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# Regulatory Reform Developments in Europe

## Banking Challenges and Opportunities in an Era of Global Crisis

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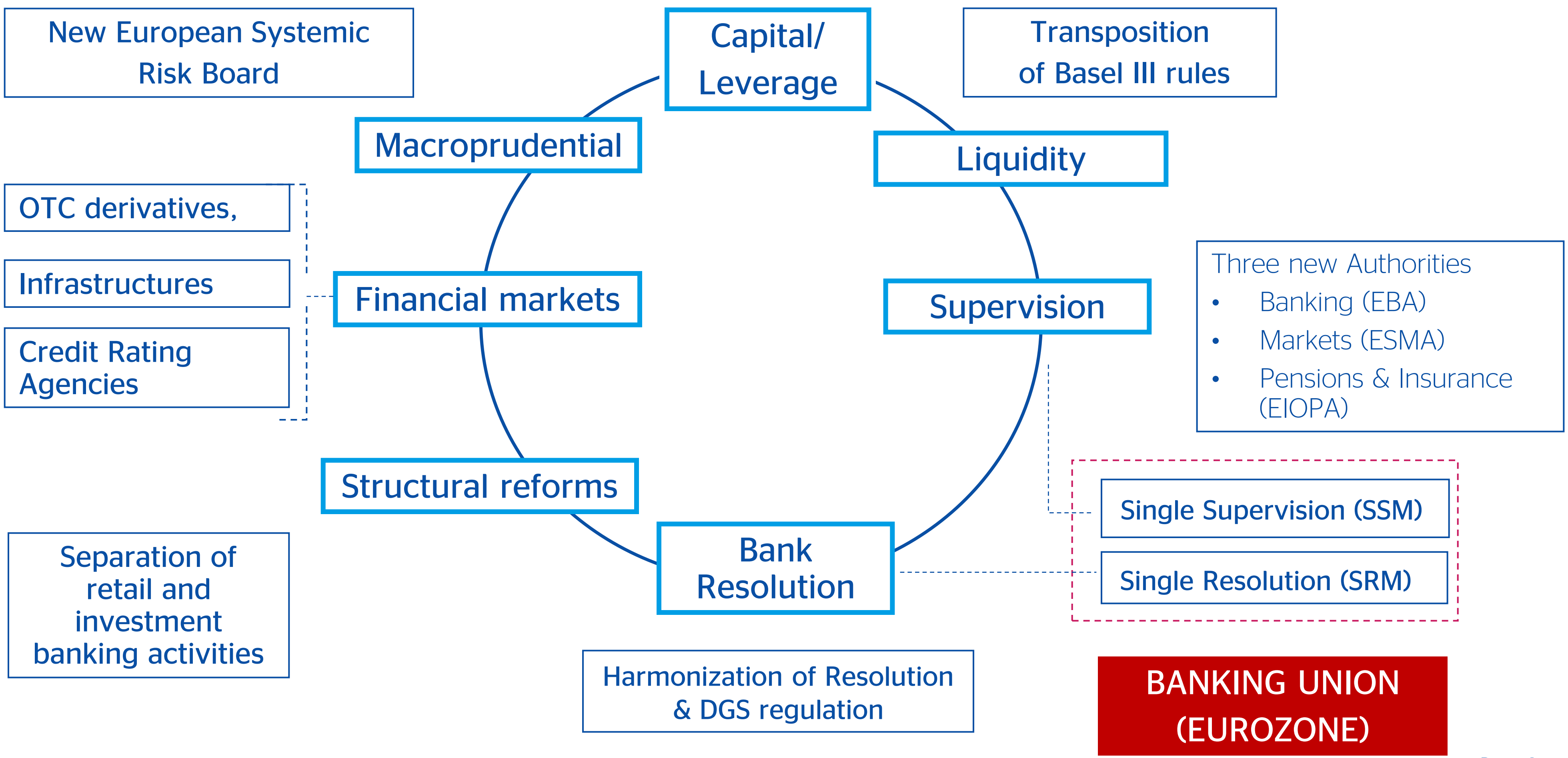
Section 1

