

PRUDENTIAL SUPERVISION AN OVERVIEW

SET. 2023 | SETÚBAL

RUI PINTO



BANCO DE
PORTUGAL
EUROSISTEMA

WHO SUPERVISES?

01

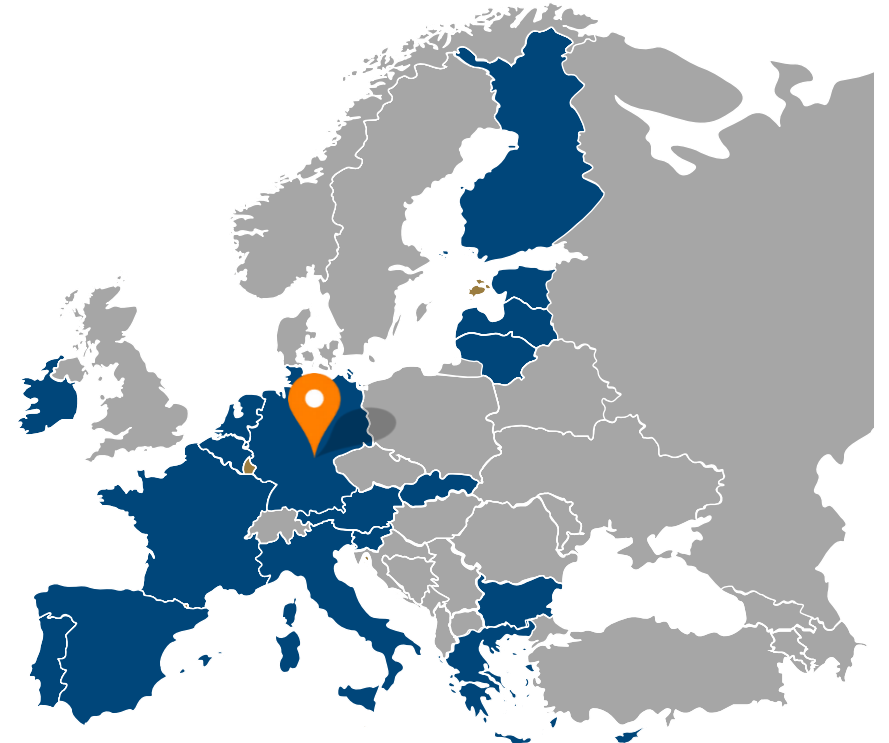


BANKING UNION: SINGLE SUPERVISORY MECHANISM

On 4 November 2014, the Single Supervisory Mechanism has entered into force, composed by the European Central Bank (ECB) and the National Competent Authorities of participating Member States of the Euro area.

The **main aims of the SSM** are to ensure the safety and soundness of the European banking system, increase financial integration and stability and ensure consistent supervision.

The SSM is responsible for the direct supervision of the largest 111 banking groups, which account for over 80% of total assets. National Competent Authorities are directly responsible for supervising over 2,000 Less Significant Institutions. To ensure efficient supervision, the roles and responsibilities of the ECB and the national authorities are allocated according the significancy of the supervised entities.



Fonte: <https://www.bankingsupervision.europa.eu/about/thessm/html/index.en.html>



THE BANKING UNION

The banking union addresses the fragmentation of financial markets within the euro area and contributes to breaking the negative feedback loop between bank debt and sovereign debt. The banking union is based on following three pillars:



WHAT IS PRUDENCIAL SUPERVISION?

02



MAIN PRINCIPLES

Principle #1

It should not be an objective of banking supervision to prevent bank failures. However, supervision should aim to reduce the probability and impact of a bank failure, including by working with resolution authorities, so that when failure occurs, it is in an orderly manner.

BCBS, Core Principles §01.13

Principle #2

Limited human, financial and material resources allocated to supervisory activities, taking into consideration the need to ensure an adequate balance between other responsibilities attributed to the Bank of Portugal.



