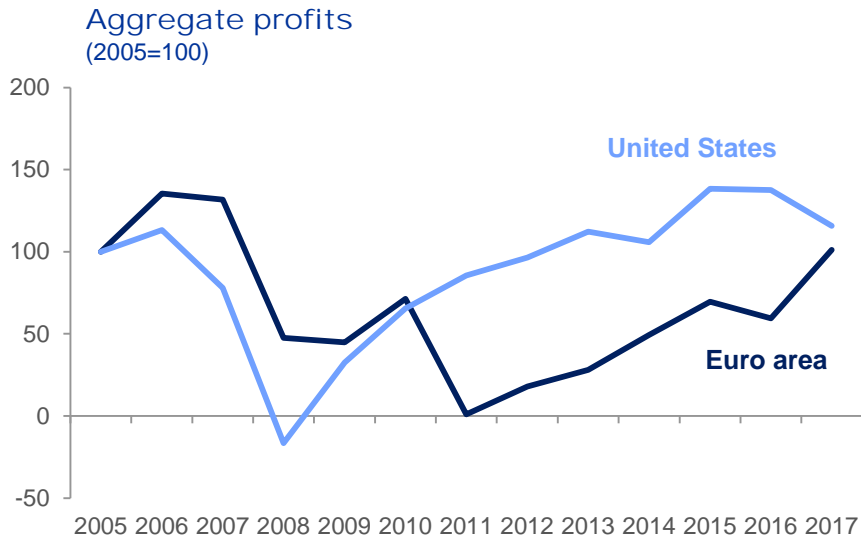
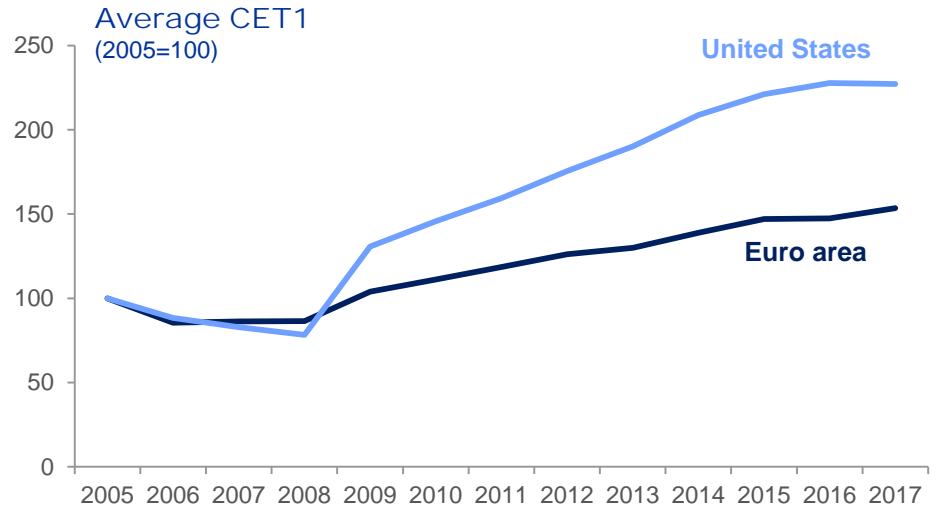
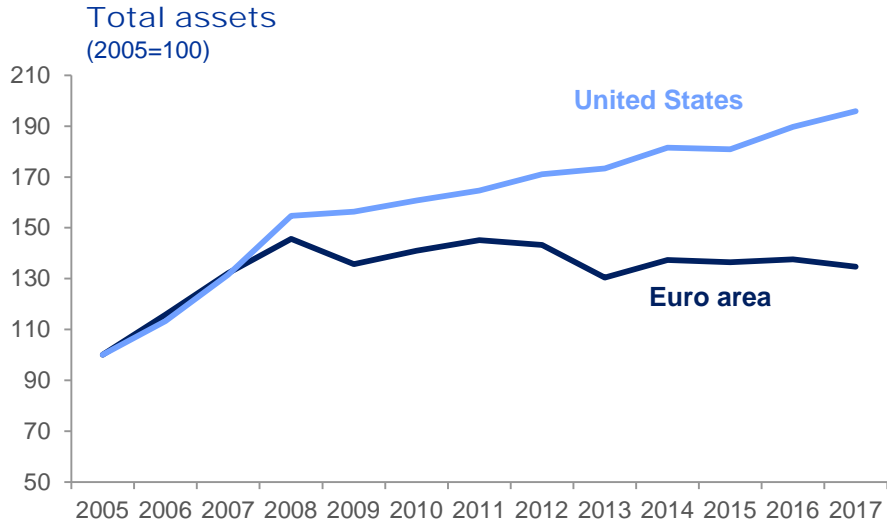
Return on equity (percentages)



