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Documentation—Technical Note on European Banking Authority**

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EUROPEAN BANKING AUTHORITY

TECHNICAL NOTE

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GLOSSARY

ATC	Advisory Technical Committee of the European Systemic Risk Board
BCBS	Basel Committee on Banking Supervision
BoS	Board of Supervisors
CfD	Contracts for Differences
COREP	Common Reporting
CEBS	Committee of European Bank Supervisors
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
EBA	European Banking Authority
EC	European Commission
ECB	European Central Bank
EFFE	European Financial Stability Framework Exercise
EIOPA	European Insurance and Occupational Pension Authority
ESA	European Supervisory Authorities
EP	European Parliament
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
EU	European Union
FSAP	Financial Sector Assessment Program
FINREP	Financial Reporting
IASB	International Accounting Standards Board
IRB	Internal Ratings Based
JC	Joint Committee
MB	Management Board
MoUs	Multilateral Memorandum of Understanding
NSAs	National Supervisory Authorities
RTS	Regulatory Technical Standards
RWA	Risk Weighted Assets
SREP	Supervisory Review and Evaluation Process
SSM	Single Supervisory Mechanism
TN	Technical Note

EXECUTIVE SUMMARY

In spite of limited resources, the achievements of the European Banking Authority (EBA) in its first two years of existence are significant, but the pace and prioritization of its activities have been dictated by the crisis. Efforts directly related to the crisis, such as the stress test and recapitalization exercises, while highly important under the circumstances, may have diverted scarce resources and management attention from other aspects of its mandate related to enhancing convergence and quality of supervision in the European Union (EU). However, in its short existence, the EBA has been very active in its regulatory mandate, and 23 draft technical standards have been produced, the large majority of them related to capital.

The EBA has operated under constraints that have resulted in reputational risk. For instance, in its stress testing and risk dashboard activities the EBA may not collect data directly from the financial institutions, nor verify the correctness and integrity of data provided by the national authorities. The EBA has relatively cumbersome decision making processes, and its budget for staff is largely inflexible, being subject to the financial rules of the EU institutions. As a result, delays and data inaccuracies have brought significant reputational risk in its first years of activities.

Going forward, the EBA should concentrate increasingly on its supervisory convergence and quality assurance tasks. Thus, the EBA is recommended to advance its work and accelerate the convergence on Pillar 2 practices (common methodologies for supervisory review and evaluation process). This is crucial to reduce the scope of regulatory arbitrage for aspects of supervision that will not be covered by the Single Rulebook. Another example of activity that should receive priority is the current work on consistency of Risk Weighted Assets (RWA). The initial work identified divergences in the application of Internal Ratings Based (IRB) models, differences of interpretation/implementation of the regulatory framework, and dispersion across banks in the gap between expected losses on defaulted and non-defaulted assets. This work is of great relevance for supervisory convergence and the level playing field in the single market. It should be kept in harmony with Basel Committee on Banking Supervision (BCBS) Level 3 exercises, and followed up with the issuance of Guidelines (and perhaps Regulatory Technical Standards - RTS) to ensure consistency.

The creation of the Single Supervisory Mechanism (SSM) will bring a new dimension and urgency to the EBA's supervisory convergence role. The European Central Bank (ECB) will need to implement supervisory procedures for the operation of the SSM in the timeframe established by regulation, which means it may front run in some aspects the content of the envisaged European Supervisory Handbook. While this is unavoidable given the short implementation timeframe of the SSM, it is important that the EBA works closely with the new supervisor so that the SSM can build its procedures based on best available guidelines, and aligned with the EBA's view of the Handbook that will apply across the EU.

The EBA also needs to foster cross-country cooperation by further encouraging more joint supervisory activities (including joint onsite inspections) through the colleges of supervisors' framework and resume the performance of thematic peer reviews. It is also recommended to implement peer reviews on the adequacy of supervisory resources, and governance arrangements of supervisory authorities, because the consistent quality of supervisory outputs across the single market depends greatly on these factors.

The EBA should play a more pro-active role in cross-border supervisory colleges using its soft powers, and be able to participate in core colleges of EU banking groups having activities outside the EU. The EBA's engagement in colleges should go beyond the EU and cover the larger non EU international groups active in Europe. The EBA should ensure that its Guidelines are observed and implemented in practice. It should use its soft powers ("name and shame") to foster effective and regular multilateral exchanges of information, ensure genuine joint decisions that are required from the colleges, and continue pushing for mediation when no joint decision can be reached. Going forward, the EBA should be assertive in the colleges in ensuring a level playing field across EU countries (between in and out the SSM).¹ The EBA will also have a role to play in the EU's relationships with the outside world.

In its oversight capacity, the EBA should now prioritize the strengthening of transparency and the reliability of data. The 2011 stress test exercise showed the value brought by disclosure of detailed information. However, quality assurance is key. The EBA should strive to (i) enhance the quality assurance process; (ii) promote the disclosure of granular asset quality information; and (iii) expand depth, and coverage of audits. In addition, the EBA should raise the awareness of supervisors on asset quality issues, in particular by issuing Guidelines for supervisors on best practices for the conduction of asset quality reviews, addressing some specific sectors, and urgently pushing for enhancing comparability and completeness of Pillar 3 reports. The EBA should work with national authorities and coordinate the provision of technical expertise where needed.

¹ SSM could impact the mediation role of the EBA. With the current set-up, ECB as an independent institution is not subject to the mediation of the EBA, while mediation of the EBA is binding for all member countries. This brings about the complaints of the euro-outs.

