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**COMMITTEE ON ECONOMIC AND MONETARY AFFAIRS**  
**PUBLIC HEARING WITH ANDREA ENRIA**  
**CHAIR OF THE SUPERVISORY BOARD OF THE EUROPEAN**  
**CENTRAL BANK**  
**BRUSSELS**  
**THURSDAY, 14 OCTOBER 2021**

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**IN THE CHAIR: IRENE TINAGLI**  
*Chair of the Committee on Economic and Monetary Affairs*

*(The hearing opened at 9.03)*

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**Chair.** – We move on now to the next point, which is our public hearing with Andrea Enria, Chair of the Supervisory Board of the ECB. I would like to welcome Andrea Enria. Your last appearance in ECON took place on 1 July 2021, and today what we would like to discuss with you is the supervisory focus on credit risk in the context of the recovery from the COVID-19 crisis and outlook on supervisory measures; the supervisory attention on emerging risks from digitalisation and climate change; and the policy initiatives on the finalisation of Basel III on Anti-Money Laundering and on the completion of banking union. Mr Enria, you have the floor for an introductory statement of around 10 minutes, and then we will have our usual Q&A session.

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**Andrea Enria**, *Chair of the Supervisory Board of the European Central Bank.* – Thank you Chair, I'm very glad to be with you this morning. The banking union is sometimes compared to a house, albeit one which is still unfinished. And if I were to use this metaphor myself, I would say that so far our house seems to have weathered the COVID-19 storm rather well.

But we need to make sure that there is no damage hiding beneath the surface. During the 18 months after the start of the pandemic, banks proved resilient and capable of supporting our economy, largely because they were better capitalised, less leveraged, and had more liquidity than a decade ago.

This was a serious test of the framework we set up following the 2008 financial crisis, and we can be fairly pleased with the results so far. This positive outlook owes a lot to the public support provided at European and Member State level and the actions taken by the supervisors as well.

However, we still have to complete our common house and ensure it is fit to withstand future storms. Banks need to prepare themselves for the fundamental challenges posed by digitalisation and climate change. We also need to remain vigilant about the impact of the

pandemic on asset quality, as well as other emerging risks such as increasing leverage and complexity in financial markets.

And of course, we need to make further progress on the missing elements of the banking union, without which our house will not be complete. We are gradually moving out of the pandemic phase along what looks like a swift process of economic recovery. The risk outlook still warrants some caution though, and it is still too early to declare victory, I think.

Real GDP in the euro area will exceed pre-pandemic levels by the end of this year. The recent stress tests conducted by the EBA and the ECB have showed that, following an adverse, quite severe three-year scenario, the average CET1 ratio of euro area banks would remain very close to 10%. Against the backdrop of improving macroeconomic conditions and decreased uncertainty, we lifted our dividend recommendations last month, so enabling banks to pay dividends again, but we are sticking to the capital flexibility initially announced, so until the end of 2022.

Those banks that have used buffers to cope with the impact of the pandemic will have, as I said, until at least 2022 to replenish them. Our timelines remain unchanged, and ample room for loss absorption remains available under the current framework for the banks we supervise.

Allow me to say a few more words on how we will follow up on this year's stress test exercise. Following a two-step approach, each bank will first be assigned to one of four Pillar 2 Guidance buckets based on the stress test outcome. Supervisors will then exercise discretion and adjust the Pillar 2 Guidance to the capital buffers to the individual profile of each bank. This process will assure a level playing field, reinforce consistency when setting capital guidance and provide more clarity and transparency to the banks and the market about the supervisory implications of the stress test. So I hope that these will lead us to a different level in terms of the understanding of how we use stress tests in our capital framework.

We are setting the guidance – the buffers – now, but we have made clear that banks will have to concretely fulfil this expectation only by the end of 2022 – so when, as I mentioned already, the flexibility related to the pandemic will be phased out.

We are keeping a very close eye on the build-up of risks on bank balance sheets. Banks expect their ratio of their NPLs to total loans to continue decreasing this year and in 2022. NPL numbers indeed appear rather favourable – they continue decreasing – but we also see that asset quality seems to start deteriorating. If we look at faster-moving metrics, such as the share of forborne loans, so loans which have been subject to some forms of restructuring, or Stage 2 loans, so loans that banks themselves have reclassified as a significant increase in risk, these shares have increased, starting in the first quarter of this year.