Source: ECB consolidated banking data.

Note: Data exclude subsidiaries and branches of foreign banks

### 3. Benchmarking with the United States



Source: SNL

Notes: Based on a sample of 37 euro area and 41 US banks. For CET1 ratios, some figures have been extrapolated due to data gaps.

## What do banks still need to do?

- Address profitability by adapting business models while increasing revenues and cutting costs
- Maintain and develop risk management and continue strengthening governance
- Clean up balance sheets, reduce the level of NPLs

# Competition, efficiency and stability

### Competition intensifies

- Cross-border M&As
- Fintechs
- Digitalisation
- Changing customer behaviour

### Stability maintained

- SSM
- SRM
- Help with NPLs – stronger banks buy weaker banks

### Efficiency increases

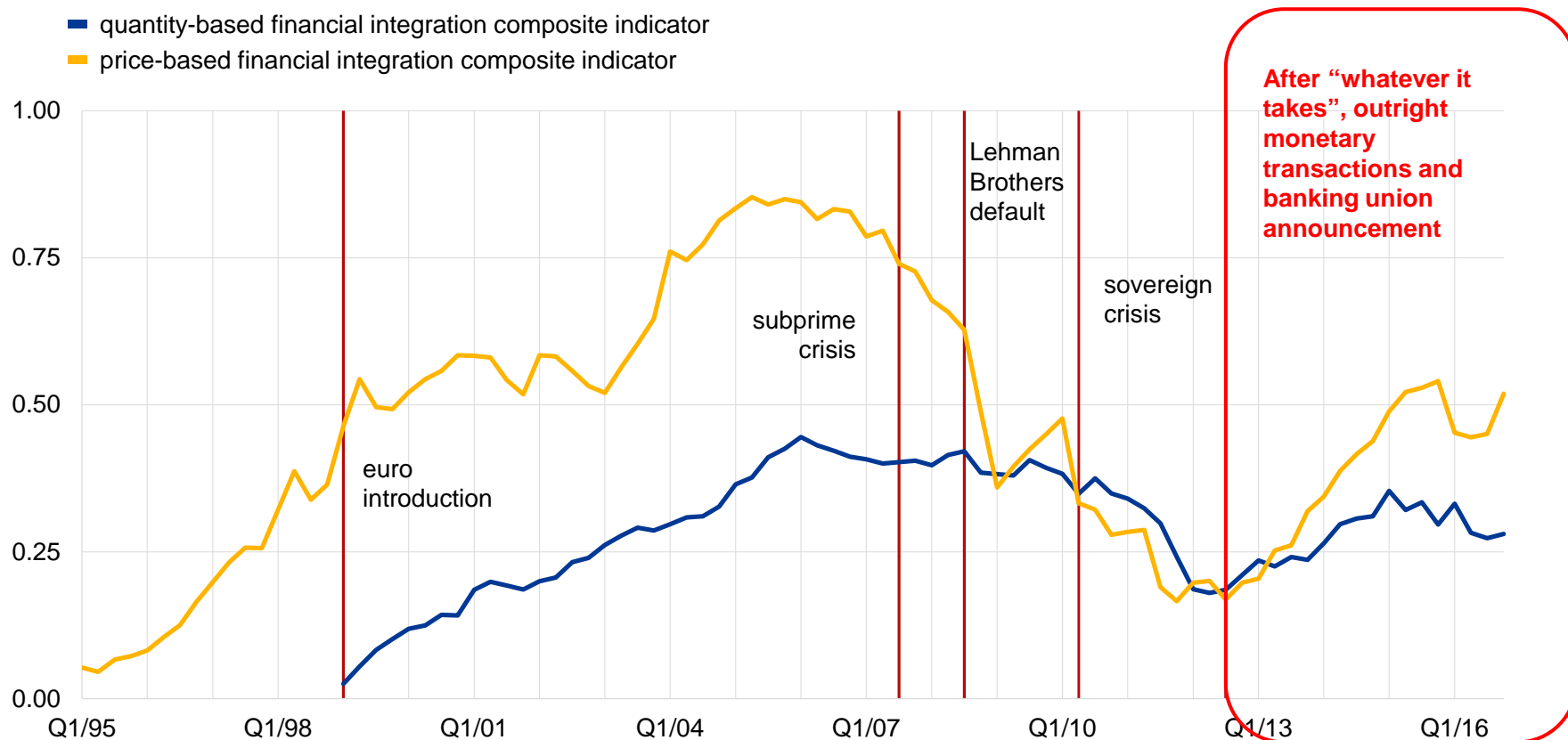
- Competition
- M&A
- Digitalisation

### Benefits of financial integration

- Balanced transmission of monetary policy
- Financial stability (i.e. risk-sharing, payment systems)
- More opportunities for companies and entrepreneurs
- More options for savers and borrowers
- Increased competition among banks

## 4. The coming consolidation – a boost for financial integration

### ECB indicators of financial integration (price and quantity-based)



Sources: ECB Financial Integration Report, various issues. Sources: ECB and ECB calculations.

Notes: The price-based composite indicator aggregates ten indicators covering the period from the first quarter of 1995 to the fourth quarter of 2016, and the quantity-based composite indicator aggregates five indicators available from the first quarter of 1999 to the third quarter of 2016. The indicators are bounded between zero (full fragmentation) and one (full integration). Increases in the indicators signal greater financial integration. For a detailed description of the indicators and their input data, see the statistical annex of the Financial Integration Report.

# On the road to financial integration

### Important factors in progress

- Institutional development (inc EDIS)
- Technological development: a facilitator
- Market conditions: support consolidation

This means the time has come for a period of higher integration – good for the economy & society