I. INTRODUCTION AND SCOPE

1. **This report is an overview of the EBA's performance against its mandates, given economic conditions prevailing in the banking sector in the EU.** The review was carried out as part of the 2012 Financial Sector Assessment Program (FSAP) assessment of the EU, and was based on the regulatory framework in place, the supervisory practices employed, and other conditions as they existed on December 12, 2012.
2. **The report is based on the laws, regulations, and other supervisory requirements and practices that were in place at the time of FSAP mission.** Ongoing regulatory initiatives are noted by way of additional comments. The team² received responses to a detailed questionnaire that had been provided by EBA prior to the commencement of the exercise, and met³ with the EBA on December 7, 2012. The analysis has been complemented and supported by discussions with the European Commission (EC), the other European Supervisory Authorities, some national supervisory authorities (NSAs), ECB, legal firms, and market participants. The authors are grateful for the full cooperation extended by all.

A. Banking Sector Structure

3. **Banks remain a key contributor to the EU financial and professional services industry.** Banks account for 3.6 times the EU GDP in size and 7 percent in revenues (€900 billion in 2010; source: FBE). They employ 1.5 percent of the EU workforce (three million staff). The sector grants 85 percent of the funding to corporates, against 30 to 50 percent in the United States.⁴ Over the past five years (2007–2012), some consolidation has occurred. The number of credit institutions has decreased by 5 percent⁵, mainly in Netherlands, Germany and France, due to mergers, restructuration or closures. There were 7,913 EU credit institutions at end–October 2012.⁶
4. **Outlook for the sector remains challenging.** Since the outbreak of the financial crisis, asset quality has been deteriorating. Nonperforming loans account for 8.4 percent of gross loans in June 2012, against 2.6 percent in December 2007.⁷ On the positive note,

² The team comprised Fabiana Melo and Nadege Jassaud, Monetary and Capital Markets Department, IMF.

³ The team's analysis relied on interviews, the self assessment and internal procedures documents, but the team did not have access to internal minutes and work papers that could substantiate a more comprehensive review.

⁴ Barclays, March 2012, Can European bank funding be fixed?

⁵ 631 institutions in Ireland (mainly as a consequence of the reclassification of 419 credit unions as credit institutions on January 1, 2009) and in Malta and Slovakia, as a consequence of joining the EU.

⁶ Credit Institutions are undertakings whose business is to receive deposits or other repayable funds from the public and to grant credits from their own account, deposits, or other repayable funds.

⁷ Based on a sample of 90 largest EU banks (same sample as for the EBA stress test), using Bloomberg data.

capital buffers have increased between December 2008 and June 2012; the Tier 1 ratio of EU banks exceeded 10 percent at end-June 2012, against around 7 percent in December 2008⁸ and overall profitability remained positive.

5. **European financial integration has resulted in a sharp increase in cross-border banking groups and exposures within the EU banking system over past decades.** Even though declining compared to 2011, there are still some more than 87 EU cross-border banking groups, of which 40 with significant operations outside of their home country (44 in 2011).⁹

II. EBA GOVERNANCE

A. Institutional Arrangements and Accountability

6. **Like the other European Supervisory Authorities (ESAs), the EBA is governed by a Board of Supervisors (BoS).** The BoS is composed of the heads of the 27 national supervisory authorities (NSAs), with observers from the EC, European Systemic Risk Board (ESRB), the ECB, European Securities and Markets Authority (ESMA) and European Insurance and Occupational Pensions Authority (EIOPA). Only the Heads of the NSAs, or in their absence, their alternates, have the right to vote. The EBA Chairperson is responsible for preparing the work of the BoS and participates in its meetings but has no voting right. During 2012, the BoS met seven times and had four conference calls (six and 10 times respectively in 2011). Only one BoS member just attended one physical meeting in 2012, infringing Article 40, 1 (b) of the EBA Regulation that requests a minimum of two attendances.

7. **The assignment of one vote per member, and a decision making process requiring majority—either simple or qualified¹⁰—have facilitated rapid and forthright decision-making, but national interests may still influence decisions.** The EBA Regulation explicitly cites (in Article 42) that the voting members of the EBA’s Board of Supervisors shall act independently and objectively in the sole interest of the Union. However, some alliances or concerted decisions may happen. A voting member cannot vote on a matter where he/she has a material personal conflict, but it does not prevent him/her from voting on a matter concerning its own competent authority.

⁸Tier 1 ratio excluding hybrid instruments—as a proxy of the core Tier 1 ratio—based on EBA data (57 banks with not all banks reporting all data for all periods).

⁹ In the absence of a comprehensive list of EEA cross-border banking groups and their establishments, EBA staff rely on what competent authorities duly reported.

¹⁰ Adoption of technical standards requires qualified majority. “With regard to regulatory technical standards, implementing technical standards, guidelines and recommendations (Articles 10, 15, and 16 of the Regulation) and measures and decisions adopted under the third subparagraph of Article 9(5) of the Regulation and under Chapter VI of the Regulation, decisions of the Board of Supervisors shall be taken on the basis of a qualified majority of its members.”

8. **Within the Banking Union, new issues may arise.** Countries that will not participate in the SSM fear the current decision making process at the BoS will allow the SSM members' position to always prevail. At the time of the FSAP, no agreement had been reached on voting rights.¹¹ One of the risks was to get to a compromise that would raise the required votes for approving a proposal in practice, coming very close to a unanimity principle. The EBA's ability to take effective decisions could then be seriously hampered. A possible solution could be the introduction of an independent and restricted decision making body, which would put all countries, in and outside the Euro area, on the same footing. Decisions taken by this body should be subject to a veto power of the BoS, which would ensure monitoring and the possibility to reject decisions on the basis of a bipartisan majority of the BoS.

