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The Banking Union: achievements and challenges

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1. Introduction

Let me begin by thanking the organisers, both PWC and the Instituto de Empresa, for their kind invitation to participate in the closure of this presentation of the third report on the Banking Union.

We can hardly overstate the importance of the Banking Union for the European construction project and, in particular, for ensuring the sound working of Economic and Monetary Union (EMU). A true monetary union among sovereign States is not confined to the use of the same banknotes and coins in each country, nor to the denomination of trade transactions with the same metric. Monetary union requires the conditions in which liquidity is exchanged to be homogeneous across the entire area. Insofar as these exchanges are typically intermediated by financial institutions, by means of whose liabilities trade and financial transactions are settled, the appropriate flow of liquidity within a monetary union demands that the risk associated with these liabilities should not depend on the location of the institution issuing them.

Naturally, to achieve this homogeneity, bank crisis-prevention and management mechanisms are needed along with risk-mutualisation arrangements that minimise the link between national economic and fiscal conditions and the ability to preserve the value of bank liabilities in each jurisdiction. These requirements include a single supervisory mechanism as a prevention tool, a single resolution mechanism that pursues the homogenous treatment of banks with viability problems and has a common fund to make this economically feasible, and an integrated deposit guarantee scheme that ensures identical coverage throughout the monetary area for eligible deposit-holders.

We can already claim that the project to set up a Banking Union that includes the above-mentioned ingredients is close to becoming a tangible reality. Just a few weeks back we celebrated the first anniversary of the start-up of the first of the three pillars of the Banking Union project, the Single Supervisory Mechanism (SSM); the Single Resolution Mechanism, the second pillar of the Banking Union, is now under way and will be fully operational from 1 January 2016.

Admittedly, certain relevant aspects have still to be set in train. First, the single resolution fund must be strengthened to ensure that it is strong enough to withstand future banking crises, without destabilising the public finances of the countries concerned. Further, we must step up efforts to move forward on the third pillar of the Banking Union, the establishment of a common deposit guarantee scheme, based on the proposal released by the European Commission last week.

I would like to focus today on the Single Supervisory Mechanism, the most developed component of the Banking Union. In this connection, I shall review the milestones reached and address what I consider are the main challenges ahead for us.

2. SSM milestones

The first SSM milestone took place precisely before it assumed full supervisory responsibility, and it entailed successfully conducting the “comprehensive assessment” of all significant euro area banking groups. This review helped to enhance the information on the situation of European banks and to identify the measures that could be necessary to strengthen their solvency.

In this respect, it should be recalled that Spanish banks were those that evidenced fewest incidents in the asset quality review process, which entailed adjustments of little more than 0.1% of its risk-weighted assets. This outcome, along with the limited impact of the stress tests, highlighted the fact that the reform of the Spanish banking system undertaken in previous years had met its objectives.

At present, we are working on the stress test scheduled for the coming year. This test, following the methodology of the European Banking Authority, will be made on a sample of banks – six of which Spanish – covering 70% of euro area banking assets. The results will be published at the start of the third quarter of 2016.

One of the main challenges of the SSM at the outset was to make its complex governance structure workable. This complexity derives from the institutional restrictions imposed by the Treaty, from the need to ensure the separation of the monetary policy and prudential supervision functions attributed to the ECB, and from the objective of achieving a suitable incorporation of the national authorities into the new framework without impinging on the ECB’s leadership in supervisory decisions.

As you know, the central SSM body is the Supervisory Board, which is responsible for the planning and implementation of oversight tasks and for submitting decision-making proposals to the Governing Council, which the latter may approve or object to, but not amend. The Board is made up of 25 members: the Chair, Vice-Chair, four members appointed by the ECB Governing Council and the representatives of the national supervisory authorities of the 19 participating Member States.

The Supervisory Board is intensely involved in all the SSM’s key actions, as a result of the competencies directly attributed to it under the prevailing European Regulation and the absence of extensive delegation powers. Indeed, in its first year alone, the Supervisory Board has adopted around 1,200 decision proposals. This heavy workload, far greater than is habitually the case for the maximum decision-making bodies of supervisory agencies in other jurisdictions, is an operational challenge of the highest order that the Board is so far responding to with considerable effectiveness, maintaining a high frequency of face-to-face meetings complemented by numerous teleconferences and written procedures.

More generally, the start-up of the SSM has necessitated major changes in the internal structure of both the ECB and the national authorities. In the case of the ECB, four new directorates general for microprudential supervision have been created, and the staff has been increased to assign to this new function more than 1,000 employees.

At the same time, the national authorities have made a great effort to adapt to this new framework. In our case at the Banco de España, the Directorate General Banking

Supervision was restructured and its departments reorganised to create a structure mirroring that adopted by the ECB, so as to provide for smoother interaction between both institutions.

