Supervisory and regulatory issues for 2020

Citi's European Banks
Regulatory Trip 2020

Paris, 16 January 2020

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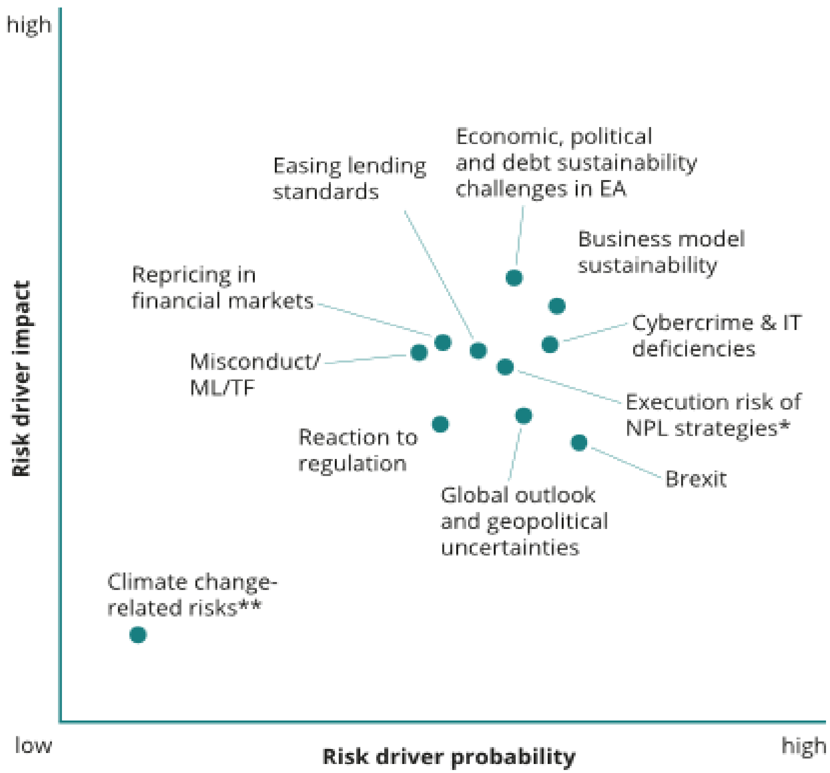
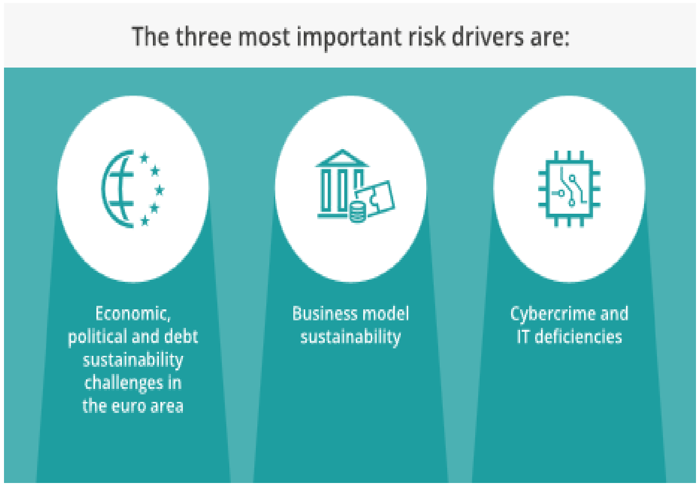
1 - SSM analysis for 2020 (1/3)

SSM Risk Map for 2020



Source: ECB and national competent authorities.
*The execution risk attached to banks' strategies for non-performing loans (NPLs) only applies to banks with high levels of NPLs.
**Climate change-related risks are more relevant over the longer-term horizon (i.e. a horizon of more than three years).

