

The functioning of the Banking Union



BANCO DE PORTUGAL
EUROSYSTEM

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União Bancária:
A nova fronteira da regulação
financeira na UE



- 1. Lessons from the crisis**
2. Regulatory and institutional developments
3. The Banking Union
4. The EU institutional set-up
5. Looking ahead



Some important takeaways from the crisis (I)

Before the crisis:

- Widely accepted theory that markets would be capable to self-regulate (proved to be flawed);
- Emphasis on individual institutions and lack of adequate macro-prudential supervision, with the ultimate goal of achieving financial stability;
- Little focus on conduct supervision;
- Failures to challenge supervisory practices on a cross-border basis and lack of cooperation among supervisors;



Some important takeaways from the crisis (II)

- Flaws in the regulatory framework:
 - Low levels of good quality, loss-absorbing, capital;
 - Pro-cyclicality;
 - Opaqueness of models;
 - Lack of a harmonised liquidity framework;
 - Over-reliance on external ratings;
 - Poor corporate governance principles and misaligned incentives, for instance in remuneration practices;
 - Lack of harmonisation across countries.



Some important takeaways from the crisis (III)

- Credit booms in many countries have been followed by either economic underperformance/macroeconomic imbalances or a financial crisis
[Dell'Ariccia, et al (2012), IMF]
- High debt can be a drag on economic growth
[Ceccetti, et al (2011), BIS]
- High levels of public debt tend to exacerbate the effects of private sector deleveraging after a crisis
[Jordà & Schularick (2013), Federal Reserve Bank of San Francisco]



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What happened since the onset of the crisis?

- G20 initiatives to overcome some weaknesses detected;
- BCBS/FSB agreements on Basel III and further initiatives:
 - More and better capital;
 - Macroprudential capital buffers (e.g. countercyclical capital buffer, buffer for systemically important institutions);
 - A harmonised liquidity framework and limits to leverage;
 - The need to revise specific parts of the regulatory framework (e.g., trading book and market risk, standardised approach for credit risk);
 - Definition of attributes to resolve credit institutions.



What happened since the onset of the crisis?

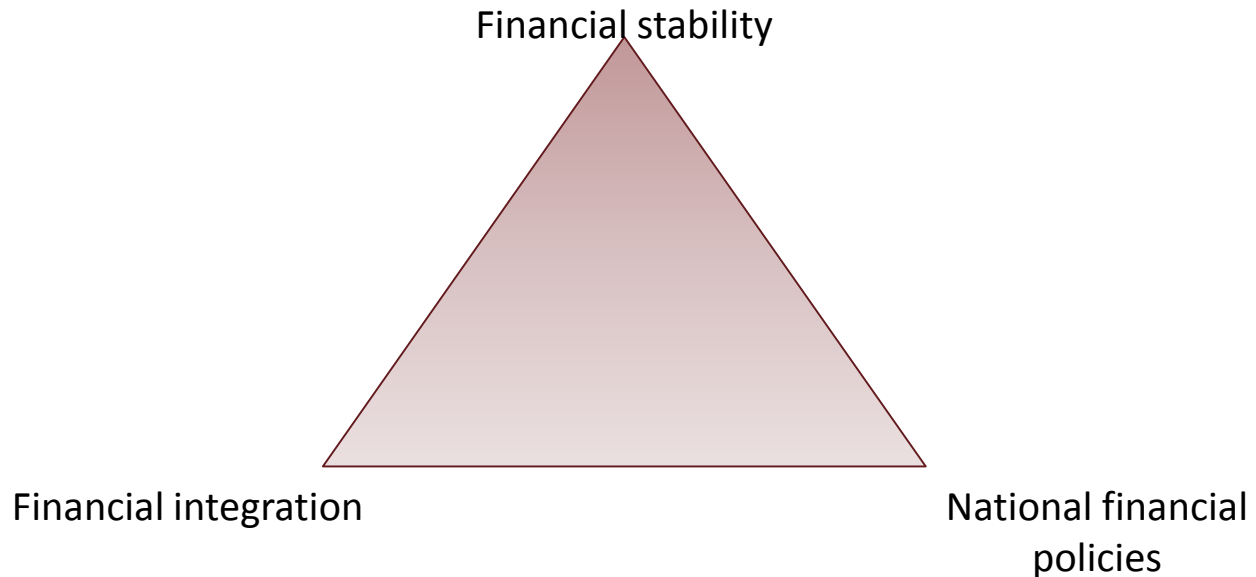
- In the EU:
 - Single rulebook: agreement on the Capital Requirements Regulation /Capital Requirements Directive IV (CRR/CRD IV) package and the Bank Recovery and Resolution Directive (BRRD) – transposing Basel III, with some additional elements;
 - Overhaul of the institutional set-up.
- In the USA:
 - Dodd-Frank Act, including an overhaul of the institutional set-up, namely the creation of the Financial Stability Oversight Council (FSOC).



