

# European Banking Union What assessment for the one-year anniversary of the SSM? (\*)

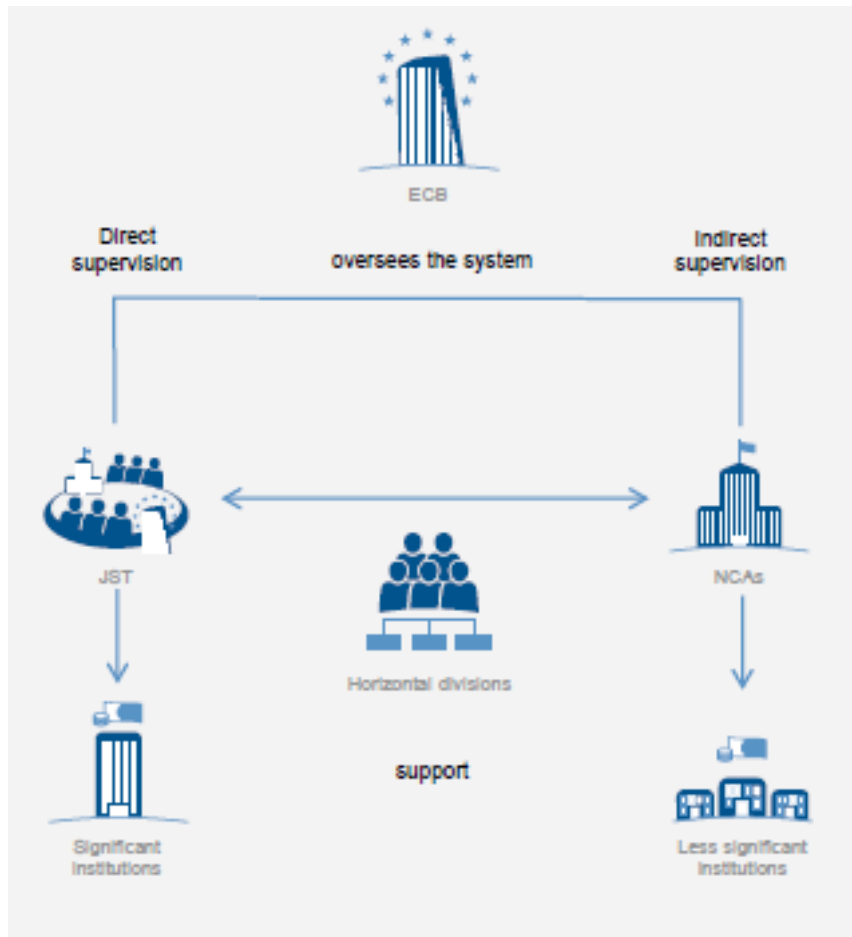
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Banque de France-SciencesPo Seminar  
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(\*) discussions with M. LE and A.-L. Kaminski are gratefully acknowledged