Key risk drivers

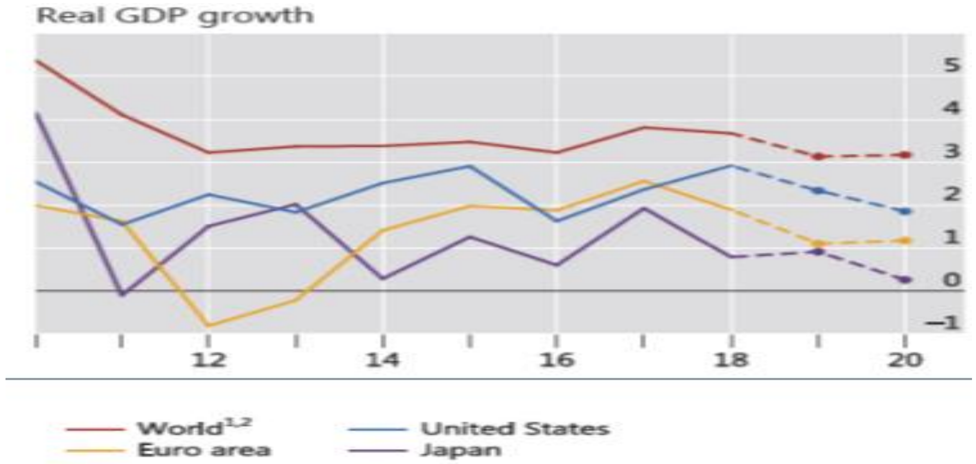


SSM analysis for 2020 (2/3)

Economic, political and debt sustainability challenges in the euro area have grown over the past year, increasing risks to the euro area banking sector, including credit risk and profitability prospects.

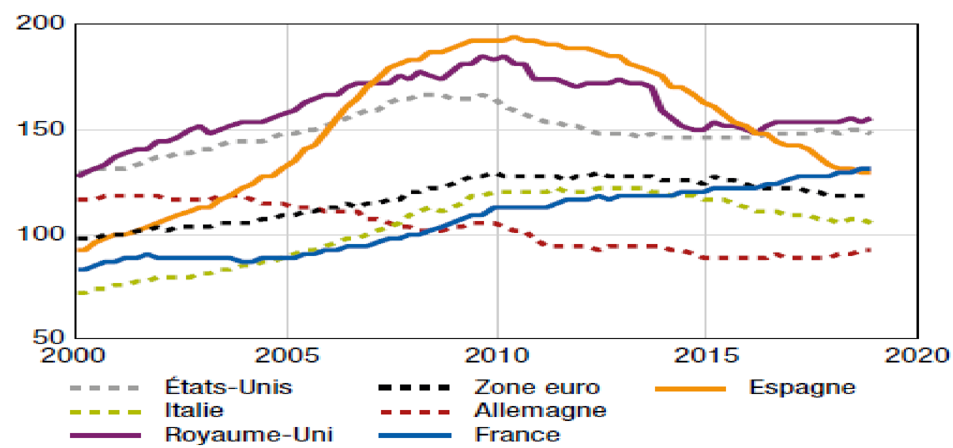
- the euro area economic growth projections for 2019-20 have been revised down compared with a year earlier but still point towards economic expansion.

- debt sustainability concerns remain pronounced, exposing euro area countries with high debt levels to sudden changes in financial market perceptions



Source: Standing Committee on assessment of vulnerabilities, FSB, 2019

Private sector debt % GDP



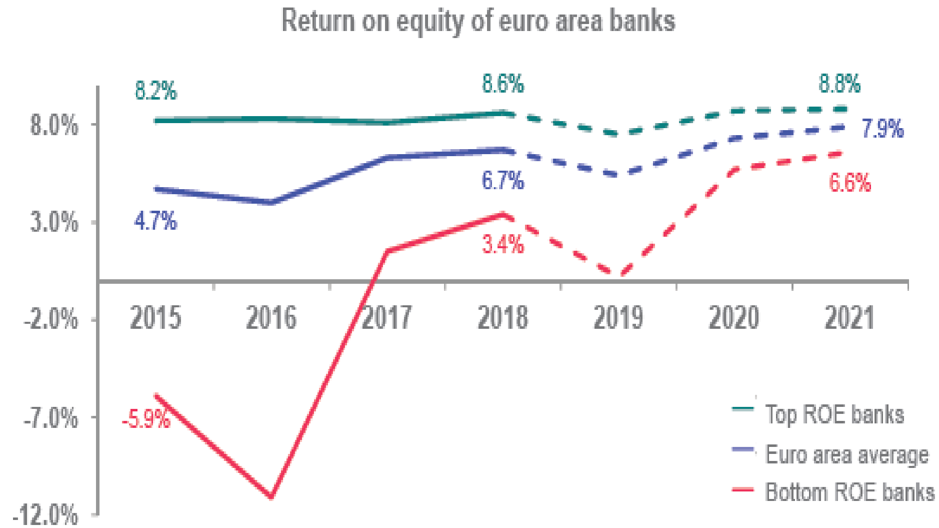
Source : Banque de France.