We have also seeing a build-up of residential real estate vulnerabilities in some countries. During the first quarter of this year we have seen that bankruptcies have also started to increase in some sectors, although they generally remain below pre-pandemic levels. All in all, banks' NPL projections may be optimistic, and banks should remain cautious with releasing provisions and ensure that they have adequate credit risk controls in place.

Credit risk controls has been the real focus of our supervisory action in the last year. In this vein we are also performing deep dives into vulnerable sectors, we have completed the food and accommodation services sector, and we are now moving to the commercial real estate sector.

Finally, the focus on asset quality should not blind us to other sources of risk that may be building up below the surface. We are increasingly looking at the risks posed by banks' excessive search for yield, which is feeding the growing appetite for leverage observed in the

risky segments of the equity and credit markets, as well as the increased complexity and opaqueness in financial markets.

The Archegos case showed that banks' exposure to non-bank financial institutions could be a source of concern, especially when the counterparts are not regulated or are lightly regulated, and when they show unsatisfactory levels of transparency on the leverage and concentration of their portfolios.

A sudden adjustment in yields, triggered for instance by changing investor expectations about inflation and interest rates, could in this context cause asset price corrections and direct as well as indirect losses for banks. We carefully monitor banks' governance and risk controls in order to promote responsible behaviour and make sure that the growing signs of market exuberance do not end up reviving threats to financial stability.

The challenges for our banks go beyond asset quality and financial exuberance. In particular, we are pushing banks to improve their management of the risks posed by climate change and digitalisation. Of course, we expect them to be also able to benefit from the opportunities that are raised by these structural changes in our economies, but in many cases we think that this could also provide an opportunity for banks to adjust their business model and restore their profitability and take on the challenges ahead of them.

The pandemic has definitely increased the use of digital banking services, and we have seen an increased acceptance of the use of digital channels in the distribution of financial services – a 28% increase in a very short period of time, which usually should have taken years to materialise. We think that this provides avenues for further cost optimisation and revenue growth for banks.

Moreover, we are aware that these benefits will accrue through time, while banks need to take the upfront costs and investment in new technologies right now. A more digitalised banking landscape will also, inevitably, have a direct impact on banks' risk profiles, notably in the form of IT and cyber risk. So digital transformation needs to be part of a holistic strategy spanning the overall business model, internal organisation and governance, as well as risk management.

Turning to climate and environmental risks, we see a somewhat similar picture. Banks need to adapt their strategies and enhance their risk management capabilities to ensure their business models are resilient in the short, medium and long term. They also need to be transparent about their environmental footprint to mitigate reputational damage.

The outcome of our assessment of banks' current practices has shown that few banks had developed sound climate and environmental risk management processes. We set clearly in our guidance our expectations, and we asked banks to self-assess themselves against our yardstick, and they are being quite candid in admitting that they are quite some way from where we would like them to be.

Therefore we need to see progress and we need to understand how their business models and risk profiles will be developed and how they will take these physical and transition risks into account in their business, in their risk management especially.

Our forthcoming supervisory stress test in 2022 will be focused on climate risk and will be the first bottom-up exercise in which banks themselves will have to make their own projections, and this will be an important appointment to check progress and to also develop our supervisory approach to the issue.

We are aware, and banks have complained, that getting the right data to perform the exercise will be challenging, but this is one of the intended outcomes of the exercise. We want banks to increase their awareness of the data gaps they have and to effectively manage climate risk and to take swift actions to fill these data gaps. So this will be a learning exercise for the banks and for supervisors as well.

These structural challenges allow banks to more decisively tackle the issue of the long-term sustainability of their business models, which was there even before the pandemic struck, and the low cost-efficiency and depressed profitability remain a serious area of concern also for us as supervisors.

We have seen some signs, so to some extent the pandemic could have been a positive trigger for banks to bite the bullet and make more radical changes to their business models. We've seen banks cutting the branch networks, refocusing the business models and the acquisition or disposals of business lines that have enabled them to rebalance their business mix, but there is still a lot of work to be done.