# Introduction : SSM is up and running



# Introduction : distribution of tasks within SSM



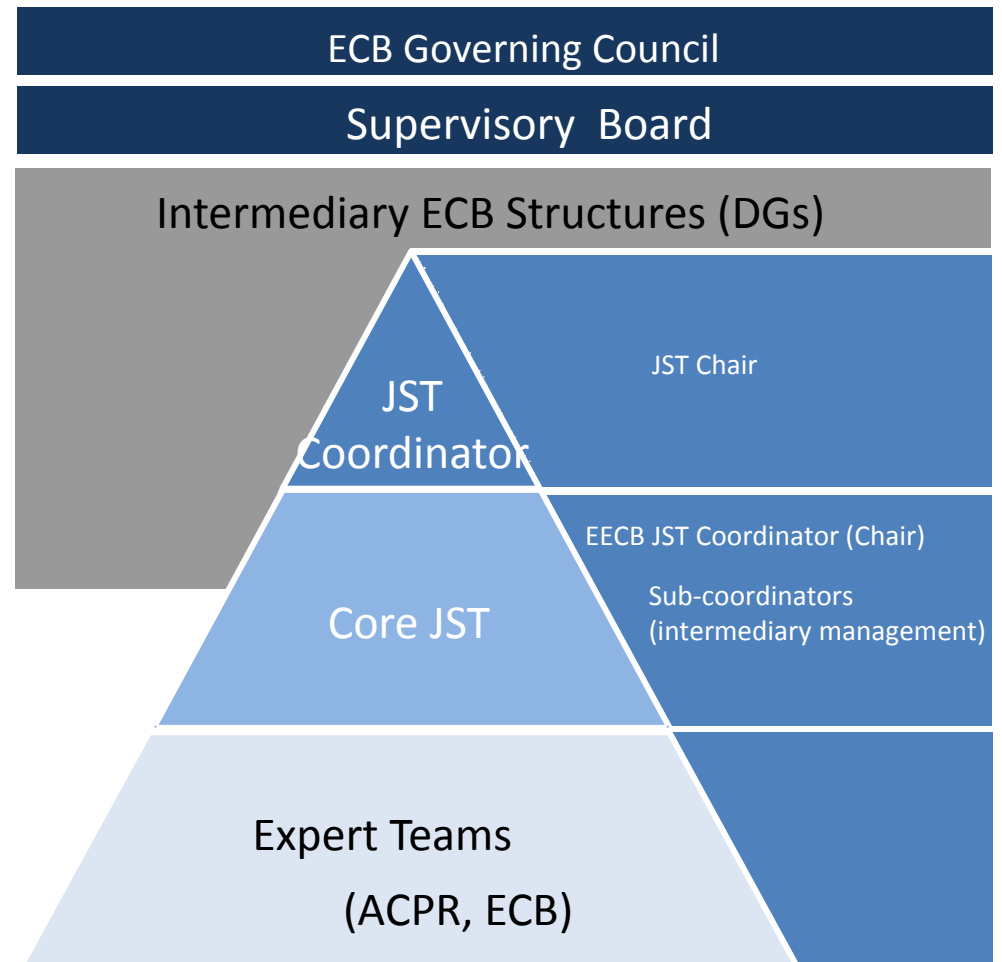
# Introduction : Single Supervision

A shared competence	Significant Institutions	Other institutions
<b>Licencing</b>		+ 
<b>Prudential supervision</b> <ul style="list-style-type: none"> <li>▪ Prudential requirements (CRR) – Own funds, leverage, liquidity, large exposures,...</li> <li>▪ Minimum requirements in terms of governance, risk management, internal control, compensation, internal models (CRD4)</li> <li>▪ Surveillance on a consolidated basis, as well as complementary surveillance of financial conglomerates</li> </ul>		
<b>Other supervision</b> <ul style="list-style-type: none"> <li>▪ Insurance</li> <li>▪ Resolution</li> <li>▪ Banking structure and separation</li> <li>▪ Consumer's Protection</li> <li>▪ Anti-Money Laundering and terrorism financing</li> <li>▪ Investment and payment services</li> <li>▪ Special status Financing (Stés de financement)</li> </ul>		

# Introduction : Core structure

## Joint Supervisory Teams at the core of the Single Sup. Mech.

- One team for each banking group, from ECB and ACPR
- In charge of day-to-day supervision and definition of annual supervisory programme
- In charge of implementing decisions by Supervisory Board/Governing Council
- Size and composition varies across groups
- One strategic : citizenship of coordinator – Chair is not from the country where the bank is headquartered