SSM analysis for 2020 (3/3)

Business model sustainability remains an area of focus as significant institutions (SIs) in the euro area continue to struggle with low profitability

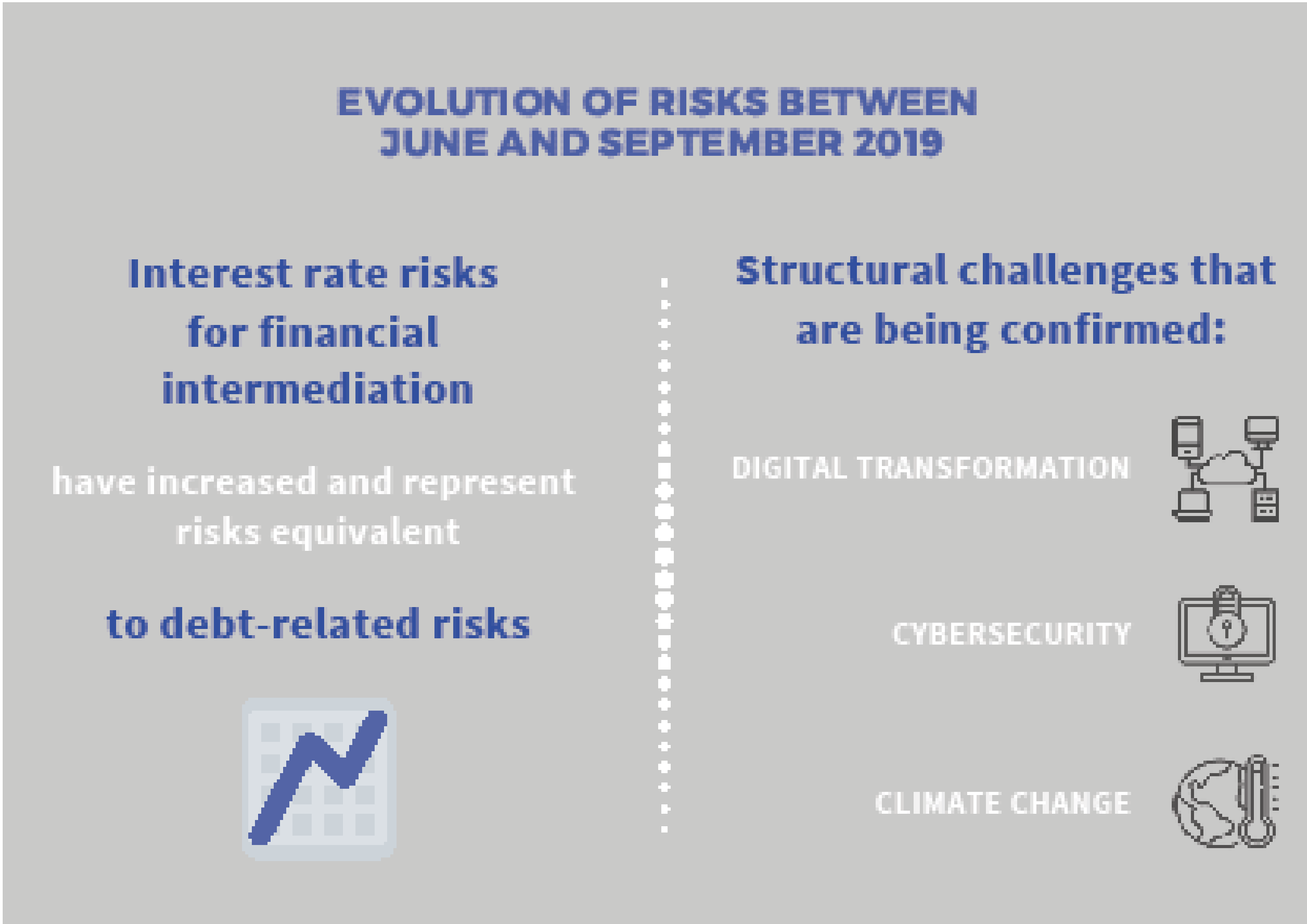
- the outlook of prolonged low interest rates and intense competition weigh further on banks' ability to generate income.