9. **It would be desirable to confirm in practice independence from the EC.** The procedure for the adoption of technical standards gives room for objections by the EC upon certain grounds (which have to be based on EU-wide interests and within three months). When the EC does not intend to endorse a draft regulatory technical standard (or to endorse it with amendments), it sends it back to the EBA, explaining the reasons why it does not endorse it. The EBA has six weeks to amend the draft and resubmit it in the form of a formal opinion to the Commission. If the new draft is not amended "in a way consistent with the EC's proposed amendments," the EC can make its own amendments and adopt it. While the period under review remains short to draw conclusions, there has been no example of undue interference on the substance by the EC.

10. **The EBA has a Management Board (MB) that focuses on managerial aspects.** The MB is composed of six members selected from the BoS, by its members. The MB is chaired by the EBA's Chairperson. Decisions of the MB are adopted on the basis of a majority of the members present, having each one vote. In the event of a tie, the EBA Chairperson has a casting vote. The quorum is reached once at least two-thirds of the members with the right to vote are present. The EBA Executive Director and a representative from the EC participate in the meetings of the Management Board, with no voting rights. The MB focuses on managerial aspects of EBA, such as the development of the annual work program, the budget and resources.

11. **The EBA's Chairperson and the EBA Executive Director are appointed by the BoS, following an open selection procedure.** Both are appointed for five years terms with the possibility of reappointment for one more term. Before the EBA Chairperson takes up his/her duties, the EP may object to the designation. The Chairperson may be removed from office only by the European Parliament following a decision of the Board of

¹¹ The agreement reached in the ECOFIN Council on December 13 provides that decisions on breaches of EU law and on binding mediation will be taken by the Boss upon proposal by the panel, by a double majority (majority of the participating and the non-participating member states). On regulatory decisions of a horizontal nature (e.g., draft technical standards, guidelines, recommendations) the principle of qualified majority is also combined with a requirement for a double simple majority. The Council compromise is still subject to discussions with the European Parliament which are expected to conclude early in 2013.

Supervisors. The Executive Director is appointed by the BoS after confirmation of the EP. The Executive Director may be removed only upon a decision of the BoS.

12. **The EBA is accountable to the European Parliament and the Council.** In accordance with Article 43, EBA's BoS reports its work program to the European Parliament, Council and Commission each year as well as an annual report on its activities and on the performance of the Chairperson's duties. Article 50 of the EBA Regulation provides for EBA's Chairperson to be invited to the European Parliament and Council to make a statement and to answer questions put by members of the European Parliament. It also provides for the Chairperson to report in writing on EBA's main activities when requested.

13. **The Banking Stakeholder Group facilitates consultation with stakeholders in areas relevant to EBA's tasks.** The EBA's Banking Stakeholder Group is composed of 30 members appointed to represent in balanced proportions credit and investment institutions operating in the Union, their employees' representatives as well as consumers and other users of financial services such as SMEs. The Group is consulted on actions concerning Regulatory Technical Standards and Implementing Technical Standards and, Guidelines and Recommendations, to the extent that these do not concern individual financial institutions.

14. **Past IMF recommendations to enhance BoS Governance are still valid (European Financial Stability Framework Exercise - EFFE May 2011).** In order to mitigate national interests, representatives of some other EU institutions (except the Commission), and possibly the EBA Chairperson, could have a vote on the Supervisory Board. The powers of the Management Board could be further strengthened, with more delegated powers from the Board of Supervisors. For instance, one could set up a permanent Executive Board, composed of independent representatives.

15. **The level of seniority at the BoS should be preserved.** To ensure an adequate level of representation at the BoS, members who do not comply with the Article 40 of EBA Regulation should have their votes suspended. To incentivize the right representation, a mechanism of written procedure could be introduced for all the representatives at the BoS, who are not the Board of Supervisors' members.

B. Data issues

16. **The Regulation establishing the creation of the ESAs contains provisions indicating that the ESAs should be able to access, via European and national counterparties, all the information necessary to conduct their activities; but this provision has not been used in practice.** Where information is not available or is not made available by the NSAs, the EBA can address a duly justified and reasoned request to other institutions, or the financial institutions themselves, but always through the respective NSAs. However, this provision has not been used in practice. In at least one case, seeking to assess

the NSAs' handling with regard to the Financial Conglomerate Directive, the EBA has only received partial answers from NSAs but has not used further its powers of data collection.

17. **This lack of direct, easy access to institution-specific data poses reputational risks.** Since the EBA needs to go through NSAs to obtain detailed supervisory data, delays are incurred, which negatively affects most EBA oversight activities (stress tests and risk assessment). In particular, requiring a vote from the BoS to provide data for particular studies that the EBA wants to implement might hinder its ability to be timely in its work. Furthermore, as the EBA does not have powers to collect data directly from the financial institutions, it has to rely on the NSAs. The NSAs perform the first level data control and are well placed to ensure the quality of the data transmitted. However, if the correctness and data integrity are not well ensured by the NSAs, the EBA incurs reputational risk while using and publishing the information.

C. EBA Staff and Budget

18. **The last two years were crucial in setting up and extending the human resources team.** EBA's staff increased from 58 to 95 between May 2011 and December 2012, according to the initial plan presented during the previous IMF mission. Currently the Chairperson and Executive Director are supported by three Directors and seven Heads of units. EBA staff are composed of 68 temporary agents, 12 contract agents and 15 seconded national experts. Staff have been trained during 2011 on an average of one day per staff member and in 2012 for 1.5 days per staff member.

	2011	December 2012	2013 Planned
Temporary agents	46	68	93
Contractual agents	8	12	15
Seconded national experts	4	15	15
Total	58	95	123

Source: EBA.