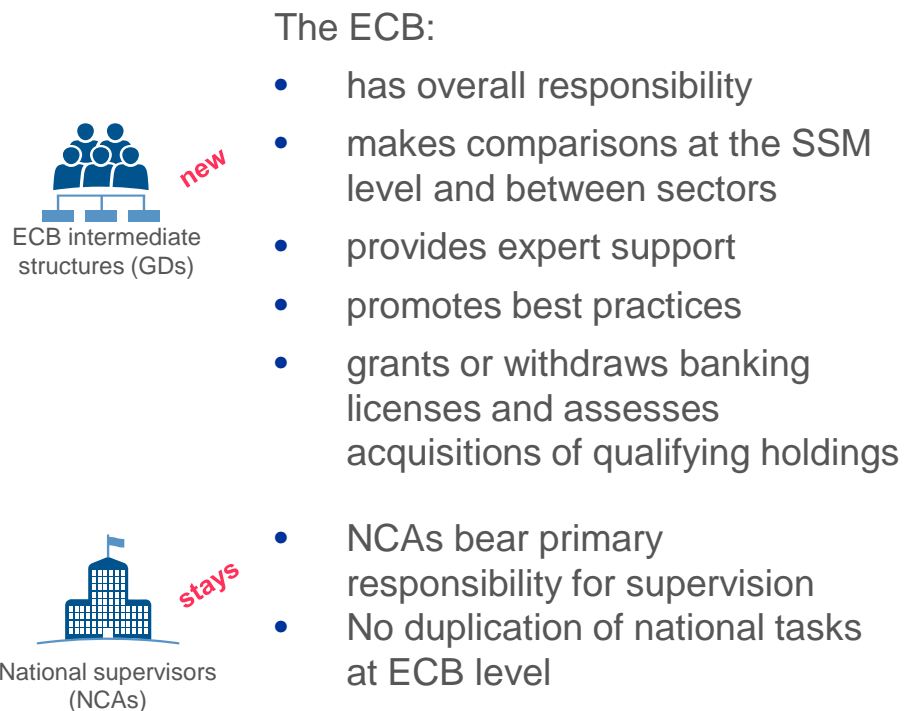


# Q&A

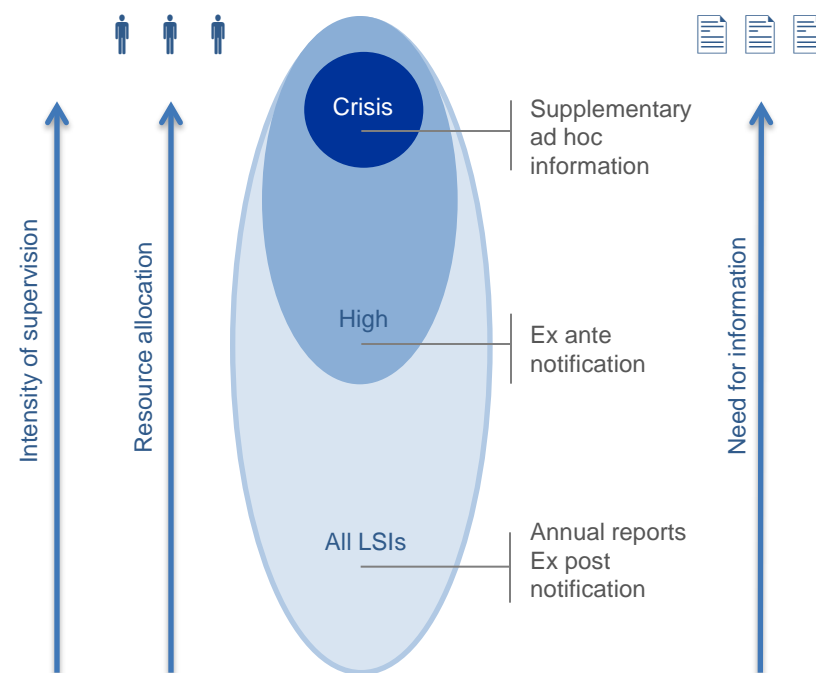
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## Supervision of less-significant institutions (LSIs)