# Plan

1. One year later, has the literature revised its expectations ?
2. First year's achievements and the way forward

# 1 – One year later, have the general public and academia changed their expectations ?

## A) Expectations

- Banking Union in Europe, risks and challenges, CEPR (2013)
  - Bank-sovereign nexus due to excessive home bias in banks' sovereign holding
  - Issue of burden sharing
  - Supervision and resolution
  - Legacy issues
- Veron (2015)
  - Idea of Banking Union emerged in 2012 in the aftermath of the euro crisis; major requirement for the feasibility of ECB's OMT programme
- Beck and Wagner (2013)
  - The higher the cross-border externalities and the lower the country heterogeneity, the more likely supranational regulation is desirable
  - But a one-size-fits-all approach is neither desirable nor realistic

# 1 – One year later, has the general public and academia changed their expectations

## B) J.-E. Colliard's contribution to the debate

- “*Optimal supervisory architecture and financial integration in a banking union*”, ECB Working Paper
- “*Multinational Banks and Supranational Supervision*”, joint with G. Calzolari and G. Loranth
- Jean-Edouard has previously written another extremely valuable contribution for supervisor :
  - “*Strategic Selection of Risk Models and Bank Capital Regulation*”
  - It is a very flexible theoretical model allowing to compare various regulatory arrangements in a simple way



# 1 – One year later, has the general public and academia changed their expectations

## *“Optimal supervisory architecture...”*

- National supervision ignores spillovers abroad but has more efficient on-site inspection
- 3 types of arrangements for SSM framework : centralized, delegated or joint.
- Optimality depends on three features :
  - cross-borders activities : when intense, favor centralized supervision to internalize spillovers abroad
  - regional specificity of assets : when very specific, favor local supervision because of informational advantages
  - Bank’s opacity : when low, favor mixed supervision
- Multiple equilibria and possibly sub-optimal situation

# 1 – One year later, has the general public and academia changed their expectations

## *“Optimal supervisory architecture...”*

- Important results :
  - More centralized supervision should increase cross-border lending and improve market integration
  - Different banks should face different supervisory arrangements : quite in line with the SSM leaving the supervision of small banks to NCA.
- What about regulatory capture or domestic bias for national or supranational supervisor ?
  - Would it change the role of informational advantage in the model ?
- What about introducing the Single Resolution Mechanism in the model ?
  - Supranational supervision can lack of credibility without supranational power for closing or restructuring inefficient banks
- Institutional specificities: is US “joint” model or different ?

# 1 – One year later, has the general public and academia changed their expectations

## *“Multinational Banks and Supra. Supervision”*

- In a situation where **deposit insurance (DI) remains national, supranational supervision improves supervision:**
  - Limit the home/foreign coordination issue in monitoring
- But supra. supervision affects the structure of multinational banks (branches vs subsidiaries) :
  - SSM favors expansion through branches:
    - Internalize the cost of failure for foreign DI in case of subsidiary
  - Can even lead to limit expansion abroad
    - Financial integration decreases which is a bad outcome...
- Supra. supervision increases the burden of home DI and weakens its credibility (less able to keep its commitments)

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## *“Multinational Banks and Supra. Supervision”*

- Interesting point : **shifting from national to single DI** has mixed effects overall
  - Increases the monitoring of foreign subsidiaries but has ambiguous effect on home monitoring : risk of arbitrage
- What about the cooperation agreements framework currently discussed ?
  - Allow lending across DI. Equivalent to higher  $\alpha_f$  and a lower  $\alpha_h$  but not a common  $\alpha$ . Different conclusions ? Strategic behaviour?
- Credibility of DI depends on banks' size (see FDIC example):
  - What about allowing heterogeneous size distribution ?
- Missing point : different regulatory regimes for branch vs subsidiary
  - No capital requirements for branch on a solo basis (only at the mother bank's level)
  - In case of domestic bias for capital holding (i.e. if banks prefer having the capital at home), could favor expansion through branch