Let me now move to the European regulatory framework and the banking union to conclude. We will continue, of course, to contribute to the work on completing the banking union and strengthening the regulatory framework, because we are very well aware that our common house will remain vulnerable as long as some elements remain missing.

The first element to be accomplished is the single rulebook, of course, where the outstanding Basel III reforms were just in the last mile of our race and we have seen the finishing line. We are very much looking forward to the proposals from the European Commission. I already made clear that we consider it of paramount importance that the outstanding Basel III standards are implemented in full and in a timely and faithful manner. We should heed the lessons of the COVID-19 crisis, which is that a strong banking sector acts as a shock absorber rather than a shock amplifier.

Indeed, the ECB and EBA analysis confirms that the short-term transitory costs pale in comparison to the long-term benefits of strengthening the resilience of the financial system. The ultimate goal of the exercise, of the final package, is not to raise the capital bar, but of course for some banks there would be distributional effects; some banks would need to make adjustments, as their use of internal models to complete capital requirements has so far placed them on the low end of the distribution, contributing to excessive variability and a lack of comparability in the sector.

We also strongly support the Commission's legislative proposals to establish both a single rulebook for anti-money laundering and an EU-level AML authority. Effective AML/CFT supervision at the European level is important to enhance the credibility of the financial sector in the EU, and we look forward to cooperating with the new authority to make our respective supervisory functions more effective and efficient.

As regards the completion of the banking union, we are pushing for a more integrated banking market, relying on the tools we have within the current framework. For example, we have advocated that banks could rely more extensively on branches and the free provision of services, rather than on subsidiaries, to have more pull than the use of capital and liquidity and avoid the segmentations that we see in the market today – this would help developing, of course, cross-border business. But we have to acknowledge that there are limits to what we can achieve without legislative changes. And to have real progress, the co-legislators should really think about the steps needed to complete a fully-fledged banking union. And the euro crisis management, of course, is the one in which we need an immediate fix, if possible.

Ultimately, the European deposit insurance schemes need to be part of the framework, as they provide the funding support to facilitate the orderly management of failing banks and it would address the host jurisdictions' concerns over local financial stability and the use of taxpayers' money.

So, I would conclude here. The economic outlook has improved but caution remains of the essence. We will continue to be very focused in our vigilance, in our monitoring of the build-up of risks, and we should not lose sight of our final goal of completing the banking union. Thank you very much for your attention and I look forward to addressing your questions.

1-005-0000

**Georgios Kyrtos (PPE).** – I would like to thank Mr Enria for his presentation and for his good work at the ECB. I have three questions. The first has to do with annual inflation in the United States. According to the official figures that were released yesterday, annual inflation in September was in the United States 5.4% and core inflation, excluding energy and food prices, 4%. How could high inflation in the USA affect risk management and the resilience of the European banking system? This is the first question.

The second question has to do with the ECB that wants banks to include more climate-related and environmental risks in their strategy and risk governance, but as of late I believe that we also face major energy risks, and according to President Lagarde and the European Commission, high energy prices will persist at least until April 2022. Does the ECB plan an assessment of the energy risks for the European banking system?

Finally, do you expect the issue of long-term low profitability of European banks to be resolved in the next few years, or do you think that low profitability of European banks will become part of a new normal?

1-006-0000

**Andrea Enria, Chair of the Supervisory Board of the European Central Bank.** – The first question on inflation in the US: I mentioned in my introductory remarks the concerns that we have about some financial flaws that have developed in certain segments of financial markets, in the credit markets, in structured equity markets. Indeed, the concern we have is that, if there is a sharp upward revision of inflation expectations by investors and this is linked to the expectation that the interest rate environment will change in a sudden mode in the months to come, this could lead to important and maybe sudden sharp adjustments in the prices of the riskier assets.

We know that also European banks are quite exposed to highly-leveraged finance customers in the US, and there is also some exposures in the commercial real estate market, so I think that these could be the channels through which turbulence in these segments of the market could impact directly on European banks. As I mentioned, we are doing quite a lot of work in this area on leveraged finance. There has been a specific focus also on the supervisory review and evaluation process (SREP) this year, and we are putting pressure on banks on containing the risks in this segment. We are doing a specific investigation on the prime brokerage activities and on commercial real estate, as I mentioned – we are doing a sort of deep dive already now. So we are trying to assess and contain the risks generally and also in relation to possible developments in the US.