19. **Endowing the EBA with the adequate resources, on a flexible basis, is crucial.** Currently, the EBA's budget is part of the EC's overall budget, with 40 percent coming from the EC Section of the General Budget of the EU and 60 percent from obligatory contributions from the NSAs. While contributions from NSAs may impede the independence of the EBA, the budget process subordination from the EC means that EBA's staffing policy is subject to the rules applicable to all EU agencies. Indeed, the salaries, and levels of seniority are dictated by EU rules and the budget determined by the EU Budgetary Authority (the Council and the European Parliament) to a great level of detail. While tasks from new regulations should in theory go with immediate additional budget, the EC budget rules, allocate the new staff only when the new regulation is published in the Official Journal. For instance, the new tasks in terms of recovery plans will require 16 new staff according to the EBA, whereas the

EBA staff will, however, need to await the final publication of the Directive, although in theory the EBA's proposals for some of the Technical Standards contained therein should be almost ready for consultation and validation by that time. Staff and other expenses are not fungible. EBA cannot use free budgetary resources from other projects to meet these immediate needs.

20. **The participation of NSA staff in technical working groups is helpful and desirable in the current decentralized setting, but the EBA should not rely too much on such resources.** Standing and Technical Committees—staffed by NSAs—are significant and desirable complement resources. There are currently four Standing Committees (Standing Committee on Regulation and Policy; Standing Committee on Oversight and Practices; Standing Committee on Accounting and Auditing; Standing Committee on Financial Innovation) and 20 sub-groups. NSAs are also seconding staff, for defined period of time, even sometimes for very short thematic projects. As the NSAs have more abundant resources than the EBA, the resulting work may potentially reflect this national-based membership. In addition, work continuity may become overly dependent on availability of NSAs.

21. **Like the other ESAs, the EBA advocates for more flexibility in staffing but also needs to take a medium term view, particularly considering the establishment of the SSM.** Given the current stage of the banking industry in the process of implementing Basel III, a critical mass of staff is necessary to ensure proper drafting and implementation of the technical standards across the EU. To help this process, more flexibility in the budget should be considered. One option could be a separate and specific budget line in the overall EU Budget, outside the Commission's funding. The EU body in charge of data protection (the European Data Protection Supervisor) is funded on the general budget of the EU. An alternative that might be envisaged is to explore additional sources of funding, e.g., fees on financial institutions. However, the planning of staff needs also to take a medium term view, particularly considering the establishment of the SSM. As the ECB will be given a supervisory role for euro area member states, the EBA mandate should provide for the necessary adjustments to the range of its activities and may have to refocus on specific core tasks.

III. REGULATORY AND SUPERVISORY ACTIONS

A. Developing a European Regulatory Framework

22. **As noted by the 2011 EFFE, the EBA is a regulatory agency of the EU.** The Directives and Regulations for the banking sector are adopted by EU legislators based on the proposals of the EC. The EBA has been empowered to draft technical standards (Level 2), but these only have binding effect once endorsed by the Commission, and Guidelines (Level 3). The EBA participates in the Level 1 process giving Opinions on EC rulemaking proposals, but such Opinions are not binding nor require a response. The EBA recently sent to the EC, EP and Council two Opinions expressing concerns regarding own funds definition

and the application of transitional floors to capital requirements, in both cases suggesting amendments to the Capital Requirements Regulation (CRR) which forms part of the fourth Capital Requirements legislative package (CRR/CRDIV). The level of technical detail in Level 1 legislation in the European framework leaves in fact little room for Level 2 regulation, and is not conducive to the timely adjustment of prudential rules.

23. **To perform its regulatory duties (technical standards and supervisory practices), the EBA established internal procedures for rulemaking and consultation.** High level processes have been established in alignment with the other ESAs, and include general directions on the development, drafting, cost-benefit analysis and impact assessment, consultation, the role of the Banking Stakeholder Group, submission to the EC, publication, and analysis of proposed EC amendments to the Technical Standards.¹² There is also a public statement on its consultation practices (EBA DC 57). In addition, the EBA has developed detailed internal guidance on its regulatory process, such as quality criteria for drafting Technical Standards, and templates for the various documents to be used in the process.

24. **A Policy Analysis and Coordination Unit (PAC) is responsible for general coordination of regulatory activities within the EBA as well as with external stakeholders.** It counts on a legal analysis team to support the legal mandates and legislative drafting; and an impact assessment team which provides guidance on the impact assessment methodology to be applied. PAC has nine staff, while regulation activities themselves are conducted by some 25 people distributed in three Units under the Regulation Department.

B. The Single Rulebook

25. **The single rulebook derives from the idea that technical rules should be defined at the EU level and adopted through EU regulations.** That would ensure their direct applicability to all banks, eliminating the additional layer of local rules. Such measures would reduce costs of compliance, limit the scope for regulatory arbitrage, and prevent loss of competitiveness of EU-wide groups.

26. **The single rulebook will impose uniform technical standards that will be binding, once approved by the EC.** The draft Technical Standards developed so far are mostly focused on CRR/CRDIV legislative framework, in particular on own funds, credit risk and market risk. The only component of the Single Rulebook that has been endorsed so far is the Regulatory Technical Standards on Capital Requirements for Central Counterparties. EBA has submitted these draft Technical Standards to the Commission in September 2012 and they were endorsed by the Commission (and thus became binding) on 19 December 2012.

¹² EBA DC 030, Decision of the European Banking Authority adopting a Procedure for developing and adopting Draft Technical Standards and Guidelines and Recommendations

27. **Although the EBA's regulatory efforts have been recognized, industry and observers note that due to the extremely tight timetables for CRD-related regulatory work, consultation periods are narrow.** In addition, as noted above, there is concern over the Parliament and the Council's power to object these Technical Standards and, where necessary, to block their adoption (see comments on governance, above).