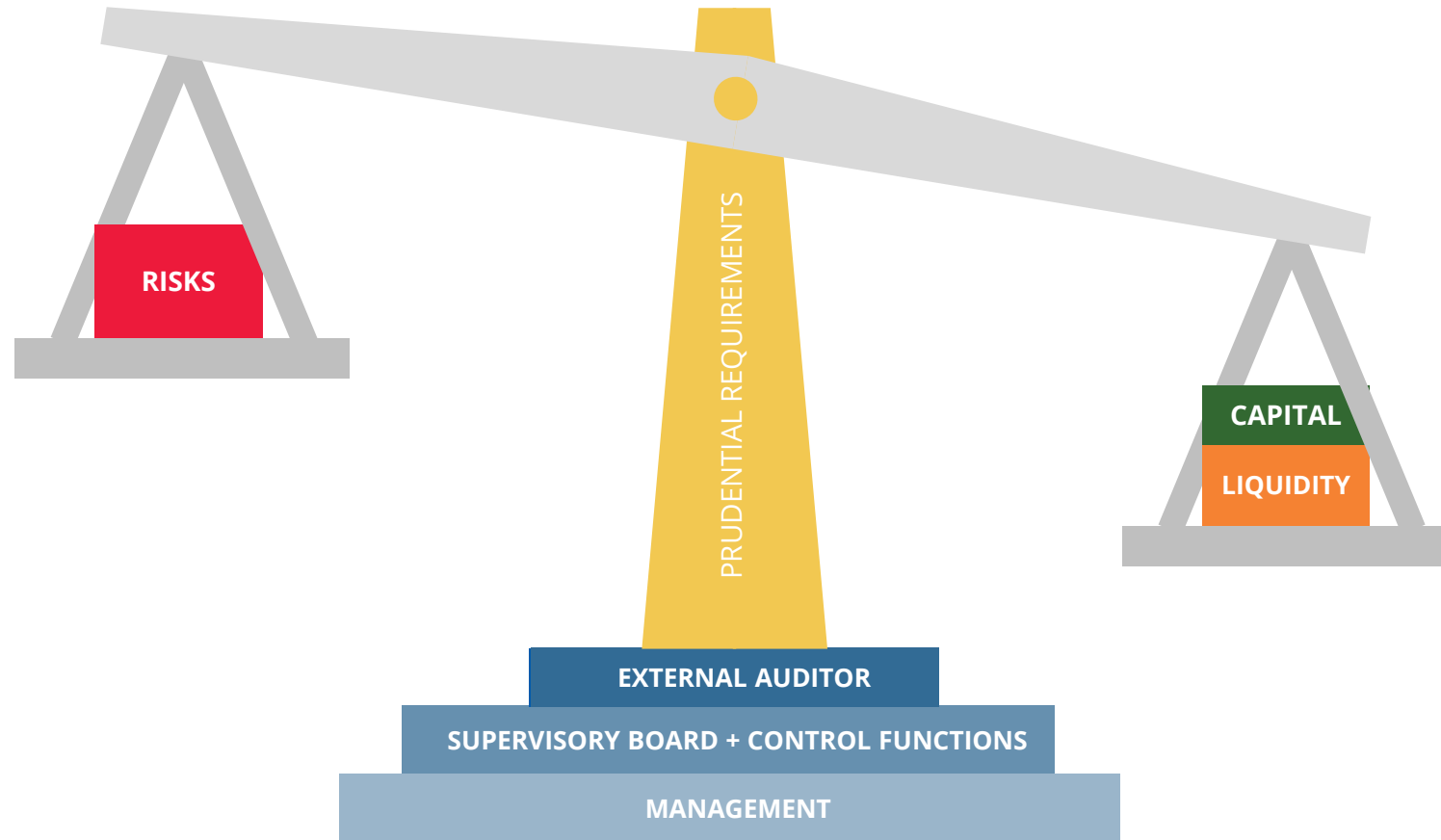
Risk Tolerance

It is impossible to know and control, in detail and at all times, all the activities of the institutions under supervision. As such, the supervisory activity is conducted following a risk-based approach, with a higher dedication of resources to the main risk factors of the banking system and focusing on the institutions with greater systemic relevance.

Risk-based supervision recognizes the finite nature of available resources to ensure that they are allocated in a more efficient manner to reduce the risk of disturbances in the stability of the financial system.

WHAT IS PRUDENTIAL SUPERVISION?

IN A NUTSHELL





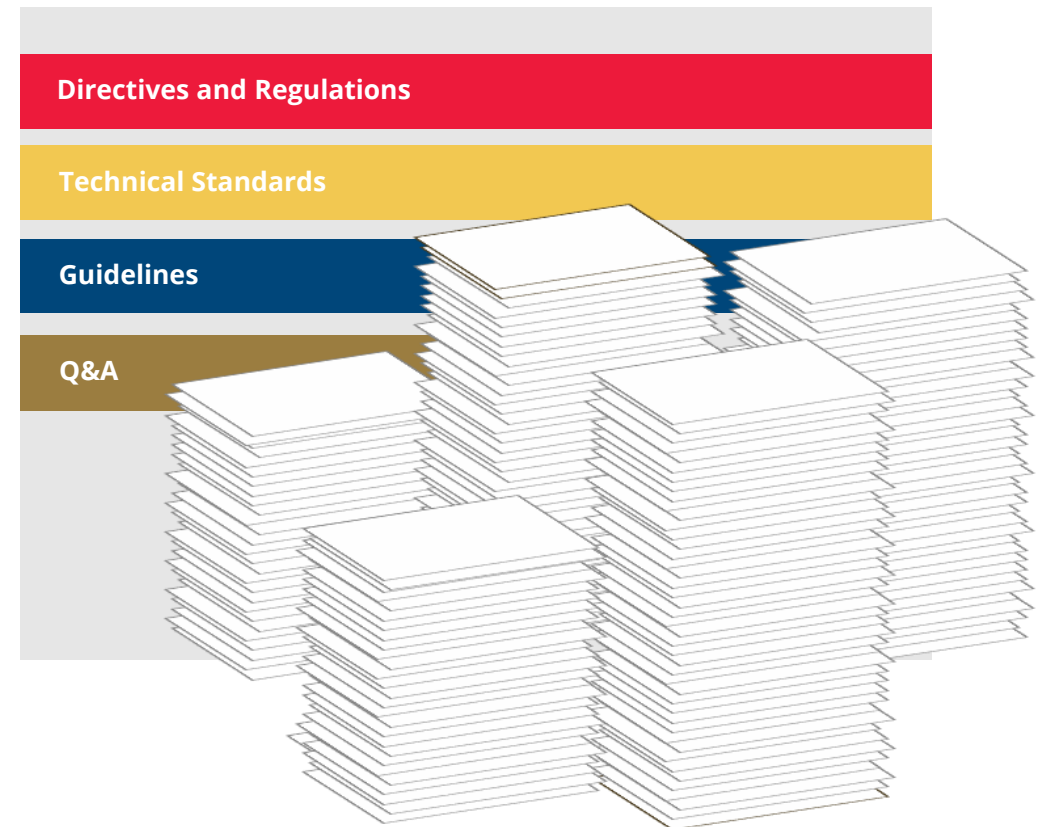
AN OVERWHELMING NUMBER OF RULES IN THE PAST DECADE

The Capital Requirements Directive (CRD/CRR) and the Recovery and Resolution Directive (BRRD) have more than 600 pages.

Additionally, there are more than 100 technical standards for regulation and delegated or implementing acts, with hundreds of pages.

Furthermore, the subjectivity of the legal requirements has forced the EBA to respond to more than 2,300 questions to guide institutions in the implementation process (Single Rulebook Q&A).

But, CRD V has just been transposed and CRD VI is in the final phase of discussion at the European level.



HOW IS SUPERVISION CONDUCTED?