On climate risk and energy risk, well to some extent, again we are pushing banks to start considering the risks in their framework. And banks have been, as I mentioned, candid enough to admit that they do not have sufficient data to cover for these risks. This is particularly true for climate risk. Energy risk – to some extent, of course, it has an interaction with climate risk because different sources of energy could – a sharp change in the reliance on sources of energy, also a sharp change in the cost of different sources of energy could indeed effect the solvency,

the financial strength of banks, of banks' customers. That's the main channel through which these developments are reflecting banks in banks' balance sheets. So we are pushing banks quite hard to fill this data gap and actively manage these risks, so setting a risk appetite framework, having allocated responsibilities in their board, and running internally-effective stress tests. That's the attitude that we are taking there.

Low profitability, as I said, is mainly a concern, of course, for the bankers themselves and their shareholders but it is a concern also for us as supervisors, as profitability is the first line of defence in case of shocks, and it is important to enable banks to attract investors and raise capital if there is a need. So we are concerned about the low level of profitability and the low valuations of European banks.

I must say that I start being a bit more optimistic lately, because I've seen that, during the pandemic, banks have seen a significant increase in productivity, linked to the shift to remote working and digital distribution of their services, so they become more radical in the way in which they are changing their distribution machine: they're investing more in digital technologies, reducing the branch network, hiring specialised IT staff, and they are also relying more on consolidation strategies to address in a more decisive way the low profitability. We've seen, in 2020, EUR 320 billion of M&As transactions in banking in the euro area. It is the highest level since 2008 in terms of volume. And we also see, as I mentioned, some targeted transactions on asset management, custody business, equity brokerage, management of non-performing assets in which banks are either sold or acquired, lines of business to rebalance their business model. Although the aggregate figures don't show an improvement yet because they are taking one-off costs now, to finance the change, I think that we could see the benefit in the coming years. Of course, all the banks should be proactive and move fast in this area.

1-007-0000

**Jonás Fernández (S&D).** – Welcome, Mr Enria. I will put my questions to you in Spanish. I would like to ask you two questions.

The first of these concerns the implementation of the Basel recommendations, to which you referred in your opening intervention. As you know, a series of European specificities have come up in public debate which could, in one way or another, be incorporated into our EU legal framework. Some of them are probably in line with Basel, others maybe less so. I would like to know your views on the debate around these European specificities when it comes to launching discussions and developing the Commission's legislative proposal in the coming weeks.

My second question relates to the development of the banking union. In an intervention, you called on the co-legislators to make headway on the matters pending so as to finalise the design of a stable banking union. The question is, as you know – and have already said – the negotiations on deposit guarantee scheme are very much paralysed.

However, we can see from the market that this is not stopping private sector players. In recent months, we have seen new digital platforms offering opportunities for arbitrage between bank deposits in different countries which, as I say, exploit the opportunities for arbitrage between national deposit guarantees. In some cases, I believe these platforms are – we might say – anticipating regulatory developments or anticipating the problems being experienced with the co-legislators to make headway on these matters.

I would like to ask you to what extent you consider these digital platforms, among other instruments – which are in a way already operating within the Banking Union, even if the banking union does not have a European deposit guarantee – might give rise to problems of one form or another, to some kind of financial stability risk since, in a way, it would be the taxpayers

in the recipient countries that could have to shoulder the burden in a crisis, bearing in mind that the savers would be in another country and that we have seen similar things happen in the past?

1-008-0000

**Andrea Enria**, *Chair of the Supervisory Board of the European Central Bank*. – Thank you very much for your questions. On Basel, we negotiated this package at the global level and it was a difficult and lengthy negotiation. Many of the European specificities have been brought to the global table and discussed extensively, for instances on mortgages. On mortgages there has been a very, very deep discussion, and eventually we got specific recognition of these specificities in the treatment, which are already actually covered in the CRD/CRR framework.

We have already made several deviations from the Basel framework, which have determined the European Union to be materially non-compliant with international standards in some areas, and I think I would like you to appreciate that this eventually erodes the trust that we can have in cooperating with our supervisory counterparts at the international level. So my recommendation would be twofold.