# General Remarks

- **The drying-up of interbank markets was the worst possible crisis for the Eurozone** (an imperfect monetary union with no fiscal union)
- **The European legislative process  is quite complex:** the **European Commission**, the Members States (represented in the **European Council**) and the **European Parliament** are involved in the so-called "trialogue"
- It is important to distinguish between the **EU-28 and the EU-17.**The **Banking Union** is a project with a **Eurozone scope (EU-17)**
- The **EU has adopted most of the regulatory reforms** agreed within the G20 and the FSB since the beginning of the crisis
- The reform has **3 main objectives**: (i) reinforcing **bank's balance sheet resilience**, (ii) addressing **systemic risk** and (iii) **protecting taxpayers**
- **Global regulatory consistency must be reinforced**

# European regulatory reform and banking union



Section 2

# Transposition of Basel III in the EU

| | |
|---|---|
| **Capital** | • **In line with Basel III**: 4,5% CET1 + 2,5% conservation buffer<br>• **Countercyclical buffer**: up to 2,5% (national discretion) |
| **Systemic risk** | National **discretionary powers**:<br>• **Systemic risk** buffer (financial sector): 1 – 3%<br>• **SIFI Buffer** (institutions): G-SIFI (1-3,5%); Other-SIFI (0-2%) |
| **Leverage** | • **3% minimum** (binding since 01/2018) |
| **Liquidity** | • Pending calibration of **LCR**<br>• 100% target in 2018 (BIS: 2019). Earlier implementation possible at national level |
| **Remunerations** | • From 2015 **bonuses** capped to fixed salary (1:1) (2:1 with shareholders approval) |

**Implementation date: 01/01/2014**

# Bank resolution: a revolutionary change

**Objetive**

- Orderly resolution while minimizing cost for taxpayers
- Based on FSB Key Attributes (but went much further in tying the hands of the authorities)
- European approach: not only about Too Big To Fail

**Tools**

- Sale of business
- Asset separation
- Bridge institution
- **Bail-in** (main loss-absorbing tool)

## Main aspects under discussion by legislators

**Bail-in**

- Harmonized hierarchy of creditors
- Minimum internal loss-absorption
- Depositor's protection
- Discretionary exclusion of certain liabilities

**State aid rules**

- Partial bail-in in since July 2013
- Government stabilization tools / Role of European funds under discussion (ESM)

**Resolution fund**

- Funded by the industry
- Resolution fund/deposit guarantee schemes: joint or separate
- Eurozone: Single Resolution Fund under discussion

Section 3

# Resolution: bail-in and use of Resolution Fund

**8% internal loss absorption**

**8% of total liabilities** to be absorbed by shareholders & creditors before use of Fund. Depo preference and constrained discretion for bail-in exemptions

**Use of Fund**

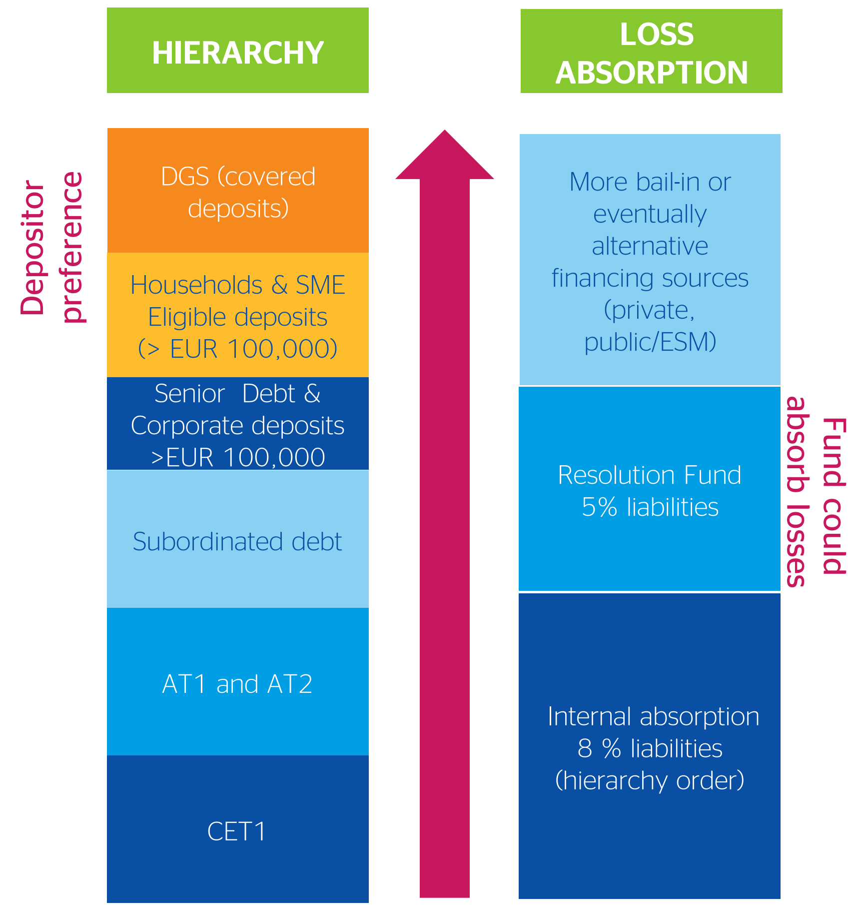
Loss absorption or capital injection up to a limit of 5% of total liabilities