C. Enhancing Supervision

28. **As part of its mandate, the EBA should promote convergence of supervisory practices to a high standard across all member states, so that regulatory and supervisory rules are implemented equally on the ground.** This mandate serves both financial stability and the single market objectives. There are several tools available to strengthen supervisory convergence, ranging from training programs, harmonizing reporting, data sharing and disclosure, participation to colleges, and conducting peer reviews.

29. **Several EBA sub-groups are working on enhancing convergence, but besides Guideline issuance little has been accomplished so far mainly due to the existing divergence in national practices and the resistance by competent authorities to changes.** Competent authorities exchange practices through the ongoing work of the EBA Standing Committee on Oversight and Practices (SCOP). Its Sub-group on Home-host and Colleges is directly involved in the work on the colleges, in particular operational functioning of colleges, joint decision making on approval of advanced models and joint decision making on institutions-specific prudential requirements. The SCOP Sub-group on Risk Assessment Systems has started working to develop Guidelines for a common SREP. Another sub-committee is focused on Implementation and Supervisory Practices, in which convergence and harmonization of practices should be a core objective.

30. **The EBA also organizes training for NSAs and other ESAs, with the objective to harmonize common understanding.** Moreover, the EBA works with the other ESAs, organizing joint cross-sector programs, to foster a common supervisory culture. In 2011, it organized seven road shows and nine seminars. In 2012, it organized 13 seminars.

31. **Guidelines for supervisory and reporting convergence issued include (i) Recommendations on the implementation of EU regulations, and (ii) best practices of issues covered exclusively by national legislation.** Regarding the first, there are Guidelines to harmonize processes concerning supervisory approval of changes in Advanced Measurement Approach (AMA) models for operational risk; Guidelines on Stressed Value-At-Risk (Stressed VaR) and on the Incremental Default and Migration Risk Charge (IRC) modeling approaches employed by credit institutions using the Internal Model Approach (IMA); as well as Guidelines on the data collection exercise on high earners and remuneration benchmarking. The Guidelines on assessment of the suitability of members of the management body and key function holders on the other hand, enter the realm of national legislation. The Guidelines include criteria and minimum requirements for fit and proper

assessments, and are aimed to be used by both banks and by local supervisors in assessing bank's practices.

32. **Regarding peer reviews, the EBA adopted in May 2011 the decision to establish a Review Panel, but conducting peer reviews has been given relatively low priority.** The Decision establishes that peer reviews would assess the degree of convergence reached by members in the implementation of supervisory provisions set in legislation or by the EBA, and to monitor convergence in supervisory practices. It is interesting to note that reviews are also to cover the adequacy of supervisory resources, and governance arrangements of supervisory authorities. An EBA methodology for the peer review was adopted by its Board of Supervisors in June 2012. A revised methodology for the peer review mechanism is yet to be published, and therefore the current methodology is the one updated by Committee of European banking supervisor (CEBS) in 2009. The process should include a review by the Panel, based on self-assessments provided by national supervisors, against "clear and objective assessment criteria" which "must be objective as reasonably possible." If the supervisor is found non-compliant, it is to be called to explain. No peer reviews have been completed in the recent past. In summer 2012, the EBA initiated a Peer Review of its Stress Testing Guidelines, to further strengthen consistency in supervisory outcomes, and identify best practices developed by competent authorities which might be of benefit for other competent authorities to adopt. In 2013, this review is due to be completed, and a peer review started on EBA's Guidelines on Concentration Risk under Pillar 2.

IV. FUTURE ROLE: DEVELOPING A SUPERVISORY HANDBOOK AND STRENGTHENING COLLEGES

33. **The establishment of the ECB as a single supervisory authority for the euro area countries has triggered a renewed discussion on EBA's mandate on supervisory convergence.** It is clear that the ECB will need to implement supervisory manuals and procedures which are consistent across participating countries and their NSA exercising delegated powers, and that might front-run or overlap with the EBA's mandate. In response, following the EC Communication and EP proposals for the SSM legislative package, the EBA's management has expressed the intention of developing a Single Supervisory Handbook. According to EBA's work plan for 2013, such a Handbook would seek to unify supervisory methodologies in order to avoid the fragmentation of the EU Single Market, and would be composed of papers summarizing best practices and Guidelines.

34. **The focus of the supervisory handbook should not be on detailed procedures, but rather on interpretation of existing standards and regulation, and orientation on how supervisors can substantiate their assessments of banks risks.** In practice, the content of such a handbook would be based on the stock-takings of supervisory practices that the EBA has already started to conduct (frameworks for the analysis of risks, ICAAP assessments and Pillar 2 decisions). The stated goal of converging supervisory risk measures and corrective actions is likely more difficult to achieve, and will take time: such

convergence would imply a more harmonized supervisory culture that can be promoted only over time.

35. **The ECB and EBA will need to cooperate strongly so that the ECB, as a new supervisor, can build its procedures based on the best practices.** The ECB should align its procedures with the overview handbook to be drafted by EBA. As any other supervisor in the EU, ECB will need to adjust its practices as Guidelines and Technical Standards are developed or updated.

A. Supervisory Colleges

36. **The EU banking regulation requires colleges of supervisors to be established for all cross-border banking groups in Europe.** CRD 2 (applicable from December 31, 2010) requires the establishment of colleges of supervisors to improve the supervision of cross-border banking groups and facilitate home host dialogue, particularly in the context of the joint decision on capital (Pillar 2 capital add-on). The colleges should also help prepare and handle emergency situations. The FSB has also promoted the establishment of supervisory colleges for all major financial institutions at the global level, as an immediate response to the financial crisis.