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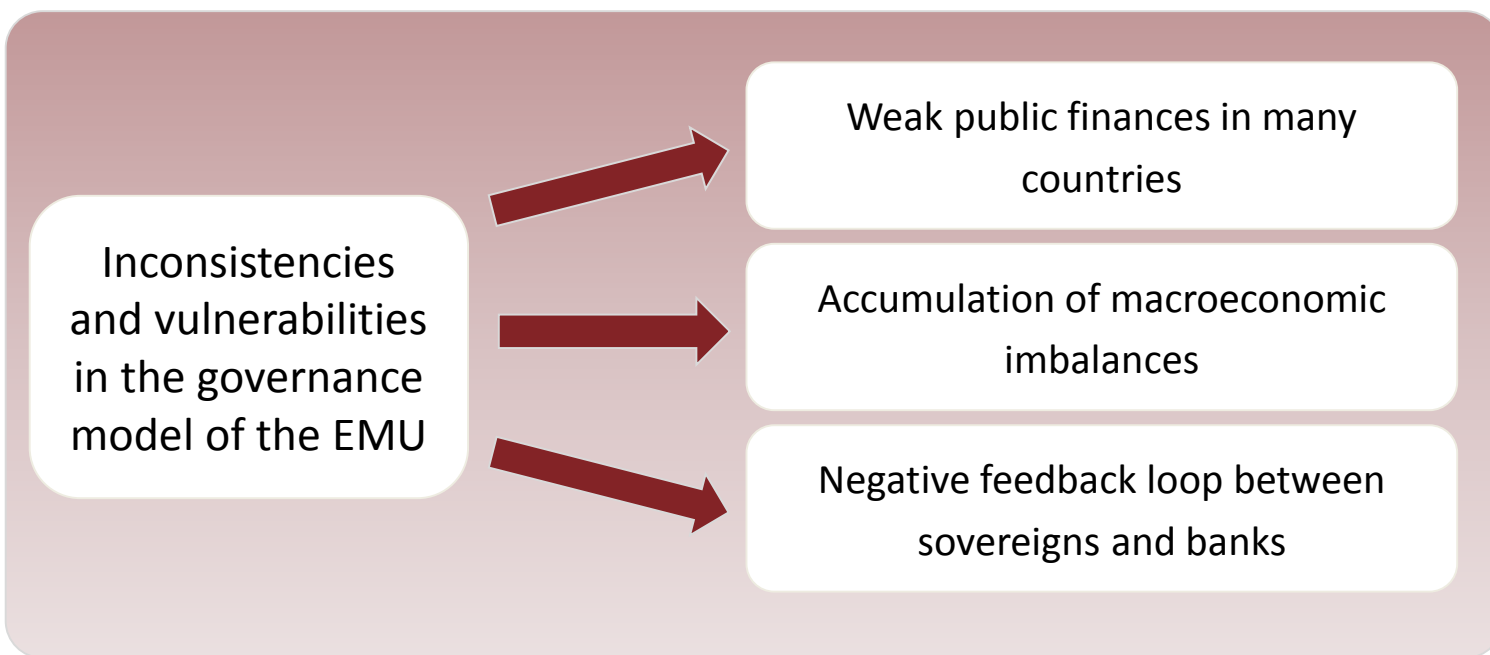
The trilemma



In a context of financial integration, pursuing national financial policies does not ensure financial stability, as national policies tend to maximise national welfare, disregarding negative cross-border externalities.