### Distribution of tasks



### Indirect ECB supervision



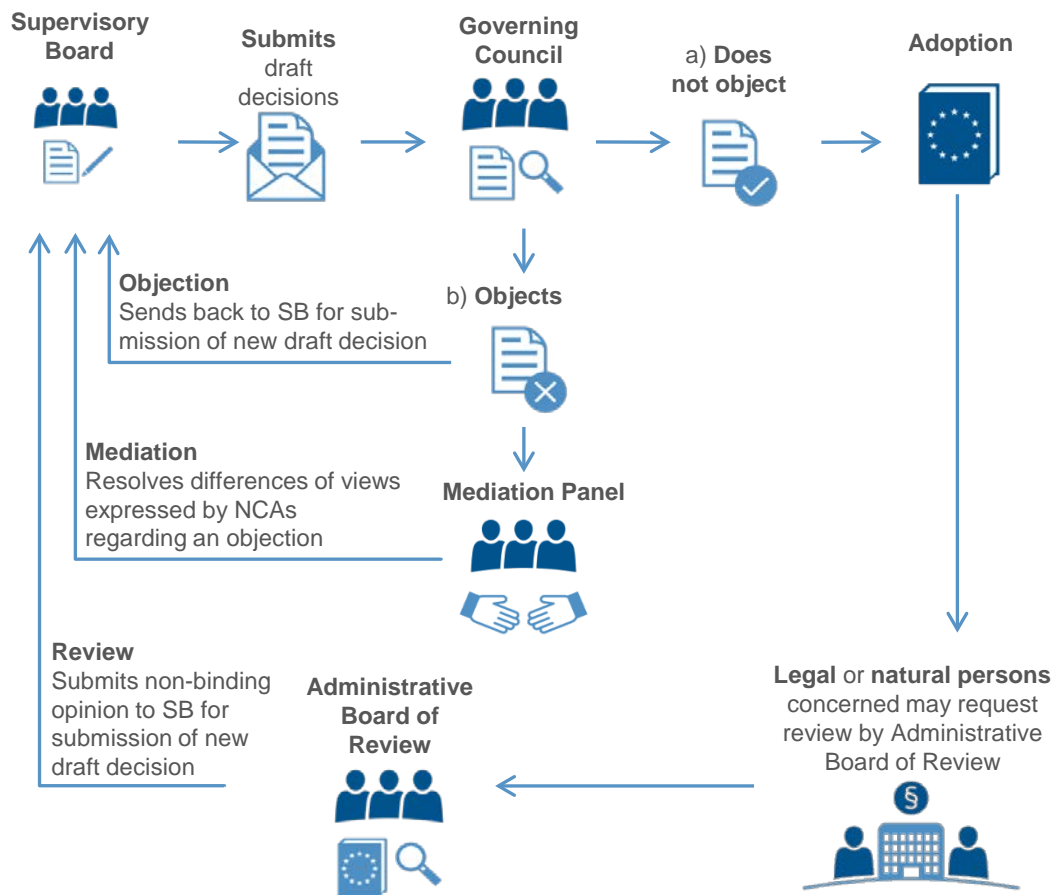
**Gradual approach, based on priority score of LSIs**

**Quantitative and qualitative information from NCAs is analysed**

# 1. European banking supervision: where we started

## European banking supervision decision-making processes

### Functioning principles



### 1. Supervisory Board (SB)

- Plans and carries out supervisory tasks
- Proposes draft decisions for adoption by the ECB's Governing Council (GovC)
- Decision-making process is based on "non-objection" procedure

### 2. Mediation Panel

- Resolves differences of views expressed by NCAs regarding GovC objections to SB draft decisions

### 3. Administrative Board of Review

- Carries out internal reviews of decisions taken by the ECB in the exercise of its supervisory powers