- at the same time, expenses have remained stable on aggregate, as cost-saving efforts have been partly offset by factors such as rising salaries, the need for IT investments and improvements in risk management.



Source: A. Enria presentation at the Forum Analysis 17 September 2019

2 - Banque de France/ACPR risk assessment (1/5)

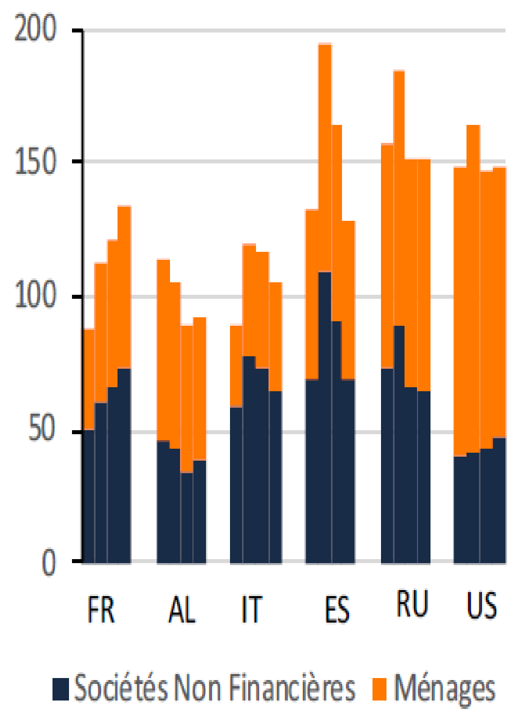


Banque de France/ACPR risk assessment (2/5)

Private debt is reaching elevated levels

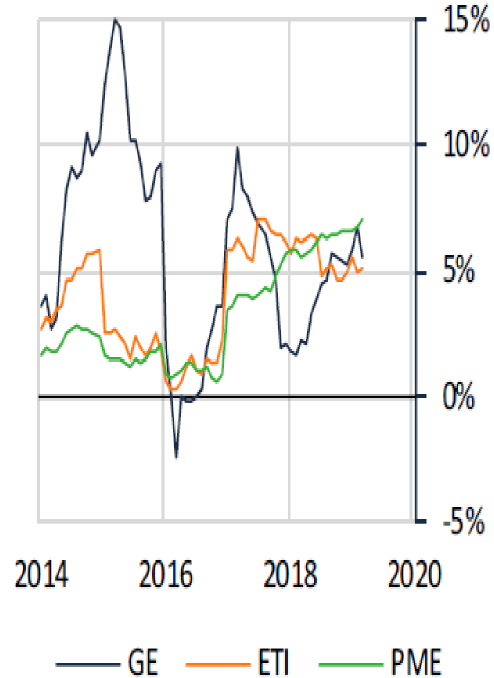
Dette des ménages et sociétés non financières 2004 -2009-2014-2019

x : pays et années sélectionnés / y : pourcentage du PIB



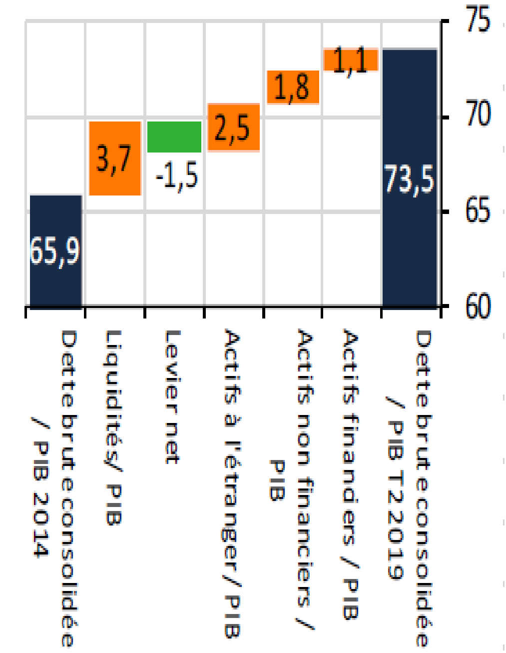
Croissance annuelle de la dette des sociétés non financières (SNF)

x : axe temporel / y : pourcentage en glissement annuel



Décomposition de l'évolution du ratio dette SNF/ PIB entre 2014 et 2019 T2

x : décomposition par facteur / y : pourcentage du PIB



2 - Banque de France/ACPR risk assessment (3/5)