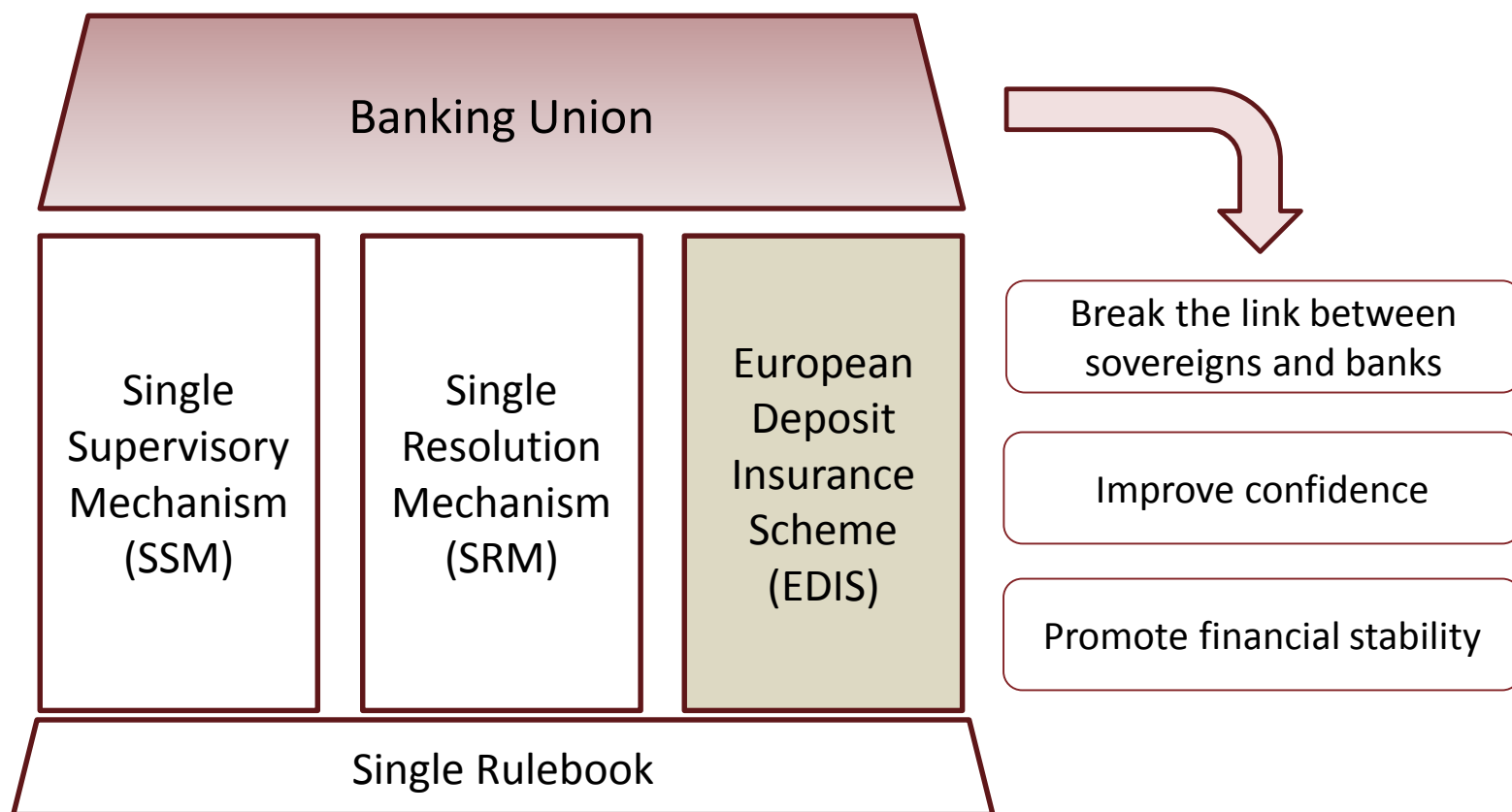
Economic and Monetary Union (EMU)



Shortcomings in the EMU model were conducive to market fragmentation, inhibiting the transmission of monetary policy and yielding systemic risk in the euro area.



