ECB-RESTRICTED

Mauro Grande
European Central Bank

Conference on Nordic-Baltic financial linkages and challenges (IMF, Eesti Pank, Sveriges Riksbank)

EU regulatory reforms: some implications

Tallinn, Estonia
13 December 2013

Outline

Outline

I. EU bank prudential framework: main features

CRD IV/CCR package applying as of 1 January 2014:

- Combination of *Regulation* (maximum harmonisation for the single bank rulebook) and *Directive* (providing constraints to national competencies)
- *Complex* piece of legislation pursuing more objectives
  - transposition of Basel III, setting-up of a macro-prudential framework, specific issues (e.g. remuneration, governance)
- *Phased-in* implementation in line with Basel III
  - *capital requirements:* many banks comply already with fully implemented Basel III
  - *liquidity requirements*: LCR from 60% in 2015 to 100% in 2018 (with possible postponement for distressed banking systems); COM legislative proposal on NSFR by end-2016
- Extensive set of *macro-prudential tools* for the banking sector at national level:
  - *Pillar I instruments : countercyclical capital buffer* (CCB) and *systemic risk buffer (*SRB) with varied involvement of EU institutions (higher for the SRB)
  - *Pillar II instruments:* to be applied to groups of institutions with limited involvement of EU institutions
  - *national flexibility:* possibility of imposing stricter prudential requirements to address systemic risks up to 2 years with high involvement of EU institutions (e.g. Council can reject a proposed measure)

I. EU macro-prudential framework: some implications

- Emerging EU framework for *bank* macro-prudential supervision articulated in *three layers*
  - national (competent macro-prudential authorities), SSM (ECB), EU (ESRB)
- National macro-prudential authorities have a policy toolkit to address *country-specific* systemic risks (both time and cross-section dimension) relating to the banking sector:
  - currently important *for some countries* given the stage of credit cycle and *in a monetary union* given the difficulty of a single monetary policy to address different financial cycles in individual countries
  - some constraints *on the sequence* in which identified macro-prudential tools can be used: (1) Pillar I, (2) Pillar II, (3) SRB and (4) national flexibility measures
- ECB macro-prudential responsibilities likely to bring *positive effects* by:
  - helping *overcome difficulties* at the national level in adopting macro-prudential measures
  - providing an SSM *common framework* for a consistent use of macro-prudential instruments
  - promoting *smooth interaction* between SSM and non-SSM jurisdictions on macro-prudential issues
- ESRB set to continue playing its important role for the *EU as whole*
  - guidelines/best practices for the use of macro-prudential tools, consideration of possible spillover effects, contribution to ensuring integrity of single market

I. EU macro-prudential framework: some issues

- Review of effectiveness of the bank macro-prudential framework by end-June 2014:
  - balance struck for *composition and use* of the policy toolkit: extent of national flexibility and adequacy of ranking for the use of instruments
  - possibly *cumbersome* process for the activation of tools especially for the SRB and the national flexibility measures
  - issue of *reciprocity*: mandatory only for the CCB (up to 2.5%), voluntary in all other cases with possible involvement of the ESRB
- Some specific SSM-related issues:
  - ECB has *no power* to block macro-prudential measures at the national level (e.g. when against single market integrity)
  - SSM as a *laboratory* for developing effective *coordination mechanisms* between macro- and micro-prudential supervision

Outline

II. EU bank resolution framework: main implications

BRRD (Council common position on 27 June 2013) intended to make bank resolution *more cost effective* and *less reliant* on public intervention (bail-out)

- *Cost effectiveness* pursued through:
  - ➢ clear identification of *responsible authorities* for resolution
  - ➢ *convergence* of resolution tools (asset sales, bridge bank, asset separation, bail-in)
  - ➢ ex-ante consideration of possible resolution actions in *resolution plans* including resolvability assessment
- *Reduced reliance* of public intervention pursued through:
  - ➢ *bail-in mechanism* allowing to write down/convert into equity shareholders' and creditors' claims
    - ✓ some liabilities excluded *permanently* and others can be excluded *exceptionally* (time constraints, criticality of functions, avoidance of contagion and value destruction) on the basis of national discretion
  - ➢ domestic financing arrangements *(resolution funds)* to be funded by the industry
- *Improved cross-border* bank resolution mainly through *resolution colleges*
  - ➢ group resolution plans, resolution schemes and financing arrangements

II. EU bank resolution framework: some issues

- Forthcoming final agreement on the BRRD should strike a *balance* between two main perspectives: *absolute "bail-out"* and need for *some national flexibility* on public intervention to cater for exceptional circumstances:
  - Council common position involves the possibility, after exercising national discretion for bail-in exclusions, of using *public money* for loss coverage/recap *only after a minimum amount of losses* equal to 13% of a bank' total liabilities has been covered by first bailing-in shareholders and creditors (8%) and then resorting to national resolution funds (5%)
    - discretionary exclusions entails possible risk of (i) *home bias* in the absence of an EU framework of constrained discretion and (ii) *more complicated cross-border cooperation* on bank resolution due to varied *distributions of losses* between banks' creditors and national resolution funds
  - EP argues that it should be possible in exceptional crisis situations for financial stability purposes to allow for a *temporary bank nationalisation* after bailing-in only shareholders and junior creditors

- *Cross-border bank resolution* issues likely to remain complex (in the absence of SRM):
  - potential for disagreement on the use of resolution funds (*burden-sharing*) and *no obligation* to reach joint decisions on resolution plans
  - but cross-border *recovery planning* and *early supervisory intervention* likely to be simplified by the establishment of the SSM

Outline

III. SSM: implications for solo supervision

SSM (earlier start on 4 November 2014) expected to *enhance effectiveness* of solo supervision of significant banks (reduced bank PB):