First of all, we do have deviations from the Basel standards that refer specifically to smaller, simpler banks, which are not international in scope, are not covered by the international standards. So if there are specific issues with these banks, as we have done already in the CRR2/CRD file package, I think that these could be accommodated in our framework.

There is understanding at the international table that this package is somewhat more impactful for European banks than it is for banks in other Member States, because we have progressed most in terms of adoption of the internal models, which is the key focus of this package. So please understand that we might need a long-phasing in period, and Basel has already introduced a long-phasing in period. So I think that working on the phasing-in period is something that could be sensible. But in my view, we should try to remain as much as possible on the Basel standards.

We have to remember that the bulk of the proposals that went to the Basel table were the results of analysis done by European supervisors, by the EBA and the ECB. These are fixes that we requested to the international framework to ensure more consistency: a level playing field in the use of internal models.

On the development of the banking union and the digital platforms: digital platforms are doing something that, I think, is to some extent legitimate, because they provide to the customers the possibility to take their deposits wherever they like in the European Union and to basically exploit also the possibility of diversifying their coverage in terms of deposit guarantee schemes.

But you are right – this is a tool that is developed by the market that they can eventually increase the instability for the system as a whole if we don't have the fix on the institutional side, because one development that we saw already in the sovereign debt crisis was that there was a clear perception that one euro deposited in a bank, for instance in Greece or in Cyprus, was not of the same value as a euro deposit in another Member State, because the safety net was perceived to be stronger in those Member States, and we have seen outflows of deposits that have destabilised the system.

So having the platform could even increase the destabilisation function of deposit outflows in case of a shock hitting an individual Member State. So this is an additional reason, I think, to make further progress in the direction of EDIS.

1-009-0000

**Ernest Urtasun (Verts/ALE)**. – Mr Enria, welcome, thanks for being with us this morning. I want to go back to the decision to leave the recommendation on dividend distribution in July.

One could argue that a more prudent attitude asking the banks to set aside sufficient capital in front of the increasing credit risk that we have would have been more prudent, and worryingly enough, one could think that this distribution payment may have happened at the expense of provisioning for increasing non-performing loans, and this would be my first question: do you have any evidence that this payment distribution has affected or will affect the provisioning of NPLs?

The second question is also in relation to the powers that legislation gives you in order to restrict or limit this dividend payment, you can only issue recommendations at the moment, and ahead of the revision of the Capital Requirements Regulation (CRR) that we will have to do in the coming months, my question would be: do you think it would be wise to grant supervisors the power to restrict or to limit this payment distribution beyond the current recommendations that you can issue?

1-010-0000

**Andrea Enria**, *Chair of the Supervisory Board of the European Central Bank*. – Thank you for your question. First of all I would like to stress that we have been the most conservative supervisor globally on dividend distributions. We have gone first into the recommendation to not pay dividends, and we have kept it in a most conservative way for longer than other jurisdictions. So we have been pretty prudent, I would say, if we compare with other supervisors globally.

I think that the rationale for the recommendation was that there was an incredibly high uncertainty at the beginning of the pandemic of how the developments would have affected asset quality and capital positions of banks. So we didn't have visibility on the capital trajectories of individual banks. We were not able to distinguish a good, well-capitalised bank with low risk from a bank that could instead become insolvent under certain scenarios. So that was the reason for a one-size-fits-all recommendation for the whole banking sector. Now, after 18 months, we have seen a sequence of macroeconomic projections that have gone better and better, and on the basis of the macroeconomic projections we have also been able to test and challenge the individual banks' capital projections in the different scenarios. We have done an extensive stress test this year that has shown on average a good resilience of the banking sector, so it would have been difficult to maintain these recommendations for longer, and we thought that we are now in a position to go to an individual bank-by-bank assessment. So to some extent I also want to reassure you that if some banks were to plan excessive pay-outs that could jeopardise their capital trajectory and their ability to cover for NPLs or asset quality problems where we would indeed enter into a serious conversation with this bank, we are entering into serious conversations with these banks, and we would ask to change their distribution plans.