37. **The EBA conducts a yearly mapping to identify cross-border groups.** EBA colleges were set up for 110 cross-border banks in 2011 and 87 in 2012 (of which the EBA focuses on 40 largest colleges). Some consolidating supervisors have also set up Core colleges for closer coordination and cooperation between the supervisors of the most relevant entities. The joint risk assessment and the joint decision, however, have to be performed and agreed by all EEA supervisors.

38. **The EBA staff participate in the colleges, yet with mixed success.** According to EBA Regulation (Article 21), in its ‘facilitator’ role, the EBA will contribute to promoting and monitoring the efficient, effective and consistent functioning of the colleges of supervisors and foster the coherence of the application of Union law among the colleges of supervisors. Staff should encourage supervisory best practices to converge and the EBA may develop draft Technical Standards with regard to the operational functioning of colleges. The EBA collects, shares all relevant information in cooperation with the NSAs, while establishing a central system to make such information accessible to all college members. It may evaluate the risks to which financial institutions are or might be exposed under the supervisory review process or in stress situations. There seems to be considerable variety as to how this ‘facilitator’ role is performed in practice, depending on the group’s structure, type of college and EBA representative.

39. **At the level of the colleges, joint assessment and decisions remain heterogeneous.** The colleges, under the coordination of the consolidating supervisor, should lead to a joint risk assessment and reach joint decisions on the adequacy of capital at group and entity level. According to an EBA staff note, most colleges have developed uniform

approaches, but with different levels of granularity and consistency. Joint decisions sometimes are only one page long, simply listing the individual capital requirements and without adequate evidence and analysis. In some cases, the EBA staff said they were not always convinced that individual capital requirements were consistent with the risk assessment, particularly where authorities imposed higher capital requirements on entities that had the best risk profile and were the most profitable of the entire group. Use could have been made of formal mediation where no joint decisions were reached. No requests for mediation were made despite some areas of disagreement.

40. **Cooperation from third country supervisors is work in progress.** EBA staff has been invited to participate in a few colleges that are set up for the EEA parts of a banking group with a parent undertaking in a third country. For the time being, however, these appear to remain exceptional cases, and some third country authorities have not granted full access to the EBA representative, whose role in supervision may not be clearly understood. Some authorities still object to granular data sharing, particularly at the level of the general colleges. Some third country supervisors are reluctant to attend crisis management colleges.

41. **For EU based banking groups, the EBA should strengthen its leading role in cross-border supervisory colleges, but the arrival of the SSM will raise new challenges.** The EBA should ensure that its Guidelines are observed and implemented in practice. It should use its soft powers (“name and shame”) to foster effective and regular multilateral exchanges of information, ensure genuine joint decisions, push for mediation when no joint decision can be reached, and seek to ensure that colleges reach action-oriented, forward-looking conclusions. Under the SSM, the design of colleges will change. The ECB will become the home supervisor, and in some cases the euro area home and host countries will participate in colleges as observers only.

V. ASSESSING SYSTEMIC RISK

A. EU-Wide Stress Test and the Risk Dashboard¹³

42. **The EBA has been strengthening bank stress testing procedures and their application.** Following the poor reception of the 2010 exercise, the 2011 solvency stress testing and recapitalization exercises were marked by more consistency checks and transparency. The recapitalization exercise recommended the achievement of 9 percent core Tier 1 capital by end-June 2012, after establishing a sovereign buffer against banks’ holdings of government securities based on a market-implied valuation of those holdings. A few banks under restructuring and recapitalization programs did not achieve the target on time.

43. **EU risk dashboard and assessment.** The EBA is producing a Risk Dashboard (which is not public) to identify and measure systemic risk and it also publishes a regular risk

¹³ A separate report on stress test was produced during the FSAP. This note will not detail the issue.

assessment. The dashboard is based on Key Risk Indicators (KRI), which are a set of 53 ratios reported on a quarterly basis by EU national authorities, covering 57 EU banks from 20 EEA countries. The definition of those variables is homogeneous and consistent with the supervisory and financial common EU reporting for jurisdiction that have adopted the COREP and the FINREP. In terms of coverage, the banks in the sample cover at least 50 per cent of each national banking sector. Time-series are however not complete, as they have been collected on a best effort basis. Moreover, while the EBA carries out consistency checks, the responsibility on the quality still rests on national authorities. The EBA provides regular risk assessments to the European Parliament, the Council, the Commission and the ESRB of trends, potential risks and vulnerabilities in the EU banking sector.

B. Contribution to ESRB Work

44. **The EBA is a member of the ESRB.** It participates in its main decision making bodies (General Board as well as Steering Committee) as well as in its Advisory Technical Committee (ATC), the ATC's Expert Groups and two permanent Working Groups on Analysis Tools and on Instruments. The objective is that its input on micro-prudential issues is reflected in the ESRB's systemic risk measures. In expert groups under the ESRB's Advisory Technical Committee the EBA has assumed the role of collecting bank specific information, such as data on asset encumbrance and innovative funding and on interbank lending in the EU. The EBA also provides the ESRB with its own bottom-up assessments of risks and vulnerabilities affecting the EU banking system. EBA contributed to the ESRB task force on stress testing, as well as EIOPA and ESMA.

45. **The EBA is following-up ESRB Recommendations.** With regards to the Recommendation on lending in foreign currencies, the EBA must by end 2013 adopt Guidelines to NSAs on capital measures relating to FX lending supervisory practices (those Guidelines have been drafted and will be approved by the EBA's BoS in February 2013). The ESRB Recommendation on dollar denominated funding includes regular data collection on funding positions which the ESRB collects from NSAs in its follow-up. The Recommendation states that NSAs may report in aggregate through the EBA, which already has received such a notification and wants to establish its own account in this data collection. It is engaging with the ESRB Secretariat and NSAs to receive further notifications of the data collections.