03

SUPERVISORY FRAMEWORK



PREVENTIVE MEASURES



Authorization

Regular monitoring

Inspections

CORRECTIVE MEASURES



Intervention

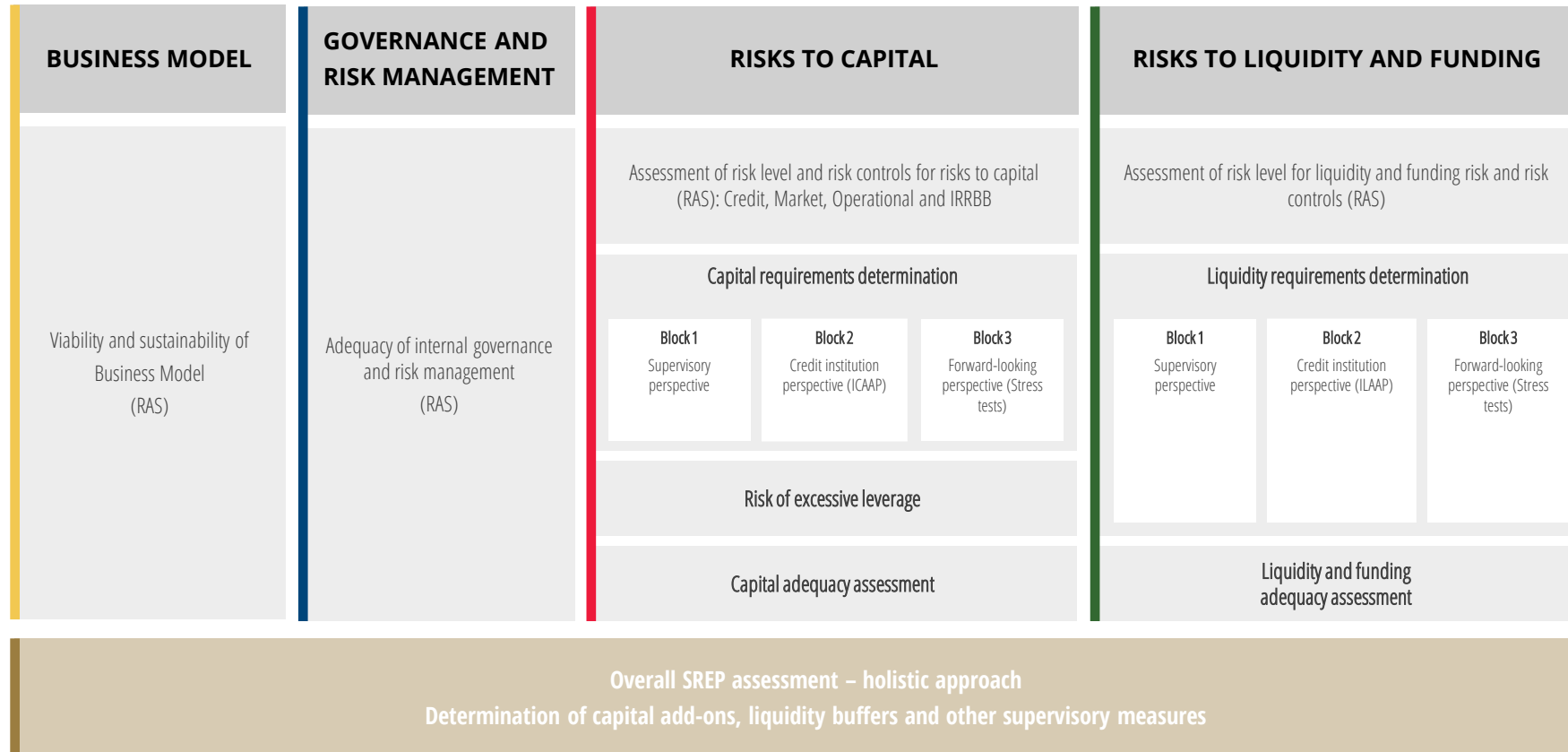
Resolution

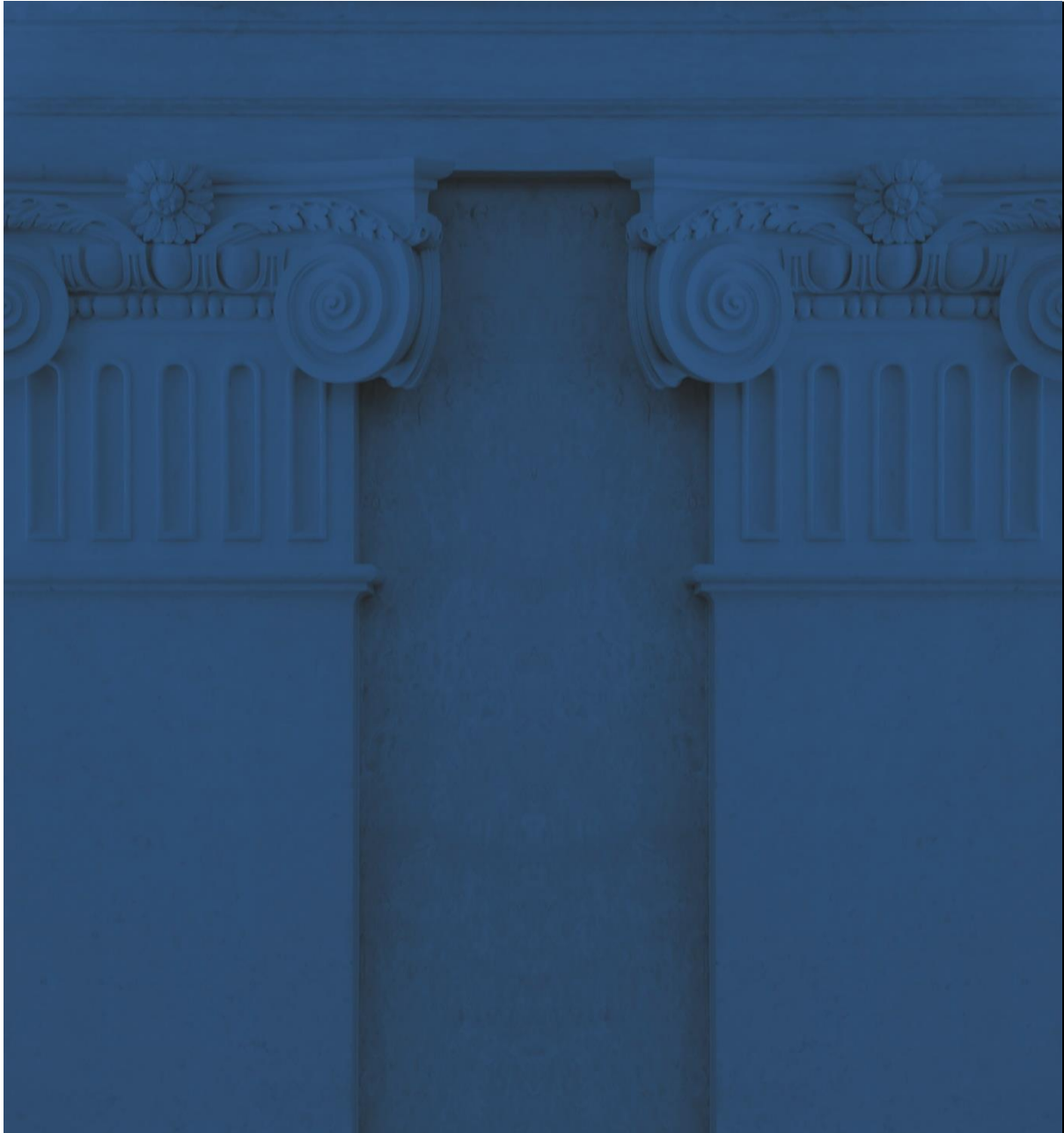
Liquidation