Pillars of the Banking Union





European Deposit Insurance Scheme (EDIS)

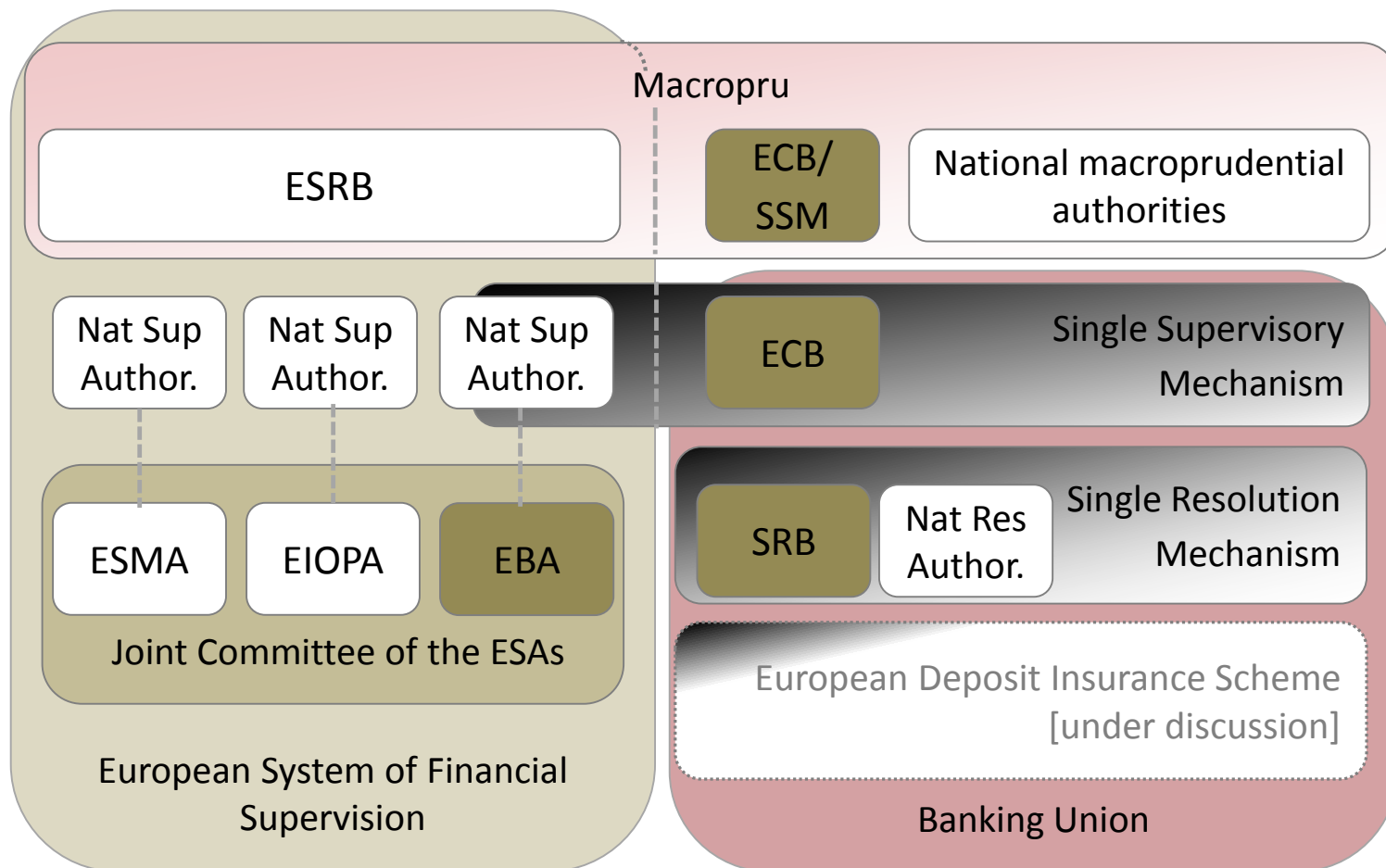
- European Commission put forward a European Deposit Insurance Scheme proposal (November 2015):
 - Reinsurance scheme for participating national DGSs in the first 3 years;
 - Co-insurance scheme for participating national DGSs in the following 4 years;
 - Full insurance for participating national DGSs afterwards;
 - SRB to manage EDIS.
- Very important pillar of the Banking Union
 - Momentum should continue to ensure that a true, common, deposit guarantee scheme is set up for the Banking Union countries.