C. Role in Fostering Transparency

46. **The EBA has been acting to promote harmonization of financial and supervisory reporting.** It is currently finalizing the draft Implementing Technical Standards on supervisory reporting, which will cover all EU credit institutions and investment firms. These draft Technical Standards will harmonize the reporting framework in the EU and will include reporting of own funds and own funds requirements (COREP), financial reporting (FINREP), large exposures, liquidity and leverage ratios. Banks will report the data to their

NSAs, which will then forward data on an individual basis to the EBA. The EBA will in the near future collect comprehensive sets of regulatory and accounting data from the banks and will be a hub of bank specific data. On COREP, FINREP and large exposures, the EBA reporting will cover 100-200 banks in the first phase, but leverage and liquidity ratio reporting covers all banks. This effort not only facilitates stability analysis, but also reduces the regulatory burden by harmonizing reporting requirements. The EBA is in the process of drafting a RTS specifying the new requirements contained in Basel 3 on own funds disclosures, including a template for own-funds. It has not yet made a decision on public dissemination of the bank specific data that will be collected through the new reporting framework.

47. **The 2011 stress test exercised showed the value brought by disclosure of detailed information.** The EBA has published the results of the EU-wide stress tests in 2010 and 2011 on its website. In 2011, a user-friendly tool was provided to access the disclosure more than 3000 data points for each bank disclosed.

48. **However, quality assurance is key, more so than stress tests themselves.** The EBA should strive to (i) enhance the quality assurance process, (ii) promote the disclosure of granular asset quality information (including collateral and risk weighted assets calculations), and (iii) expand depth, and coverage of data audits. In addition, the EBA should raise awareness of supervisors on issues related to asset quality and the need for accurate and timely reporting, in particular by issuing Guidelines for supervisors on best practices for the conduction of asset quality reviews. It should work with NSAs and coordinate the provision of technical expertise where needed.

49. **The EBA should push for enhancing comparability and granularity of Pillar 3 reports.** While it has been working on assessing Pillar 3 reports for some time, this has not been always followed up with strong actions. The EBA (and CEBS) assessments have led to the publication of yearly reports, containing findings and suggested best practices. Linked to the work on asset quality, Pillar 3 reports should also be adapted to provide the markets with more granular and comparable information.

VI. BINDING POWERS

50. **In very few cases, the EBA can issue Recommendations or binding Decisions directly to NSAs.** This applies to cases where a NSA is incorrectly applying EU law (breach of EU law, Article 17); where there is a disagreement between national authorities in cross-border situations (mediation, at the initiative of the NSAs, Articles 19 and 20); and in emergency situations declared by the Council (Article 18). In those cases, the EBA can take Decisions directly applicable to financial institutions as a last resort, only if the NSA has not complied with it, and only when EU law applies directly to a financial institution (Regulation and not a Directive).

51. **No formal case has materialized so far.** EBA has been involved in a number of soft reconciliation measures, consisting of differences between home and several host supervisors and differences between home and individual supervisors.

52. **In 2012, several actions have been taken on crisis management preparations.** The EBA issued a Crisis Management manual outlining the role of colleges of supervisors in emergency situations, as well as an EBA internal crisis management procedure guide. It also began to attend the Crisis Management Groups of a number of the major cross-border banking groups. In May 2012, it also published a discussion paper containing a template for a Recovery Plan.

53. **The EBA's coordination role in this area of activity will significantly expand when the Directive on Recovery and Resolution Planning is adopted.** In the forthcoming Directive, the EBA will have a strong role in coordination and designing resolution plans for cross-border group entities and in procedures for emergency situations.

VII. CONSUMER PROTECTION

54. **In the area of consumer protection, EBA has EU-wide responsibility.** Consumer protection is one of the core functions laid down in the EBA Regulation, which states in Article 9(1) that “EBA shall take a leading role in promoting transparency, simplicity and fairness in the market for consumer financial products or services across the internal market, including by: (i) collecting, analyzing and reporting on consumer trends; (ii) reviewing and coordinating financial literacy and education initiatives by the competent authorities; (iii) developing training standards for the industry; and (iv) contributing to the development of common disclosure rules.” The EBA also has a monitoring role on new and existing financial activities and may adopt Guidelines and Recommendations with a view to promoting safety and soundness of markets and convergences of regulatory practice. The EBA may also issue warnings in the event that financial activity poses a serious threat to the objectives laid down in Article 1(5) of the EBA Regulation.

55. **The EBA requires more staff and the building of expertise.** The Consumer Protection Unit, set up in February 2012 seems to be too lightly staffed: it is composed of only one person, and reports directly to the EBA's Executive Director. Support may be drawn from the other ESAs, if needed. In 2012, the EBA analyzed consumer protection in the context of the mortgage market and other indebtedness issues. It started with preparatory work on two Guidelines—Guidelines on responsible lending (using the Financial Stability Board Principles for Sound Residential Mortgage Underwriting Practices as a basis, with the aim to take account of internationally recognized aspects of sound mortgage underwriting) and Guidelines on the treatment of borrowers in payment difficulties (with focus on early engagement of creditors with borrowers in payment difficulties and provision of information).

56. **The regulation also provides that EBA shall establish a Committee on financial innovation, which brings together all relevant competent national supervisory authorities with a view to achieving a coordinated approach to the regulatory and supervisory treatment of new or innovative financial activities and providing advice for the Authority to present to the European Parliament, the Council and the Commission.** In May 2011 the EBA established (in compliance with Article 9(4) of the EBA Regulation), a Standing Committee on Financial Innovation (SCFI). All relevant national competent authorities are represented on the SCFI and it was, in 2012, renamed to the Standing Committee on Consumer Protection and Financial Innovation (SCConFin).