Macro prudential measures have been activated

1. Limitation (5% of banks own funds) to exposures to highly indebted firms

2. Activation of the cyclical countercyclical buffer: 0.25% on 1 July 2019 and 0.5% on 1 April 2020

3. Recommendation of prudence in complying with best practices that ensure the robustness of the housing financing model:

   i. the effort rate to grant mortgage borrowers by ensuring that the latter does not exceed 33%;

   ii. the maturity of the credit granted by ensuring that it does not exceed 25 years.

2 - Banque de France/ACPR risk assessment (4/5)

Net effects of low interest rates on banks depend on business models

1. Income structure (interest/commissions)
2. The level of diversification (bank, insurance, asset management)
3. The share of market deposits/financing
4. The share of fixed/variable rates in loans
5. Ability to reduce costs

With interest rates in a low-for-long scenario:

- clear pressure on margins for **banking activities**
  - reduce resilience by lowering profitability
  - reduce ability of banks to replenish capital after a negative shock
  - encouraging risk-taking

- challenges faced by **insurers**
  - rise of present value of liabilities more than that of assets, undermining solvency
  - steering of clients away from euro funds into unit linked product

ACPR BANQUE DE FRANCE

2 - Banque de France/ACPR risk assessment (5/5)

CYBERSECURITY

1. Regular assessment by the SSM for significant institutions
2. Follow-up by ACPR for non significant institutions and insurers
3. Completion in 2019 of the first cyber crisis simulation exercise affecting the G 7 financial system (the aim was to assess the exchange protocol between financial authorities)

CLIMATE CHANGE

1. International cooperation with the Network for Greening the Financial System (NGFS)
2. ACPR has in place a framework for monitoring and assessing commitments undertaken by financial entities
3. Supporting and accelerating the necessary transformations and enhancing risk containment: implementation of climate test stress by French banks and insurers in 2020

Regulatory issues for 2020 (1/3)

EBA stress tests and what for future?

An EBA stress test 2020, in line with previous exercises:

- Publication of the methodology and delivery tables
- January 2020 exercise and published results end July 2020
- As in 2018, a «bottom-up» exercise with constraints, including a static balance sheet
- Focus on impacts affecting solvency with regard to different risks: credit risk - including securitisations - market risk and counterparty risk, operational risk - including conduct risk.

Open thinking for the future (speech by José Manuel Campa, 11 November 2019 at 20 th Handelsblatt Annual Conference)**:**

- Bank + Supervisory leg with dialogue and overview
- Two banking/supervisory approaches with full publication of the two test sets
- Two separate approaches, with publication of the two results sets, but little information about the outcome of the supervisory projections.

Regulatory issues for 2020 (2/3)

Implementation of Basel 3 in Europe

- EBA assessment already published
- Public consultation by the European Commission launched on 11 October
- Commission legislative proposal is expected for June 2020.

A few points of attention for ACPR:

- Application of the output floor at the consolidated level
- Link between the output floor and Pillar 2
- Focus on financing the economy

3 - Regulatory issues for 2020 (3/3)

Progress in the implementation of the resolution framework

- For the financial year 2020 the SRB is in the process of establishing the requirements for
  - MREL consolidated: recognition of eligible liabilities at the level of the resolution entity (excluding subsidiaries)
  - Subordinated MREL
  - Internal MREL

- The SRB should consult end of January on its MREL policy transposing BRRD 2 (applicable end 2020)

- The SRB main priorities for 2020 vis-à-vis banks:
  - Implementation of the bail-in and the bail-in playbook
  - Access to market infrastructures
  - Business continuity