**Financing of Fund**

**Banks:** ex-ante, ex-post and, exceptionally, alternative financing sources (private/public)

**Alternative financing sources**

**Only after 5% Fund** cap has been reached and all unsecured and **non-preferred liabilities other than eligible deposits** have been **bailed in**



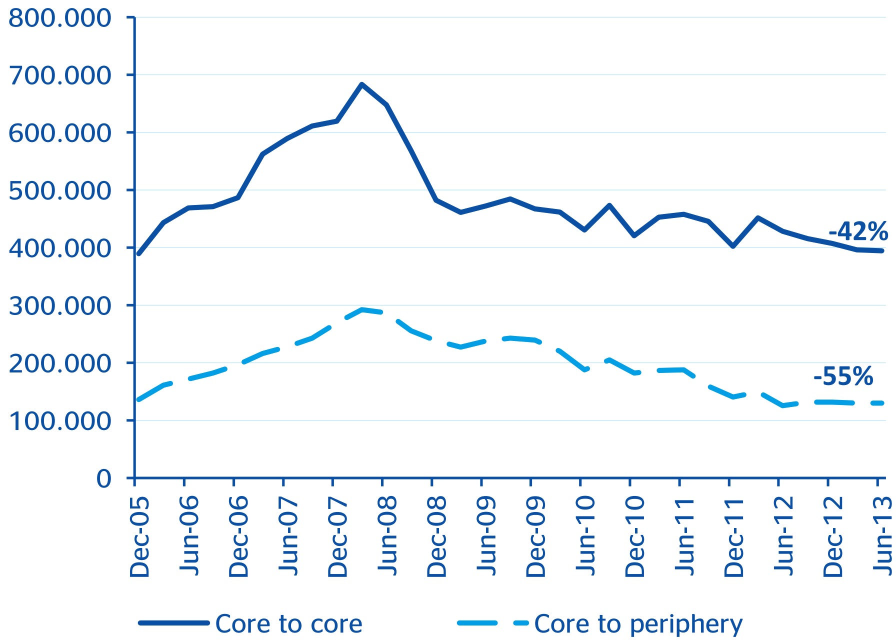
Section 4

# The Eurozone needs a banking union

## To stop fragmentation and separate sovereign and banking risk

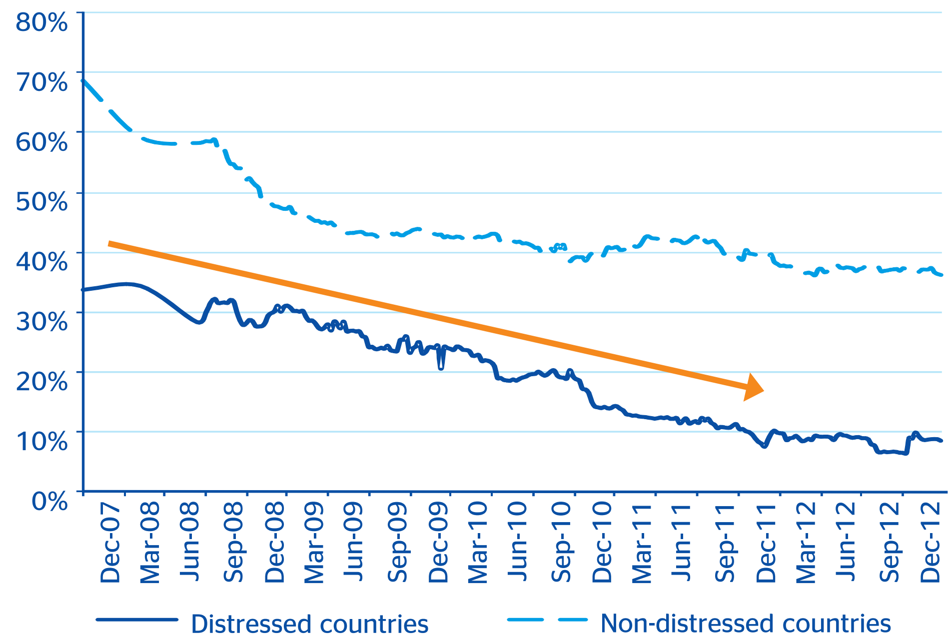
### European Banks: Average exposures to banks located in other EU members USD (dollars).