Let me also remind you that we do have a power in the legislation to intervene on a bank-by-bank basis, so we could prevent, let's say, individual banks to make distributions if we have concerns in this respect. That's why I'm not convinced that we would need an overall legal power to ban dividends for all the banks. This would make us the only jurisdiction having this power, and I think investors could be scared that we can jump in at any moment and prevent banks from distributing dividends. This would have a significant adverse impact on the banks' ability to tap capital markets at a moment in which their valuations and their attractiveness for investors is already pretty low. So the recommendation has been effective. All the significant institutions have respected our recommendation, so we have been pleased with the outcome. If we had specific cases, we would have tools to intervene, so we think that these problems do not need a legislative fix.

1-011-0000

**Antonio Maria Rinaldi (ID)**. – Mr Enria, honourable colleagues, the review of the Basel IV rules, and in particular the question of the CCF (credit conversion factor), which introduces capital absorption on sight and self-liquidating credit lines, may lead to credit restrictions for

small and medium-sized enterprises and individual firms. This could therefore increase the cost of credit at a sensitive time for the post-pandemic economic recovery.

I believe the Basel IV proposal, or at least the guidelines – we will know the details at the end of the month – are detrimental to these types of enterprises and therefore wanted to ask whether you consider that a more suitable solution might be found in order to reconcile the needs of such enterprises, which are so important for European economies.

1-012-0000

**Andrea Enria**, *Chair of the Supervisory Board of the European Central Bank*. – Indeed, the issue of credit conversion factors has been discussed extensively at the Basel table, and these types of arguments have been the object of a series of debates. To be honest with you, I am convinced that the current treatment is correct and we should be in line with the Basel proposal. If you look at what happened in the first quarter of last year when the pandemic struck our economies, we have seen a massive jump in lending in the first months of the crisis, which was exactly that customers were drawing on the liquidity lines provided by the banks. That was a very positive feature, to be honest, of our framework, because that was the channel through which the banking sector supported the economy in front of a very unexpected and sharp shock. But at the same time it was also a massive increase in the risk-taking. If the capital treatment before of these facilities were not to be implying sufficient capital coverage, banks might have found themselves immediately in danger of hitting the capital requirements after the shock.

So the point is still that the Basel framework has shown during the pandemic that having the banks well-capitalised, covering also for this potential risk which is embedded in credit lines, liquidity lines, is essential to make banks shock absorbers when the crises come, rather than shock amplifiers. If the shock comes and banks find themselves short of capital, they put on the brakes. They start not lending any more and they become pro-cyclical and exacerbate the crisis in the system. So I think all in all the Basel treatment has been wise and should be maintained.

1-013-0000

**Michiel Hoogeveen (ECR)**. – Thank you Mr Enria for having this dialogue here this morning.

Concerning the banking union, you said it's comparable to a house under construction. In that regard I hope we're still building the fundamentals, because that needs to be in order when constructing a house.

Regarding that, I have a question on your home country – Italy – which is facing lots of NPLs, but a recent ECB study stated that the outstanding NPLs were decreased to 3.8% coming from 8% a year earlier.

So how can you explain the halving of these NPLS? Is it credible? And what are the guarantees the Italian Government has made to the buyers of these bad loan portfolios?

And talking about guarantees from Rome regarding loans, in a recent article in the Dutch *Financieele Dagblad* it was stated that the southern European banks were too weak to join a European banking union. Do you share this view, and what are your recommendations for banks in Italy, Spain, Portugal and Greece to come out of it?

And a final question: what are your expectations for the southern European banking sector once southern governments stop the COVID-19 support? Can you make an estimate with how many percentage points the number of NPLs will rise?

1-014-0000

**Andrea Enria**, *Chair of the Supervisory Board of the European Central Bank*. – Thank you Mr Hoogeveen. Indeed there have been countries, especially the countries that have been hit the hardest during the sovereign debt crisis, in which the levels of NPLs have soared to very

high levels, and this includes Italy, Greece, Cyprus, Portugal and Ireland. I must say that the progress made in the last years – thanks also to the policies of the ECB, which has been very demanding in this field – has been very effective. The progress has been really significant. We have seen – and I have to praise also the banks – the Greek banks, for instance, in the last year during the pandemic conducting a very significant, very sizeable securitisation of non-performing loans – indeed, assisted by government guarantees, with a programme similar to the one adopted in Italy. This has been very effective. There are government guarantees. There has been a scrutiny by DG Competition, by the European Commission, on the conditions that were granted for these guarantees so that the fees paid by banks need to be in line with market levels. Progress has been, indeed, very significant.