## 2 – First year achievements and the way forward

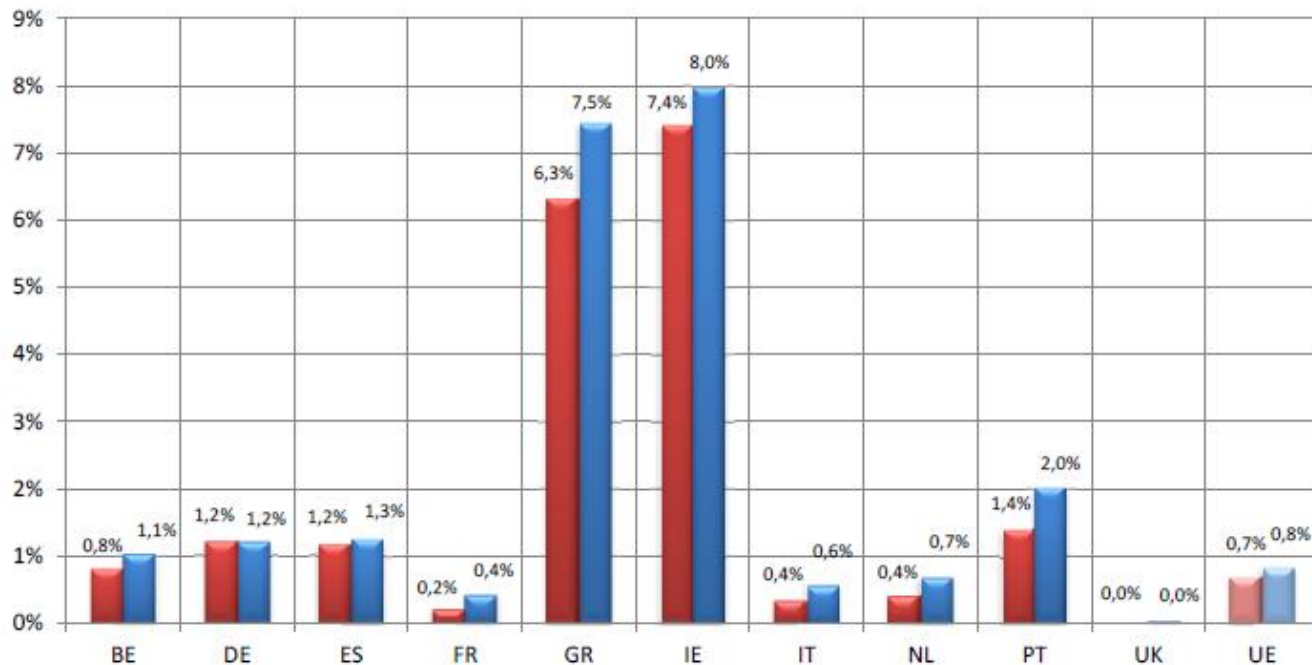
### A) Regulatory harmonization

- General expectation: higher comparability across banks– Fitch ratings “national options still limit EU bank capital comparison”
- CRR allowed further flexibility : DTAs, etc effectively used in the transition to SSM in Southern Europe, not in France (Comprehensive assessment and stress tests 2014)

# 2 – First year achievements and the way forward

## A) Regulatory harmonization

Impact of transitory measures on CET1 in baseline and adverse scenario during 2014 ST exercise



# 2 – First year achievements and the way forward

## A) Regulatory harmonization

- Important work has been carried out in 2015 based on a taxonomy of Options of National Discretion (ONDs)
  - Temporary
  - Not material
  - Material
- D. Nouy (sept 2015):
  - *Supervisory Board adopted in mid-July a policy package on close to 100 ONDs.*
  - *is being translated into a legal package, composed of an ECB regulation for general ONDs, and internal guidance laying down stances and specifications for case-by-case ONDs*
  - *will be subject to a public consultation, to be launched at the beginning of November.*
- US Experience indicates that the process may take long
- Effect on business models (cooperative banks, bancassurance and conglomerate supervision dealt with Ficod)
- Harmonisation of macroprudential buffers not yet on the agenda as seen as national competence