- Conduct of supervision from a *European perspective* (reduction of domestic bias):
  - members of the *Supervisory Board* expected to act in the interest of the Union as a whole
  - *Joint Supervisory Teams* comprising both ECB and NCAs staff from different countries for the day-to-day supervision
  - *lower inclination* to develop “national champions” and, in case of bank problems, to undertake supervisory forbearance and to delay remedial action
- Adoption of a *common approach* to supervision (supervisory handbook) towards highest standards (increase in supervisory effectiveness):
  - Risk Assessment System will include a common *rating system* based on quantitative (*common supervisory reporting*) and qualitative (including s*upervisory judgement)* elements and a common *supervisory response* function (i.e. Pillar II measures)
  - harmonised approach to *on-site inspections*

III. SSM: implications for cross-border supervision

SSM expected to lead to more effective supervision of *cross-border banks :*

- Enhanced *solo supervision* for parts (parent companies and foreign subsidiaries) of the group established in the SSM jurisdictions
- More effective supervision on a *consolidated basis* of banking groups established within the SSM (ECB acting as *consolidating supervisor*):
    - *smoother interaction* within supervisory colleges
    - *better risk assessment* for the group as a whole
    - possibly *easier agreement* on joint supervisory decisions
    - less inclination to *ring-fencing* bank assets/liabilities in stress situations
- Possibly smoother supervision on a *consolidated basis* of banking groups set up in the EU outside the SSM and with extensive presence in SSM jurisdictions:
    - ECB as *participating supervisor* and SSM NCAs as *observers* in supervisory colleges

III. SSM: some issues

Some important *pre-conditions* for an effective SSM:

- Effective *Single Banking Rulebook*
  - *national discretion* for some prudential requirements (e.g. definition of capital) allowed by CRD IV to be closely monitored and addressed by the EBA
- Effective *Single Supervisory Handbook*
  - strong need for reducing *potential differences* in supervisory approaches between SSM and non-SSM jurisdictions also to facilitate *joint decision-making* (e.g. Pillar II measures)
- Successful outcome of the *Comprehensive Assessment Exercise:*
  - *challenging* exercise covering a wide range (nearly 130) of banks representing around 85% of total banking assets to be undertaken on a *consolidated* basis (covering bank exposures both within and outside the SSM)
  - exercise consisting of *three steps:* (i) supervisory risk assessment (partially using the SSM handbook), (ii) asset quality review (consistent with EBA recommended definitions of NPLs and forbearance), (iii) stress-testing (in close coordination with EBA) carried out by ECB and NCAs with the involvement of external consultants
  - only *final outcome* to be communicated to the outside

III. SSM: some issues (cont)

- general approach for *remedial action* agreed at the political level (ECOFIN 15 Oct 2013):
  - ✓ banks to prepare strategies for restructuring oriented towards *private sector* solutions and *equal terms* for cross-border and domestic M&A
  - ✓ in case of *capital shortfalls*, specified *pecking order* to be followed: (i) private sources; (ii) national fiscal backstops (specific treatment under EDP); and (iii) European instruments
  - ✓ *national backstops*: pending BRRD implementation, activation subordinated to *minimum requirements for burden-sharing* laid down in the EU State Aid Rules (bail-in of shareholders and junior creditors)
  - ✓ *European instruments*: for EA countries ESM direct recap possible *after SSM start* and for non-EA countries possible use of existing EU facilities (e.g. BoP Facility)

- Smooth interplay between *EA countries* and *opt-ins*:
  - SSM Regulation provides for the *largest possible involvement* of and *many safeguards* for opt-ins
    - ✓ Supervisory Board, Mediation Panel, accountability regime, possibility of exit, SSM mandate
  - various *factors* affecting decision whether or not to join SSM (and SRM)
    - ✓ availability of a common financial backstop for bank recap, final design of SRM (including common backstops for bank resolution), attitude of EA cross-border banks towards their non-SSM business

III. SRM: implications for cross-border resolution

SRM Regulation intended to make handling of *cross-border* bank resolution more efficient and to ensure consistency within the Banking Union project:

- *Enhanced efficiency* (reduced bank LGD) pursued through:
  - strongly *centralised decision-making* (Commission and Resolution Board) ensuring timely and effective resolution actions
  - *Single Resolution Fund* (SRF) pooling all resources from bank contributions (target level of EUR 55 bn) and replacing over time national resolution funds
  - positive effects on the *interplay between SSM and non-SSM jurisdictions* on cross-border bank resolution*:*
    - ✓ Resolution Board to become the *group level resolution authority*
    - ✓ *simplification* of functioning of resolution colleges
    - ✓ possibly *easier agreement* on joint decisions including on group resolution plans and schemes
    - ✓ *smoother discussions* on financing arrangements (financing plans)

III. SRM: some issues

- Main issues of discussion in view of a *Council common agreement* on SRM Regulation:
  - striking a *good balance* between national and European competencies on bank resolution while ensuring efficient, effective and swift decision-making
    - ✓ *decision-making process*: e.g. EU institution (Commission versus Council) triggering resolution, voting modalities in the Resolution Board (e.g. role of Plenary) for relevant decisions
    - ✓ *structure and financing arrangements of the SRF:* single entity versus network of national resolution funds and appropriate legal basis
  - need for a *common public backstop* possibly in the form of a credit line available to the SRM and fiscally neutral in an appropriate time horizon
    - ✓ topic likely to be *separated* from SRM Regulation and further discussed in 2014
  - *start of bail-in mechanism*: possible anticipation to the start of SRM (January 2015)
  - countries *non participating* in SRM:
    - ✓ *equal treatment* of non-participating countries to be partly addressed through EBA role in SRM context
    - ✓ non-participating countries's budgets *immune* to costs and non-contractual liabilities stemming from SRM actions