HOW IS SUPERVISION CONDUCTED?

A COMMON APPROACH THROUGH SREP (SUPERVISORY REVIEW AND EVALUATION PROCESS)





SILICON VALLEY BANK LESSONS LEARNED

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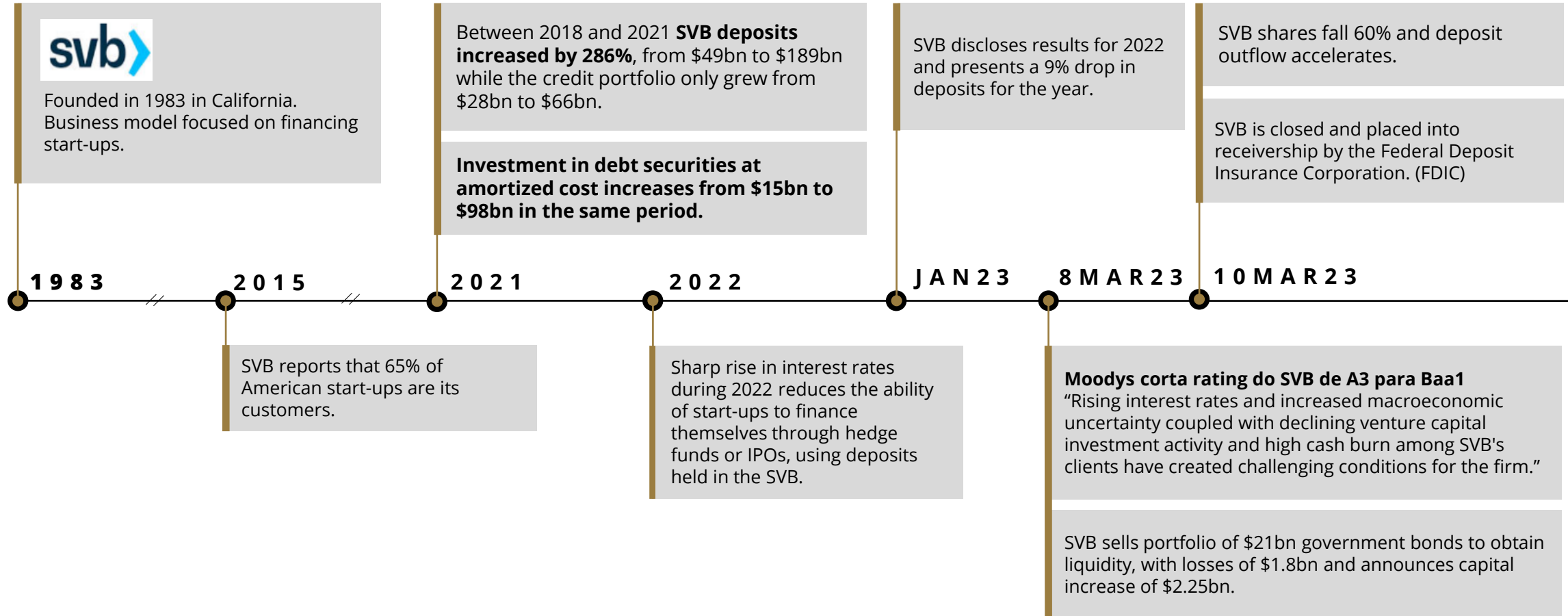