# 2 – First year achievements and the way forward

## B) Liquidity Management and resolution

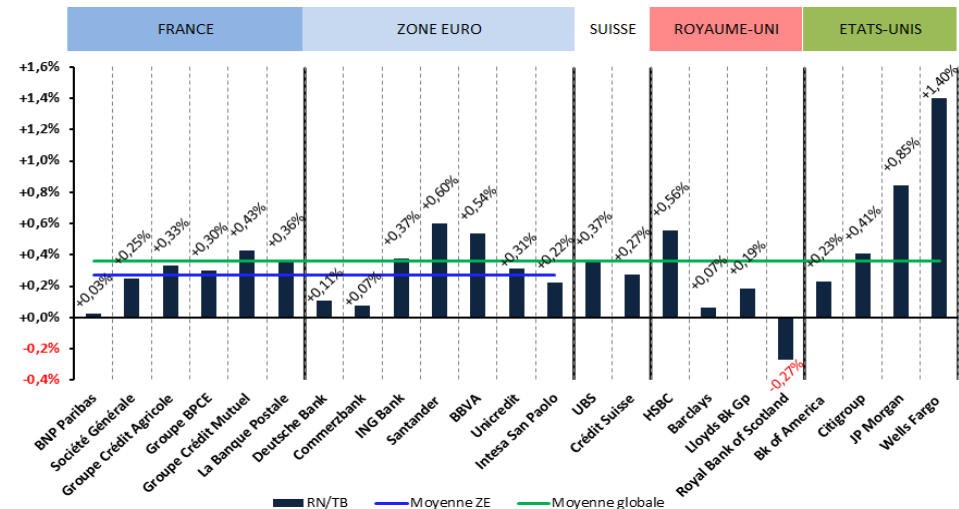
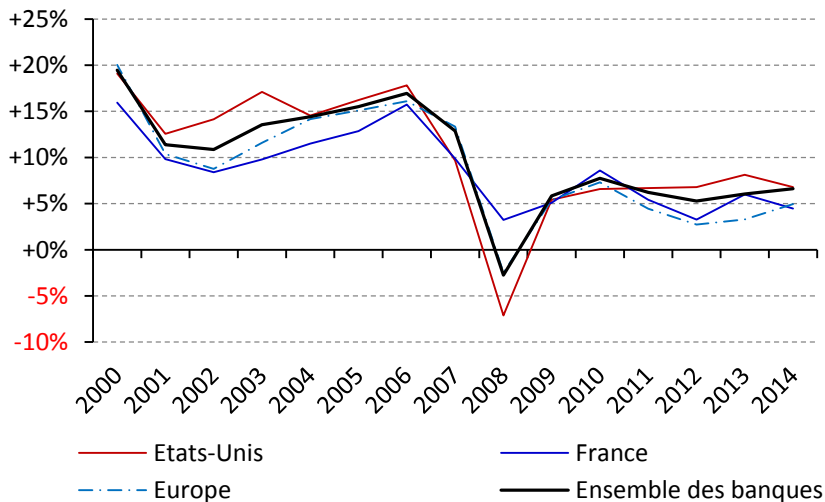
- Liquidity waivers for subsidiaries in CRR (art. 8)
  - No waiver implies stricter controls
  - But allows liquidity ring fencing
- Has not yet been addressed by SSM
- As resolution framework still untested
  - BRRD (May 15, 2014) as of January 1<sup>st</sup>, 2015 (except bail-in provisions as Jan. 1<sup>st</sup>, 2016)
  - Single Resolution Directive (July 2014) is second pillar of Banking Union
    - Anticipated by SRAB law 26 July, 2013: Resolution in France
    - Single Resolution Fund (progressively funded and operational in 2024) and Single Resolution Board in Bruxelles



# 2 – First year achievements and the way forward

## C) Remaining questions on profitability of European banks

- caveat : differences in accounting rules limit comparison with US
- however, differences (RoE-LHS chart, or RoA-RHS chart)
- improved situation with the progressive recovery of euro area
- still challenged by the low level of interest rates





Thank you for your attention

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