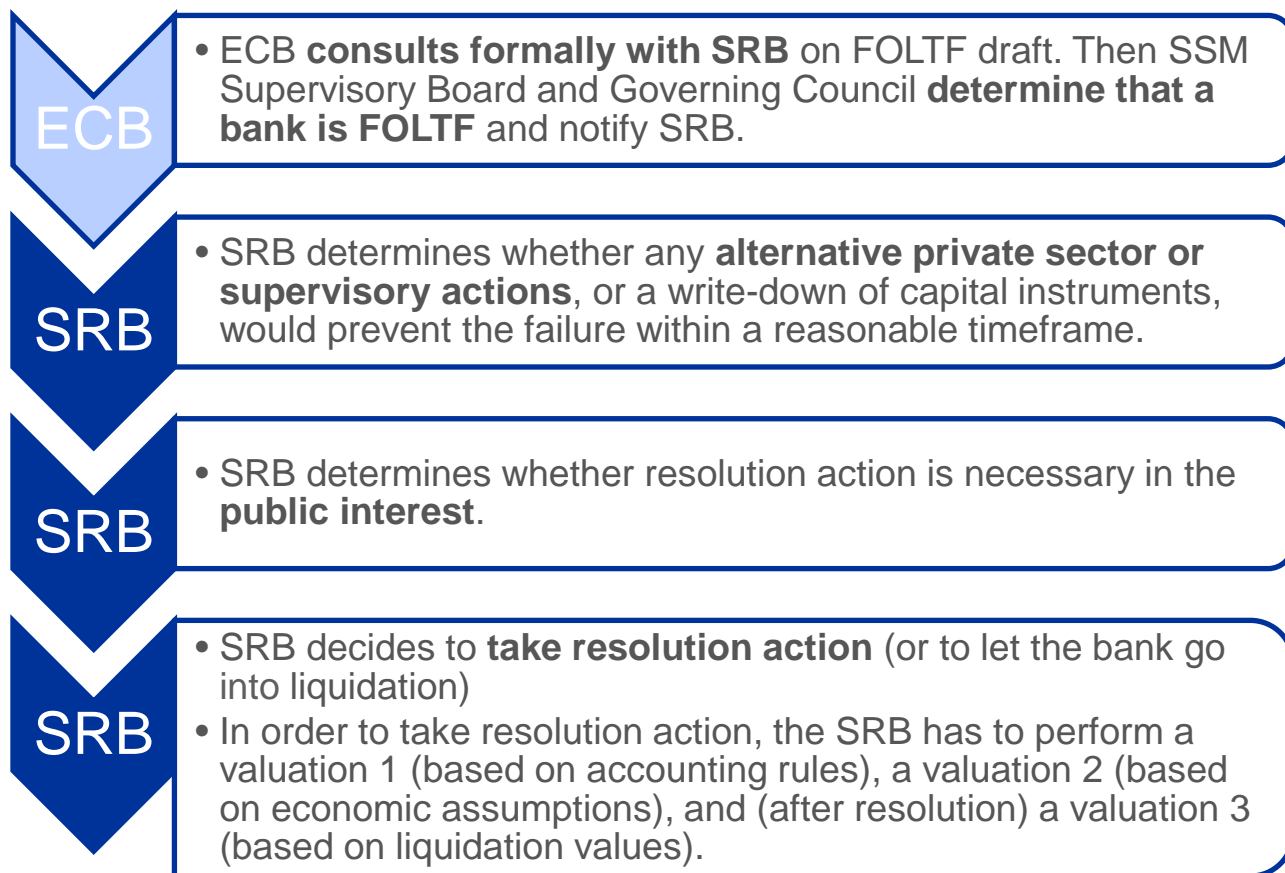
## Robust accountability framework

<b>Channels of accountability</b>	
<b>Hearings and exchanges of views with European Parliament</b>	SB Chair attends regular hearings and exchanges of views in the European Parliament and Eurogroup
<b>Written questions</b>	MEPs and Eurogroup address written questions to the SB Chair
<b>Annual report</b>	ECB submits annual report on its supervisory work to the European Parliament, EU Council, Eurogroup, European Commission and national parliaments

European banking supervision is also subject to rigorous external and internal audits:

- ECB audited by external audit firm (up until now, EY)
- European Court of Auditors audits operational efficiency (not policies) – first report on general “SSM setup”; second report on crisis management
- GovC and SB also consist of representatives of national central banks and supervisory authorities, i.e. accountability towards “owners” is continuous
- Internal audit function via DG Internal Audit and the Internal Auditors Committee
- Further internal scrutiny provided by supervisory quality assurance

# Determination of failing or likely to fail (FOLTF) and resolution



The SRB might approach the ECB during resolution, for example on the determination of capital of the new entity, licensing a bridge bank, etc.