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SILICON VALLEY BANK

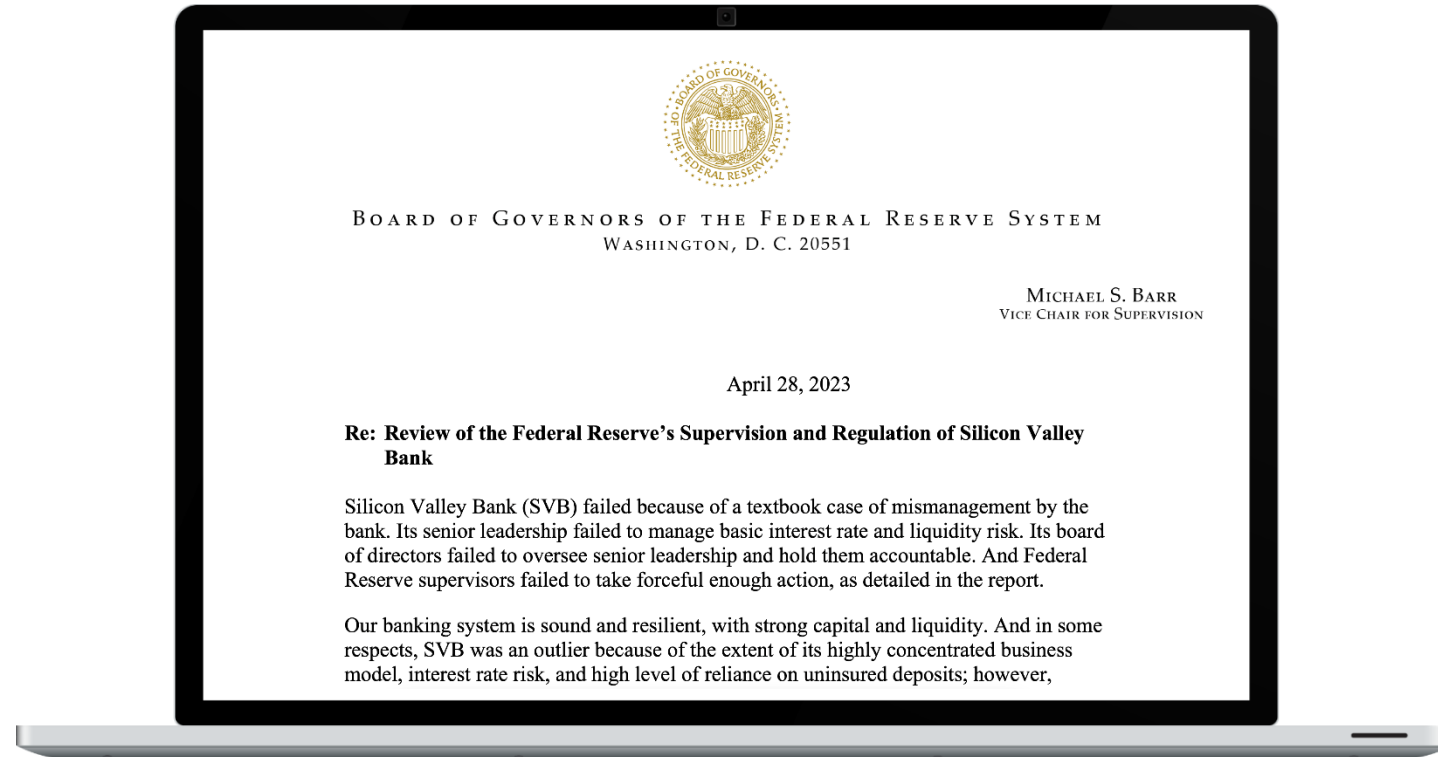
Fast growth and high concentration, but with a low control





AFTERMATH OF THE SVB FALL

FED publishes its review on the causes for the failures of SVB

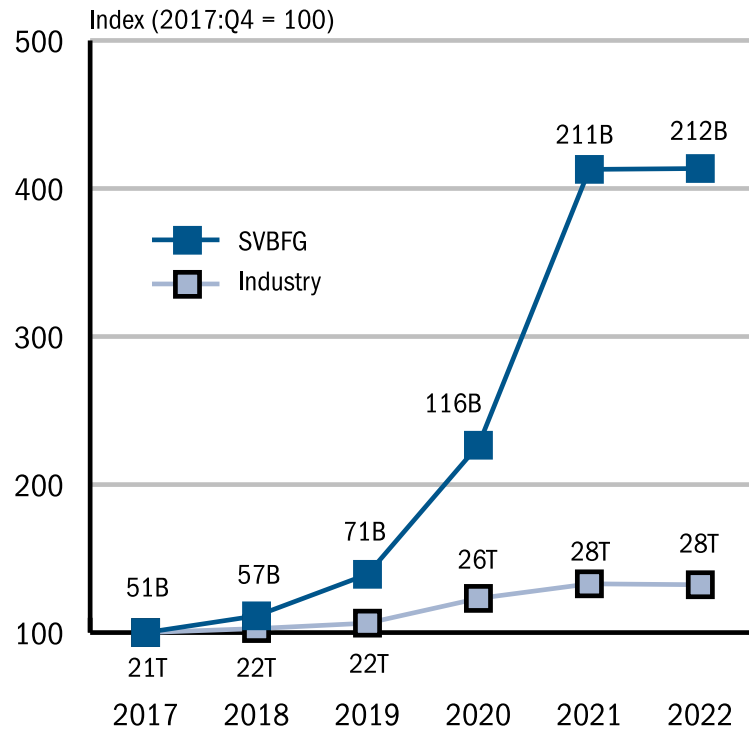


Source: <https://www.federalreserve.gov/publications/files/svb-review-20230428.pdf>



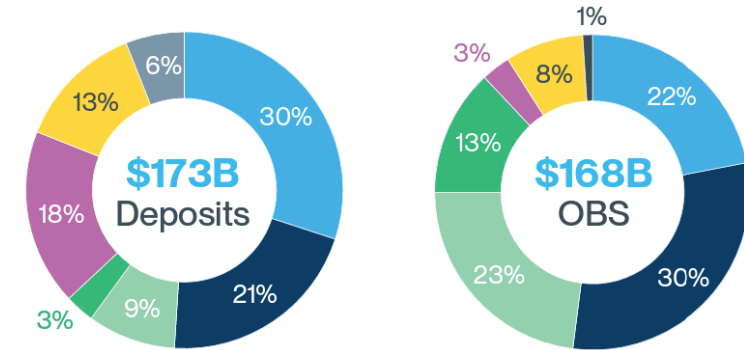
FED REVIEW

Abrupt growth and high concentration in a specific customer segment



Total client funds by client niche¹

- Early stage technology
- Technology
- Early stage life science/ healthcare
- Life science/ healthcare
- International²
- U.S. Global Fund Banking
- Private Bank
- Other



Note: All figures as of December 31, 2022 unless otherwise noted.

1. Represents management view of client niches.
2. International balances do not represent foreign exposure as disclosed in regulatory reports. Includes clients across all client niches and life stages, with International Global Fund Banking representing 3% of total client funds.
3. Based on deposit rates and total deposit balances at December 31, 2022.