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European System of Financial Supervision and Banking Union





EBA strategic areas in 2016

- Play a central role in the regulation and policy framework with the development and maintenance of the Single Rulebook;
- Promote the development and coordination of resolution policy and resolution plans;
- Promote the convergence of supervisory practices to a high standard so as to ensure that regulatory and supervisory rules are implemented equally across all Member States;
- Identify and analyse trends, potential risks and vulnerabilities stemming from the microprudential level;
- Maintain and develop the common supervisory reporting framework, as well as to strengthen its role as an EU data hub;
- Protect consumers and monitor financial innovation;
- Ensure secure, easy and efficient payment services across the EU.



EBA and the single rulebook

- CRD IV/CRR and BRRD set the primary regulatory framework, together with other important regulations and directives (e.g., MCD, AMLD, PAD);
- The EBA prepares regulatory and implementing technical standards, as well as guidelines within the scope of the level 1 legislation;
- The single rulebook is vital for the internal market and for the functioning of the Single Supervisory Mechanism and the Single Resolution Mechanism.



EBA role in the context of the Banking Union

- Vital to continue contributing to the Single Rulebook:
 - Common rules and EBA's role on supervisory convergence and cooperation are essential in an institutional set-up in which supervision is not centralised for the whole EU;
 - Minimising the potential for fragmentation between “ins” and “outs”;
 - Providing guidelines and common interpretation of the regulatory framework in order to ensure appropriate and consistent application throughout the EU.
- Importance in harmonising supervisory practices.



Selected EBA tasks, relevant in the Banking Union context

- Consistency and transparency of supervisory decisions
 - EBA Guidelines on the supervisory review and evaluation process (SREP)
 - Opinion on the interaction of Pillar 1, Pillar 2 and combined buffer requirements and restrictions on distributions
- Internal Risk-Based models
 - Mitigating variability in RWAs computation due to different interpretations of definitions and supervisory and validation practices
 - Benchmarking exercises and transparency
 - Future initiatives, including considering reduction of the scope of internal models



Selected EBA tasks, relevant in the Banking Union context

- EU-wide stress testing exercises: undertaken as a joint process with the ECB and the ESRB, that contribute with the adverse scenarios;
- Transparency exercises: disclosure of bank data, based on harmonised definitions;
- Harmonisation of rules: SSM participating countries are working towards common decisions on options and national discretions;
- Monitoring of supervisory colleges;
- Peer reviews.