# Common European supervisory culture



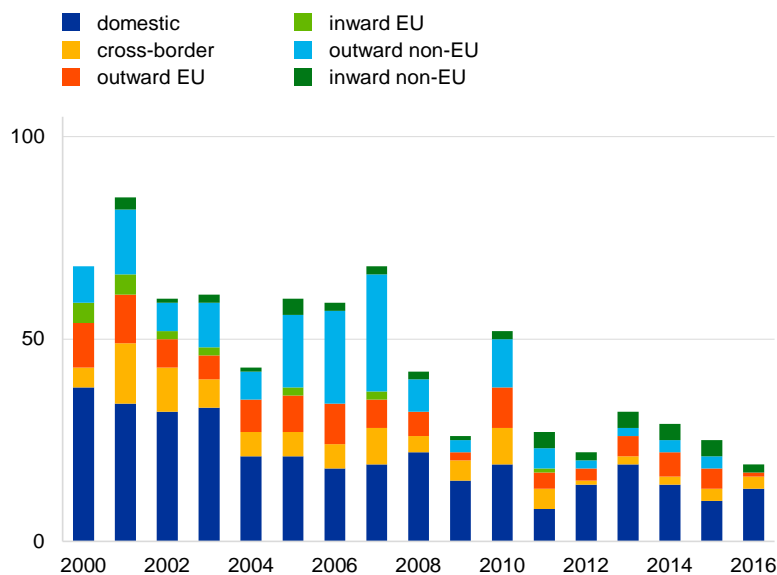
- **26 national authorities** from 19 different countries, speaking different languages, with different national supervisory cultures and traditions
- **Structure** to manage diversity:
  - Strong Joint Supervisory Teams for supervising banks
  - Several networks of experts for “horizontal” issues
  - Constant dialogue and improvement
- **Enhanced transparency**, for example via bank workshops, publication of supervisory statistics, quarterly supervisory newsletter
- **SSM training curriculum**, offering 64 system-wide training courses – more to come
- **Streamlined decision-making** through the implementation of a legal framework for delegation

## 4. The coming consolidation – a boost for financial integration

# Euro area banking sector had a declining M&A trend

- Trend visible in both number and value of transactions
- Dominance of domestic over cross-border euro area transactions
- Severe decrease in 2016 in total value of cross-border M&A

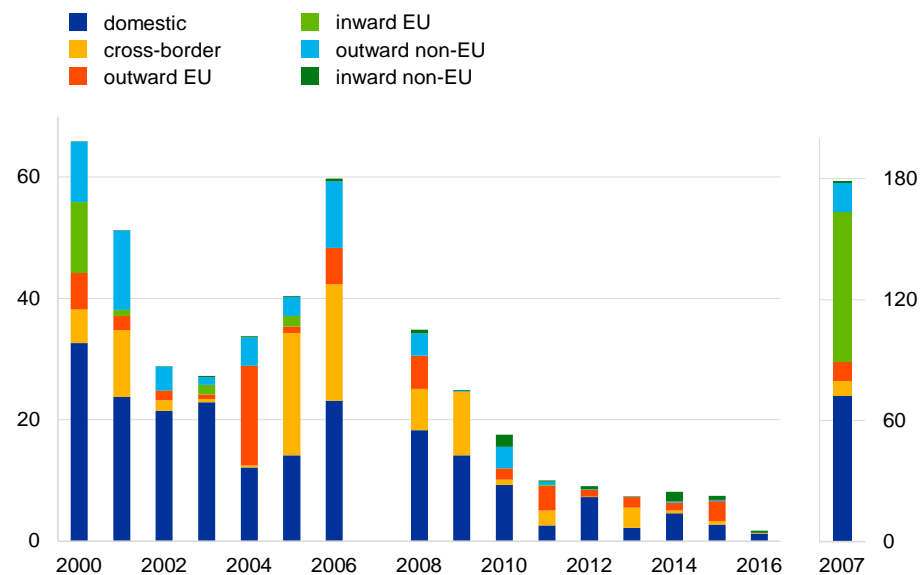
### Bank M&As in the euro area – number of transactions



Source: Dealogic.

### Bank M&As in the euro area – value of transactions

(EUR Billions)



Source: Dealogic.