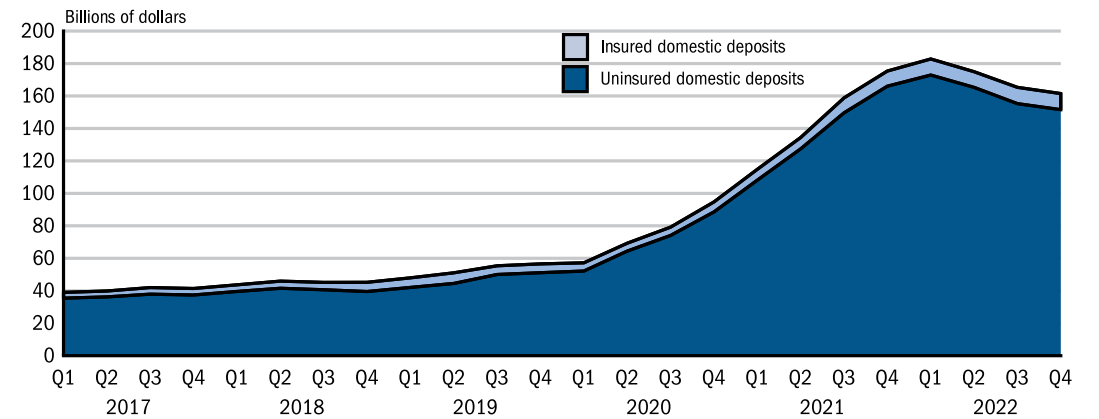
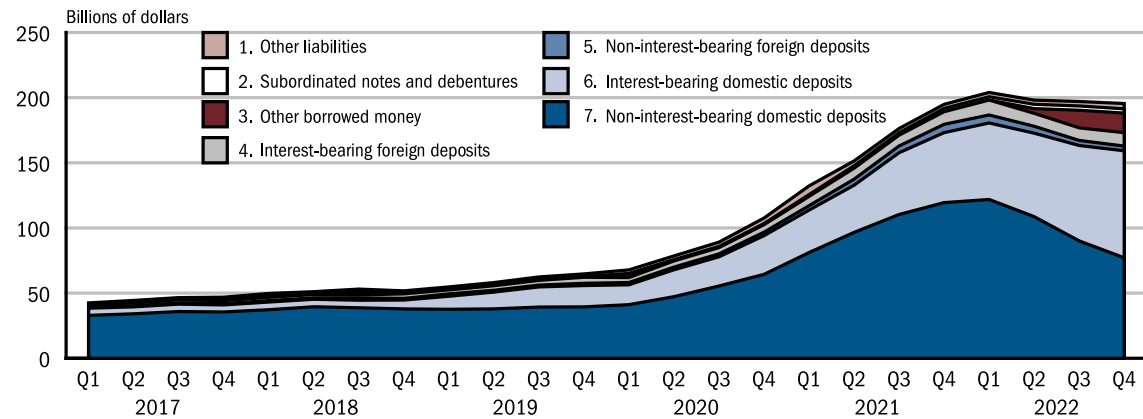


Source: Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank



FED REVIEW

Activity financed mostly by non-covered deposits

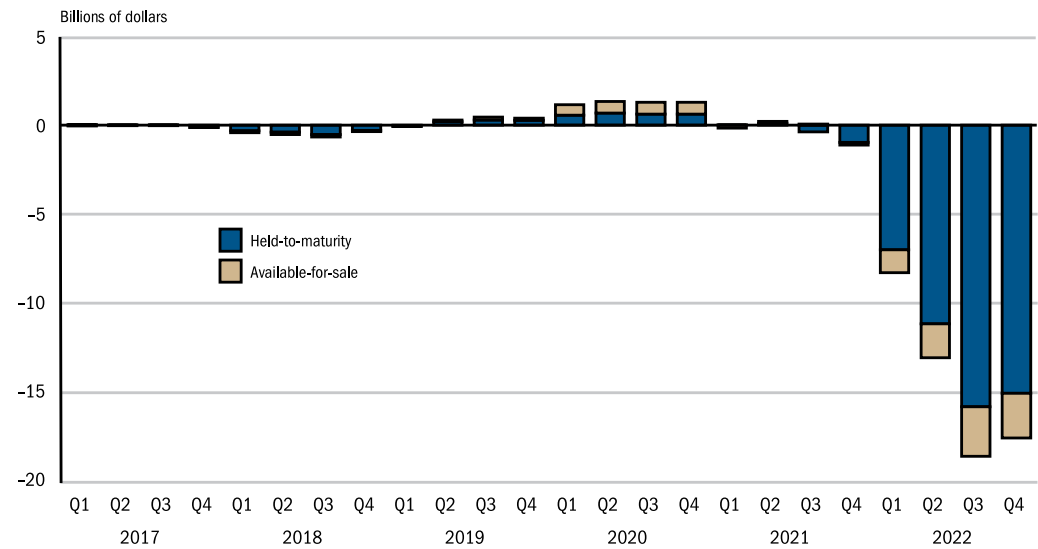
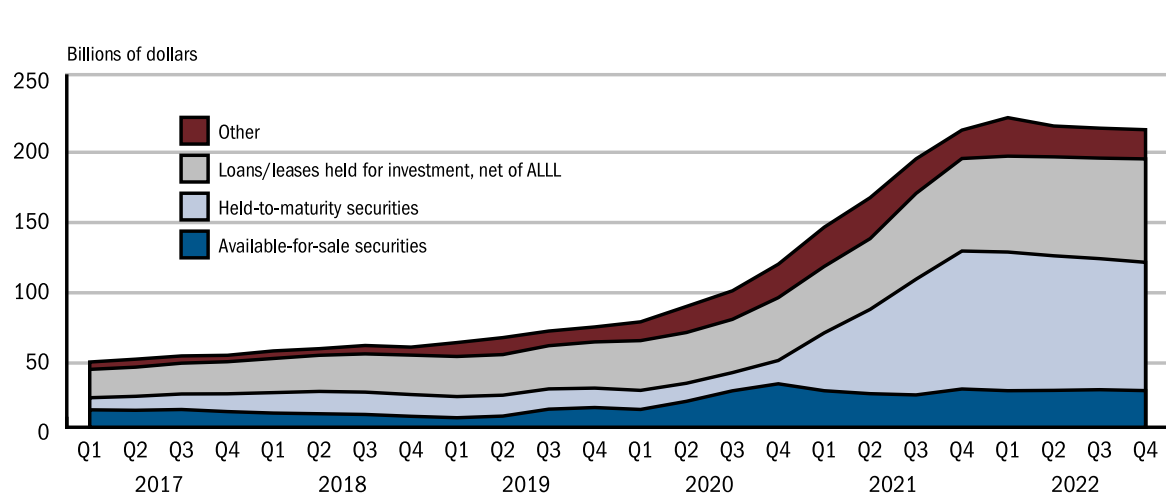