57. **Risk management and financial stability have been given much focus and care needs to be taken to avoid duplication of similar work conducted in the securities arena.** The BoS has tasked the “Exchange Traded Funds” work stream with producing a note on risk management and good practices for banks. Another workstream conducted an in-depth analysis of Contracts for Differences (CfDs) regarding the nature of CfDs structures, key risks associated to providers of CfDs and risk management of CfDs. Finally, the work stream on Structured Products (SP) is analyzing the European SP market. The need for regulatory work regarding financial innovation should be assessed based on its impact not only on the financial stability but also on consumers. Care needs to be taken to avoid duplication of similar work conducted in the securities arena (for instance on ETF by ESMA or FSB).

VIII. CROSS SECTOR ISSUES

58. **Cross-sector work is carried out by the Joint Committee of ESAs.** The Joint Committee is a forum of cooperation on cross sector issues for three ESAs. Established on January 1, 2011 (Article 54 to 57 of the ESAs), it succeeded the former Joint Committee on Financial Conglomerates. The Joint Committee should ensure cross-sectoral consistency of work, and reach joint positions “where appropriate,” in particular regarding the areas of (i) supervision of financial conglomerates (e.g. Guidelines for colleges of Financial Conglomerates will be drafted by end 2014), (ii) accounting and auditing (for instance assessing and providing cross sector consistent inputs/exchange views in order to ensure cross sector consistency in their application), (iii) micro-prudential analyses of cross-sectoral developments, (iv) risks and vulnerabilities for financial stability, (v) retail investment products, (vi) measures combating money laundering, and (vii) information exchange with the European Systemic Risk Board (ESRB) and development of the relationship between the ESRB and the ESAs.

59. **Its Chairmanship rotates between the three ESAs. The Chairperson of the Joint Committee is the second Vice-Chair of the ESRB.** The members are the Chairpersons of EBA, EIOPA and ESMA; the Chairpersons of each of the four Sub-Committee of the Joint Committee; with as observers, the Executive Directors of EBA, EIOPA and ESMA, a representative of the European Commission, and a representative of the ESRB. The Joint Committee has a dedicated staff provided by the ESAs (for EBA, one FTE

in 2011 and two FTE in 2012). In addition to work of its Sub-Committees, the Joint Committee meets at least every two months, at the premises of the ESA chairing. The Chairperson may also convene a meeting when he/she deems it necessary, including in the case of adverse developments which may seriously jeopardize the functioning and integrity of financial markets or financial stability.

60. **The Joint Committee conducts a cross sector risk assessment, which also deserves close coordination with ESRB to build on synergies.** The Joint Committee monitors and assesses the systemic risk work performed by the ESAs. It also assists in the development of the cooperation between the ESAs and the ESRB. It produces policy focused risk reports for the “Financial Stability Table” discussions at the Economic and Financial Committee of the Council of the EU meetings taking place in March and September each calendar year. These reports include preliminary policy conclusions, and provide a cross sectoral assessment which is be fed into each of the ESA’s sector systemic risk assessment work.

IX. SUMMARY OF RECOMMENDATIONS

A. Governance

- Representatives of some other EU institutions (except the Commission), and possibly the respective EBA Chairperson, could have a vote on the Supervisory Board.
- The powers of the Management Board could be further strengthened with more delegated powers from the Board of Supervisors, or a permanent Executive Board, composed of independent representative, be formed.
- Members who do not comply with the Article 40 of EBA Regulation should see their votes suspended. To incentivize the right representation, a mechanism of written procedure could be introduced.
- More resources need to be allocated to the EBA, and more flexibility in the budget should be considered.

B. Regulatory and Supervisory Actions

- Awareness of supervisors on asset quality issues should be raised, in particular by issuing Guidelines for supervisors on best practices for the conduction of asset quality reviews, addressing perhaps some specific sectors and urgently push for enhancing comparability and completeness of Pillar 3 reports.
- Convergence on Pillar 2 practices (common methodologies for risk assessment) should be accelerated. A good example of activity that should receive priority is the

current work on the consistency of treatment of RWAs. This work should be harmonized with BCBS Level 3 exercises, and followed up with the issuance of Guidelines (and perhaps draft Technical Standards) to ensure consistency.

- Cooperation should be fostered by encouraging joint onsite supervision by member countries, and resume the performance of thematic peer reviews.
- Peer reviews should be implemented on the adequacy of supervisory resources, and governance arrangements of supervisory authorities.
- The EBA should play a more leading role in cross-border supervisory colleges and be able to participate in core colleges of EU banking groups having activities abroad. EBA' engagement in colleges should go beyond the EU and encompass the larger international groups active in Europe
- The EBA should ensure that its Guidelines are observed and implemented in practice. It should use its soft powers ("name and shame") to foster effective and regular multilateral exchanges of information, ensure genuine joint decisions and push for mediation when no joint decision can be reached.
- The EBA should work closely with ECB, as a new supervisor, so that the SSM can build its procedures based on best available Guidelines by EBA and EBA's Supervisory Handbook.

C. Oversight

- Strengthening transparency and the reliability of data should be given priority. EBA should strive to (i) enhance the quality assurance process, (ii) promote the disclosure of granular asset quality information, and (iii) expand depth, and coverage of the 2012 audits.
- EBA should work at ensuring that Pillar 3 reports are enhanced and harmonized.

D. Consumer Protection and Cross-sector

- In the area of consumer protection EBA should be organized to fulfill its mandate. More staff and building of knowledge are needed.
- Work on financial innovation should be given a focus on consumer protection and overlaps with work conducted in the securities arena (for instance on ETF by ESMA or FSB) should be avoided.