Source: BIS




### Use of cross-border collateral in Eurosystem monetary policy operations (% total)

Source: ECB




**Re-nationalization of the financial systems fuelled by** (i) market-driven segmentation, (ii) rating agencies and (iii) regulation (mostly moral suasion)

Section 4

# The banking union project

## Single Rulebook

- Capital Requirements Directive (**CRD IV**)

✓ **Under implementation**

## Single Supervision

- **Single Supervisory Mechanism:**
  1. European Central Bank
  2. National supervisory authorities
- Precondition: comprehensive asset review (**AQR+ Stress test**)

✓ **Under implementation**

## Single Resolution

**Single Resolution Mechanism:**

1. Single Resolution **Authority**
2. Single Resolution **Fund**

**Under negotiation**

## Single Deposit Guarantee Scheme

- **Not in the mid term roadmap**
- **Treaty reform required**

? **To be negotiated**

Section 4

# Banking union: the way forward

1. **The EZ needs a fully fledged banking union.** This includes single supervision, single resolution and some elements of debt mutualization and fiscal union
2. **Dealing with legacy problems is key**: comprehensive assessment of banks by the ECB, Asset Quality Review (AQR) and Stress Test with EBA.
3. **Backstops**: private, public (national), public with European Stability Mechanism – ESM -- support (but no direct recapitalization by ESM before Single Supervision)
4. **Bail in** will contribute to **separate the sovereign and banking risk**: hydrids already in force, senior debt in 2018 (may be 2015)
5. **Negotiations on Single Resolution Mechanism are at a stalemate but time runs out.** Fiscal union by the backdoor? Reform of the Treaty?

Sección 5

# Global regulatory consistency is needed

## New trends in regulation puts at risk the efficiency of the reform

**New Trends**

- Extraterritoriality
- Excessive regulatory activism
- Procyclicality
- Ring-fencing
- Overlapping

→

**New Risks**

- Fragmentation of financial markets
- Pro-cyclicality // Delay in economic recovery
- Regulatory arbitrage
- Shadow banking
- Increase in cost of financial intermediation

→ Ensuring **international cooperation** and **global consistency**

**¿ How ?**

- Promoting **mutual recognition** of standards
- Ensuring a **careful calibration and coordinated implementation** of new rules. **Supervision** is key
- Intensifying the **transatlantic dialogue** between US and EU, leading towards convergence
- **Acknowledging different realities beyond US/EU**. Emerging countries: focus on financial inclusion

# Thanks!

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Annex

# Single Supervision

## Already in force. Fully operational in November 2014

A **Main goal:** Restoring confidence in the Euro by stopping financial market fragmentation

B **Institutional setup**

- **Mandate:** Eurozone-wide financial stability
- **Authority**: European Central Bank (ECB) is the ultimate responsible but:
    - Direct supervision of top 130 banks
    - Indirect supervision (through national supervisors) of the rest (6,000 banks)
- **Scope:** Eurozone + open for no euro countries willing to join
- **Governance:** Separate Board inside the ECB

→ **Why the ECB?** Prestige, independence, know-how **+ legally suitable**

→ **Risk:** Necessary separation between supervision and monetary policy

C **Prior to full operation:** legacy issue → **Asset Quality Review +Stress tets** (Nov'13-Oct'14)

Annex

# The need for an SRM

## The SRM: main objectives

Provide a **credible counterparty** to the SSM on the resolution side

Ensure a **uniform implementation** of the EU bank resolution rules

Guarantee **a level playing field** across the Eurozone

Provide the EU with a satisfactory solution **to cross-border resolution**

Provide **greater clarity** in the relationship between CMGs and resolution colleges

Annex

# Fixing the Legacy Issue

**A robust comprehensive assessment**

- Sound methodology
- High transparency
- Sound loss absorption

**Enough backstops**: sequence

1. Tapping the markets
2. Banks' balance sheet management
3. Implementing partial bail-in
4. Fiscal backstops at national level
5. European backstop

**To ensure credible results**