Source: Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank



FED REVIEW

Very high assets concentration in debt securities with long maturities



Source: Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank



SVB MAIN FEATURES

SVB indiossincrassies have increased its risk level



BUSINESS MODEL

- Clients were essentially start-up companies mainly in the technology sector
- Rapid growth and low profitability with a material change in the financial margin/NII profile in the last year.
- Bank stopped disclosing information to the market about the profile of financial margin



BALANCE SHEET

- Financing dependent on company deposits, with a high level of concentration and low coverage
- Reduced transformation ratio
- Excess liquidity invested in public debt securities at amortized cost
- Increase in the duration of the bond portfolio
- Latent losses reached values that exceeded CET1
- Reduced cash levels, insufficient to cover deposit withdrawals by the largest customers



GOVERNANCE

- Deficiencies in internal governance (internal control system; ALCO)
- Absence of a CRO for a considerable period of time



SVB RED ALERTS

Strong evidence of a high liquidity risk and interest rate risk



94%

NON-COVERED
DEPOSITS DEZ22

(low level of coverage by the
guarantee fund increases
depositor uncertainty)



46%

OF TOTAL ASSETS INVESTED
IN DEBT SECURITIES

(mostly accounted for at amortized cost,
without interest rate risk coverage and
with a maturity equal to or greater than
10 years)



\$15bi

UNREALISED LOSSES

(exceeding the capital - CET1 of
\$12 billion, as a result of the
increase in the interest rate)



MEASURES ADOPTED AFTER SVB FALL

FED intervention to stabilise deposits and avoid spill over effect

16/03/2023



- The United States Federal Reserve (FED) has provided additional funds to US financial institutions to “help ensure that banks can meet the needs of all depositors”.
- The United States Government allowed the FDIC to resolve the SVB in a way that “protects all depositors, both guaranteed and uninsured.”
- The FED started to allow banks to finance themselves for up to 1 year with North American debt securities as collateral from the Central Bank at nominal value.

MARCH - APRIL



 First Citizens Bank

- March 14: HSBC bought SVB's UK subsidiary for £1.
- March 27: First Citizen Bank acquired the SVB bridge bank from the FDIC.

MAY



- The American regional bank stock index (KBW regional index) has fallen more than 30% since the beginning of March, recording high levels of volatility.
- Other American regional banks have collapsed or recorded material losses since March (Signature Bank, First Republic, PacWest), further indicating potential weaknesses in the system.



A NEW CONTEXT

The pace of the deposits run was exacerbated by relevant context changes



- **Fast transmission of information through social networks**
- **Strong technological and digital component of bank account management**
 - **Increased speed of deposits run**



REPUTATION RISK MANAGEMENT IS ESSENTIAL



SVB LESSONS

The SVB case reinforced the importance of some aspects to be assessed by the supervisor

LIQUIDITY AND FINANCING RISK

Liquidity and financing risk Sound ALM management must consider economic value and assess the stability of deposits and the ability to sell assets at a reasonable price



INTEREST RATE RISK

Unrealised losses and the perspective of economic value when evaluating assets on the balance sheet must be taken into account, and concrete actions must be taken to control this risk.

GOVERNANCE AND BUSINESS MODEL

Solid governance and business model are foundations for “trust” in the banking system; markets and customers quickly “abandon” a bank if they perceive shortcomings at that level