We have also been very tough in the sense that we have expressed to the banks a clear expectation that they need to provision gradually for these legacy assets in such a way as to fully cover, after a certain period of time, and if they don't do that, we would have capital charges. And this SREP process is the first one in which we will start applying capital charges for the banks that have still legacy assets which are not sufficiently covered by provisions. So in a nutshell, the answer to your question is that, yes, the decrease in NPLs is relevant, is credible. We expect it to continue, and we praise banks that have continued this important process of cleaning balance sheets also during the pandemic.

In terms of weak banks entering the banking union, we have a tool – it is actually requested by law – which is to do a comprehensive assessment of all the banks that joined the European Union. That was done in 2014 when the banking union started, and we do it also every time that new banks become significant. This entails an in-depth review of asset quality – a stress test – and if there is a capital shortfall that our supervisors identify, this needs to be covered before the banks join the banking union. This is also another element that provides safeguards so that we maintain a strong banking union.

1-015-0000

**Danuta Maria Hübner (PPE).** – Thank you very much, and good morning once again. I would like to go back to the Basel III issue, and I fully share your view that we should aim at implementing all the requirements in full, because I think we indeed have to hold the banks to the highest standards, particularly when it comes to capital requirements – but also, I think, other risk management practices, and there are many of those.

And my understanding is also that the output floor is, and will be, the most controversial element of the Basel III reforms in the European banks, so the Commission will put the proposals. I apologise: I had to go and vote, and maybe I missed some answers to Basel from you, so there might be maybe some repetition, I don't know, I'm sorry for this.

But I would like to know your arguments, because I understand that there are those two options regarding how exactly the floor can apply. There can be this option that the floor applies to absolutely all prudential requirements, including the EU-specific buffers or to only some of them, and I expect that, if we have the proposal that would be put on the table, which would take this single stack approach, then we would have a difficult discussion with Member States and with some banking sector representatives.

So my question to you is: can you help us with the arguments? If you are in favour of this single stack approach, what are the major arguments in favour of costs and benefits of this approach, especially if it's combined with the output floor at consolidated levels?

1-016-0000

**Andrea Enria, Chair of the Supervisory Board of the European Central Bank.** – Thank you for your question. It's a very technical issue but a very delicate one. To be honest with you, I think I don't disclose any secrets here, I've always been unsupportive of the output floor. I

thought that the progress that we have made with the EBA repair agenda and with the ECB targeted review of internal models gives us sufficient reassurance on internal models. At the same time, we have to acknowledge that these models, as we have seen sometimes, are not entirely reliable.

We have also to acknowledge that for other jurisdictions, the output floor was a red line – not only for the US, which has a 100% output floor in the legislation, but also for emerging markets, which are not using standardised internal models approaches and which were very adamant that they would have been very concerned about an aggressive use of internal models by European banks.

So the output floor was a red line in international discussions. We started discussing with a range between 70% and 90%. We ended up at 72.5%, so it was a major success in terms of the negotiation, and I think that we now have to implement the output floor and be loyal to international commitments. We also – sorry, I cannot avoid saying that – we also have to remember that there was already an output floor in European legislation before, but it was worded in a non-Basel-compliant way, and some Member States had applied the output floor in a way that did not make it bite, which is why now, for some banks, it is so difficult to comply with the output floor. We have also to remember this point, which is, of course, another point which is important at the international table.

Now, single stack, double stack, parallel stack: the parallel stack would lead to an increasing ... we have already a very complex regulatory framework, let's be honest. This would lead to a fiendishly complex framework in which you would use two different sets of RWAs according to which requirement you are calculating. What we said is that we should stay on the single stack and we, as ECB, formally committed to avoiding an inflation of risk-weighted assets due to the output floor, leads to an automatic mechanistic increase in other requirements such as the Pillar II requirements, the Pillar II guidance, which are under our responsibility. It is clear that if we are now in charge of our own interest rate risk in the banking book under Pillar II, the fact that there is the output floor does not mean that the risk has changed, that our assessments should change, so we will recalibrate the charge in order to sterilise the effect of the output floor. We can do it via supervisory means without complicating excessively the legislative framework. So I hope that this provides you with some good arguments to avoid this complication in our legislative framework.