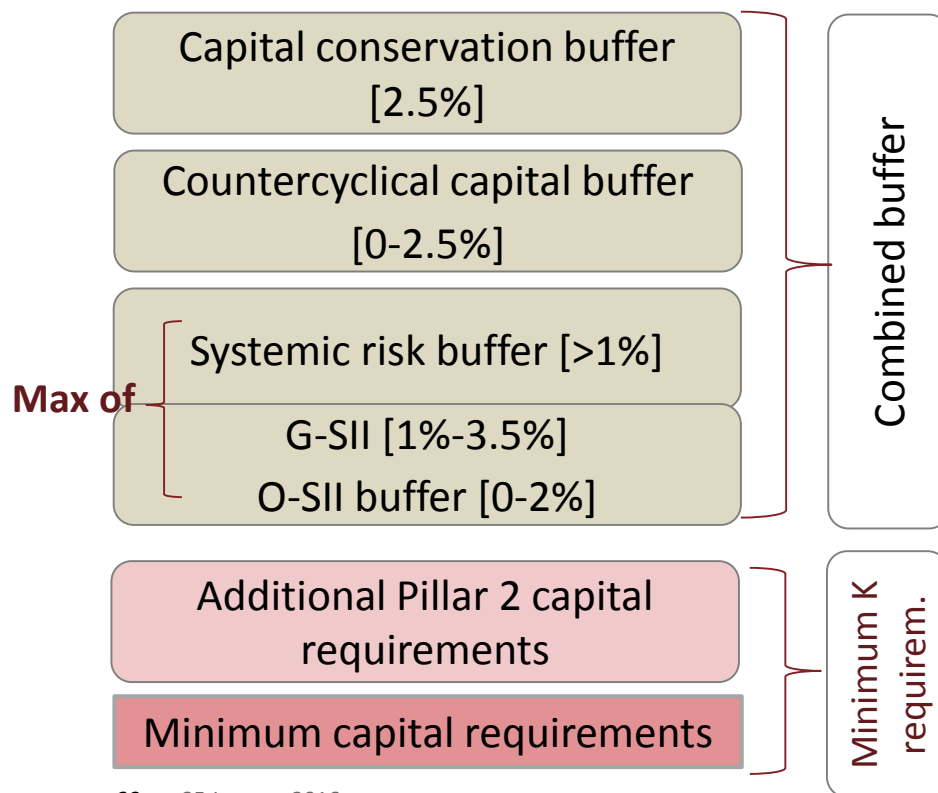
Macroprudential policy in the EU

- National macroprudential authorities are responsible for national decisions on macroprudential policy;
- *But* the ECB/SSM may apply higher requirements for banks' capital buffers and more stringent measures (available in EU legislation) in participating Member-States;
- *While* the ESRB is responsible for the macro-prudential oversight of the financial system within the [whole] Union in order to contribute to the prevention or mitigation of systemic risks to financial stability in the Union:
 - It may issue warning and recommendations to national authorities.



Macroprudential policy in the EU: policy instruments

Capital buffers and other capital requirements



Selected other instruments

Harmonised

Level of own funds

Limits to large exposures

Risk weights for real estate

Liquidity requirements

Non-harmonised

LTV/DTI



Macprudential policy in the EU: policy instruments

Countercyclical capital buffer rate as of 1 January 2016: selected countries

	CZ	DE	ES	FR
In force	0%	0%	0%	-
Announced for the future	0,5% 1 Jan 2017	0%	0%	0% 31 Dec 2016
	IT	PT	SE	UK
In force	0%	0%	1%	0%
Announced for the future	0%	0%	1,5% 27 Jun 2016	0%



Macroprudential policy in the EU: policy instruments

EU Global Systemically Important Institutions		Other Systemically Important Institutions in selected countries	
Deutsche Bank	DE	Axa, Argenta, Belfius, BNPP Fortis, Bank of NY Mellon, Euroclear Bank, KBC, ING BE	BE
BBVA, Santander	ES	BBVA , BFA, Criteria Caixa Holding, Popular, Sabadell, Santander	ES
BNP Paribas, BPCE, Crédit Agricole, Société Générale	FR	BNP Paribas, BPCE, Crédit Agricole , Crédit Mutuel, Banque Postale, Société Générale	FR
Unicredit	IT		
ING	NL		
Nordea	SE		
HSBC, Barclays, Royal Bank of Scotland, Standard Chartered	UK	Banco BPI, BCP, CEMG, CGD, Novo Banco, Santander Totta	PT

Source: ESRB

Note: In some cases, the measure is not yet active.



ESFS and the Banking Union

- The European System of Financial Supervision was scheduled to be revised after gaining some experience with its implementation;
- A review process was initiated by the European Commission in 2013;
- However, the Banking Union project brought a decisive change to the EU-institutional landscape;
- The outcome of the ESFS review is yet to be seen, but should, in any case, factor in the new reality of the Banking Union.



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Looking ahead...

- Completion of the Banking Union
- Ensuring that the EU institutional architecture is efficient
- A more active macroprudential supervision, also at EU/EA level, given the importance of cross-border effects
- Strengthening of conduct supervision
- Development of a Capital Markets Union

In September 2015, the European Commission released an Action Plan on Building a Capital Markets Union

- Challenges regarding EU Financial Services Regulation

In August 2015, the European Parliament released a draft report on stocktaking and challenges of the EU Financial Services Regulation

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