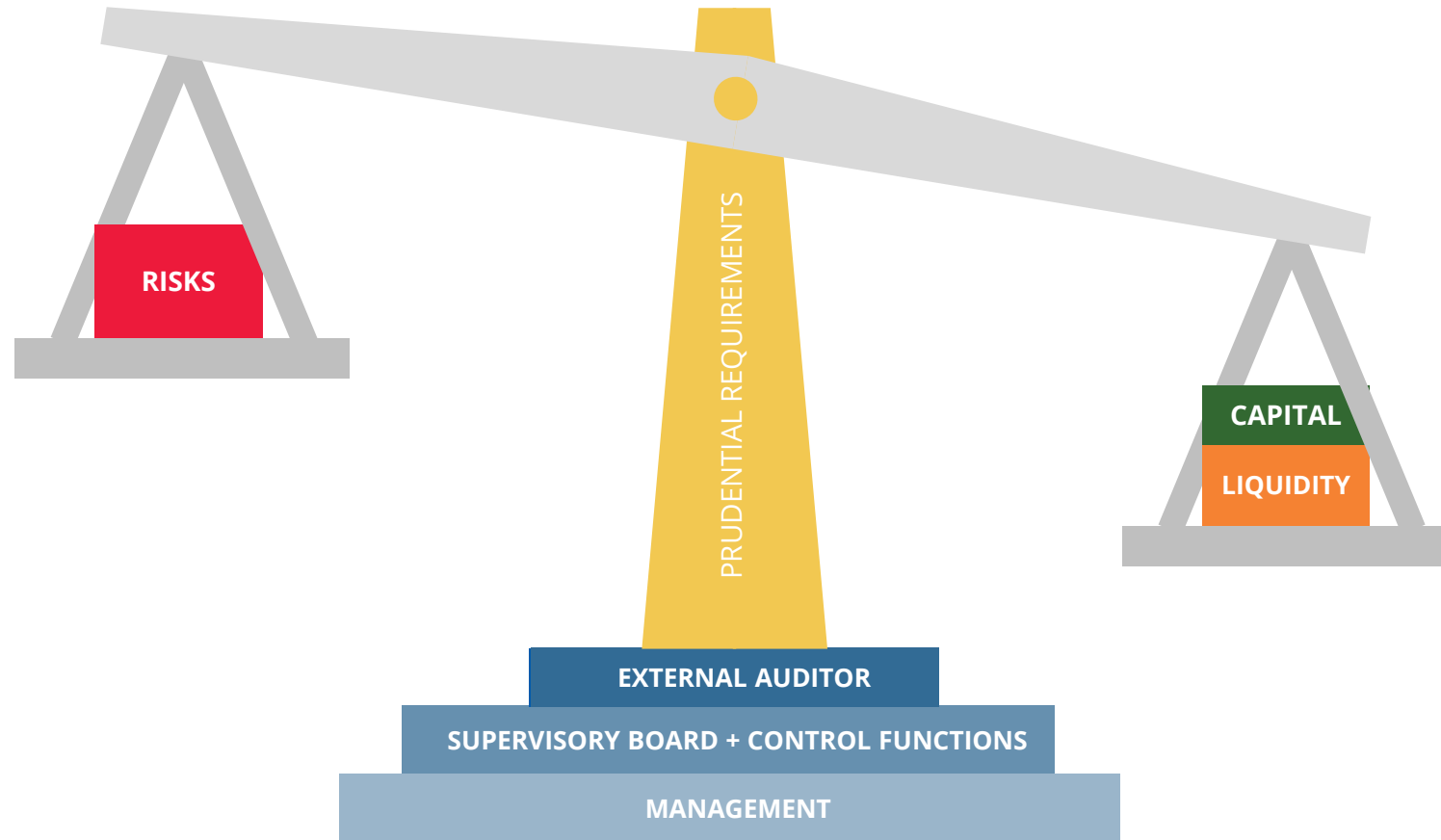
CAPITAL

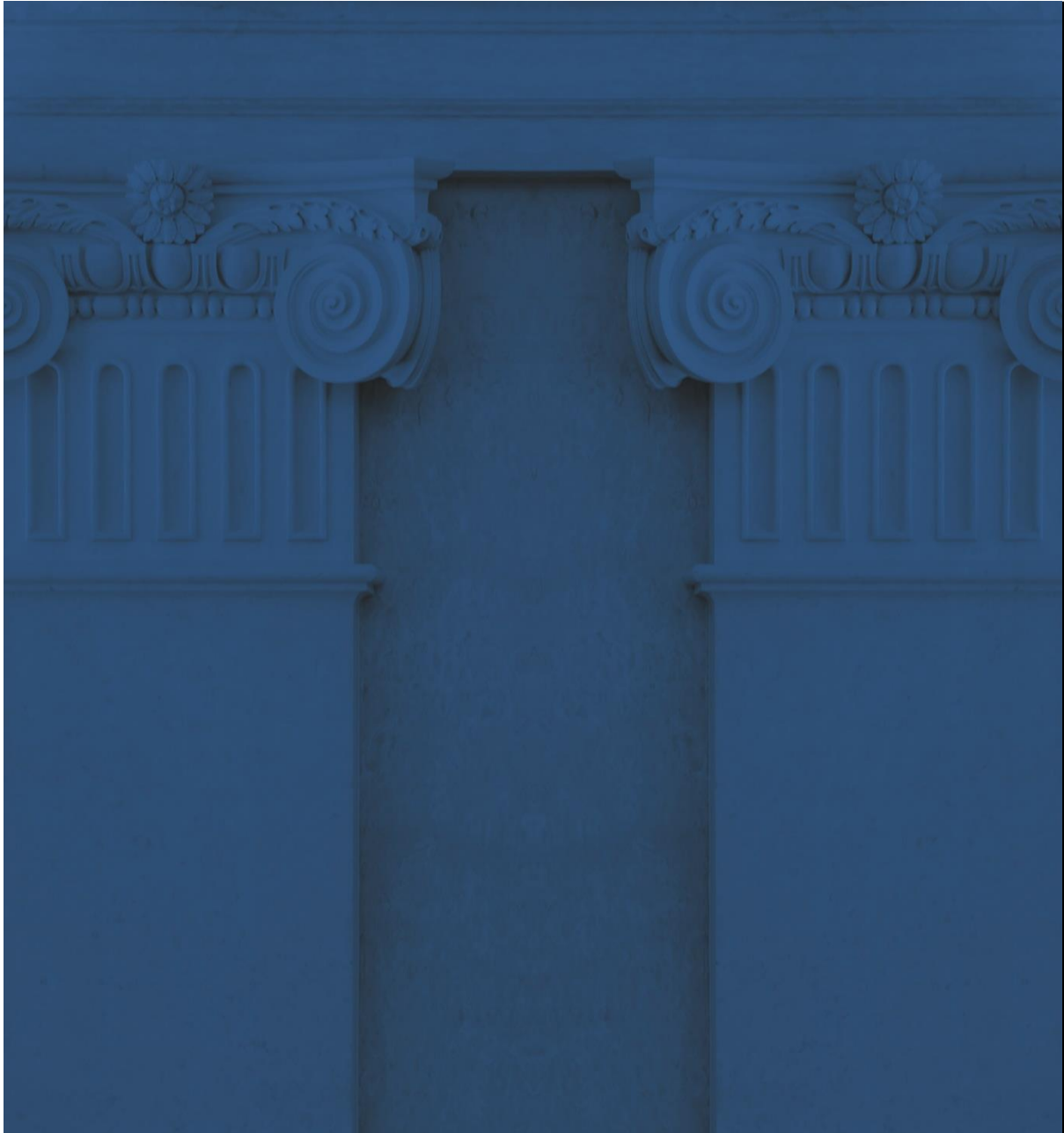
A robust capital level appropriate to the institution's risk profile provides a buffer to absorb potential unexpected losses and provide time to reinforce capital.



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