1-017-0000

**Marek Belka (S&D).** – Thank you. I have two questions. One is about banking union: when we look at the situation after the pandemic, it looks like a success, even if unfinished. The banks are better capitalised, stronger, better supervised – and yet, when I remember the rationale behind the idea of the banking union, it was to provide for efficient trans-border private capital flows. Without it, it will be doomed to deepening divergence within the eurozone.

Do you see any tickup in those trans-border flows? And can it be ever achieved without a wave of trans-border mergers and acquisitions?

The second question is for you as the Chair of the Supervisory Board of the ECB. Well, we haven't really foreseen one of the consequences of the pandemic, which is destabilisation of the global economy and chaos in supply chains. Some people are haunting us with comments about the coming stagflation. Well, it may or may not materialise. If it materialises, it may be transitory. But if it stays with us for a longer time, do you think that the monetary policy has any instrument to deal with it?

1-018-0000

**Andrea Enria, Chair of the Supervisory Board of the European Central Bank.** – Thank you for your question. On the first point: indeed, if you look at the typical indicators of a bank's

strength – balance sheet strength, capital positions, liquidity – let's say banks are in a much better place right now and we should see this as a major positive.

If you look at the indicators of integration in the banking markets, we are not in a good place. What you see is that there has been a significant drop in cross-border banking within the European Union or within the banking union after the great financial crisis, and then it stayed flat there. There has been only a tiny positive impact after the start of the banking union, which means that the scars that were generated by the great financial crisis and the sovereign debt crisis have, unfortunately, you know, led to a regulatory framework that is not supportive at the moment of integration or the banking union.

Our banks cannot consider the banking union as their domestic market, and this is a big drag in terms of efficiency, in terms of ability to get the scale needed also to compete on a global basis, and this is to some extent indeed a result of, as I said, our unfinished house.

You mentioned the cross-border M&As. Indeed, we have seen – I mentioned – a significant increase in cross-border mergers in 2020, but they've all been domestic. There has being one case that can probably be classified as cross-border, but most transactions have been happening only within domestic markets.

This to some extent is understandable, because now the driver is cost efficiency, so you need to have some overlapping of the branch network to gain in terms of cost efficiency. But indeed, some cross-border deals would be important to move forward the integration in the market. I recently have made some suggestions, because the key concern of banks is that the maths to do cross-border deals doesn't work. If they have to do a deal and then they have to keep the capital and the liquidity trapped in each and every Member State where they're present within the banking union, these means that the cost is not worthwhile taking.

So the proposal we made was to create some more space to use the waivers, which are already in the legislation – a very narrow door because the advantages are very limited, and I made proposals for that. And the other one is to ask the banks to maybe use more branching. Branches has being a tool that is in place since 1992, the start of the single market. It has not been used that much, because national authorities were very keen not to have a shift of responsibilities from the host authority to the home authorities, who were not very supportive of these transactions.

But now in the banking union, the authority would remain the same. If you have a subsidiary in another Member State and you want to transform it into a branch, you can do it without any change in the supervisory authority. It would remain the ECB and the national authorities would continue being involved in the joint supervisory teams as if nothing happened. So I think that this is a tool that could be used more to foster integration and to make the math work also for cross-border deals.

On the second point, I'm afraid I cannot take your question, because you know that there is this principle of separation with monetary policy. So I cannot take a question on what the monetary policy wing can do. But anyway, we are, of course, working in close cooperation – that we can do – with our colleagues on the central banking side to look at all the possible scenarios, also adverse ones, and try to see how these would impact on the banks' balance sheets and address the potential consequences.

1-019-0000

**Chair.** – Thank you very much Mr Enria. Thank you for your availability. Thank you to all the MEPs who participated in this debate. We can close this first hearing, and before we move to the next hearing with the two ESAs' chairs and the interim chairperson of ESMA, I will take a

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two/three-minute break because we need to test the connections with our guests. So just a couple of minutes and then we will be back. Thank you Mr Enria.

*(The hearing closed at 10.05)*