However, the most significant change has been the creation of the joint supervisory teams, made up of employees from the ECB and from the national authorities. These teams are the basis for the day-to-day supervision of each significant bank. They are coordinated by an ECB member of staff, who is assisted by one or several sub-coordinators from the national authorities, on whom the coordinator draws support for the organisation of the work and the management of the local teams. This admittedly novel design is in response to the need to combine a centralised management framework while harnessing the knowledge and proximity to banks that national supervisors provide.

It should be stressed here that more than two-thirds of the members of these teams are from the national supervisors. The staff from these authorities are also generally entrusted with leading on-site inspections within their jurisdiction. Moreover, as you know, the national supervisory agencies keep functions relating to the direct surveillance of the so-considered less significant banks.

This all explains why the start-up of the SSM has meant no saving in supervisory resources at the national level. On the contrary, the national authorities have had to address the considerable challenge posed by the loss of human resources to the ECB. In our case, thanks to the success of Banco de España candidates in selection processes, approximately one-quarter of our supervisory staff have moved to work for the ECB, including three senior managers who today occupy high-responsibility posts – one Director General and two Deputy Directors General – in this institution.

The third milestone has been the setting in place of an operational framework for the pursuit of the supervisory functions of the SSM. In this connection, work has been performed since the outset of the project to define common frameworks for action enabling the different practices pursued by different national authorities, with their greatly differing supervisory cultures, to be overcome. This work saw a Supervisory Manual devised in which processes and the operational methodology are described. Naturally, certain key aspects of supervisory procedures have still to be smoothed. In fact, the Manual should be seen as an evolving document, the regular update of which on the basis of experience accumulated is needed to complete convergence towards better supervisory practices.

Likewise, to achieve greater consistency in the regulatory framework, it has also been necessary to review the national application of the various options permitted under European regulations.

European solvency regulations – namely the Directive and Regulation on capital requirements – confer some degree of discretion upon Member States and national supervisors in the implementation of specific regulatory aspects. Such aspects include the timetable for the progressive adoption of new solvency standards and the granting of exceptions in respect of compliance with certain prudential requirements.

This degree of national flexibility had to be accepted at the time by European legislators in the complex Directive and Regulation negotiations. Naturally, the fact such a diversity of rules are in place hampers supervisory action and prevents the homogenous treatment of banks based on their objective position.

Accordingly, in recent months, the SSM Supervisory Board has worked intensely in this field. Their efforts have seen a preliminary agreement allowing a common approach to be adopted in relation to the application of these “national options and discretions” in the hands of the supervisory authorities. The terms of this agreement are now being subjected to public consultation, a process which will finalise on 16 December. I trust that this agreement, once it is finally approved by the ECB, may be implemented in the opening months of 2016 and that, in any event, future revisions of European legislation will envisage less room for discretion on the part of the Member States, so that the singleness of the relevant legal framework for banking activity throughout the EU may become firmly anchored.

To wrap up this first part of my speech, allow me to highlight certain relevant decisions taken by the Supervisory Board during this first year. Among the most important are those relating to the Supervisory Review and Evaluation Process (SREP), which has for the first time been carried out with a common methodology for all SSM banks. This process, which includes both quantitative and qualitative aspects, determines the risk profile of each significant institution, the sufficiency of its liquidity and solvency in terms of this profile and, finally, it sets the minimum capital levels to be maintained. The decisions on capital, the adoption of which for 2016 will be shortly formalised, will, for all the SSM’s significant institutions, entail average capital requirements somewhat higher than those of the previous year: around 30 basis points (bp), rising to 50 bp if the impact of the phasing-in of the capital buffers envisaged in European legislation is taken into account.

As you will recall, in January this year a recommendation on dividend distribution policy was adopted in which banks were urged to keep conservative dividend distribution arrangements so as to preserve their solvency. This recommendation will be shortly reassessed. In turn, common criteria have been laid down for recurring decisions such as authorisations for the acquisition of qualifying holdings in credit institutions, assessment of fitness and properness of board members, or the requirements to be made in capital reductions and issuances.

Finally, I must highlight the relevant role played by the SSM in the management of the Greek crisis. The SSM not only monitored the situation of the banks continuously, but, once agreement was reached between the European and Greek authorities last summer, it was entrusted with determining the recapitalisation requirements of Greece’s four significant institutions on the basis of a specific comprehensive assessment exercise, whose results were recently published. In the coming months, the SSM must ensure that the recapitalisation of these banks goes ahead as stipulated.

3. Some challenges

That said, and as I stated at the outset, the SSM has numerous challenges to face in the near future. I would like to mention four in particular.

Firstly, the microprudential policy stance sought must be clearly defined. The SSM, despite its exemplary start-up, is still under construction and its criteria, practices and specific objectives have not yet reached the degree of stability desirable. Evidently, we must shorten the transition as far as possible, so that banks are aware with sufficient certainty of the supervisor's requirements in the short and medium term and can, in this way, effectively design their strategic and management measures.

True, this objective is currently hampered by the still-unstable international regulatory framework. I trust the Basel Committee's announced intention in its recent report to the G20 to see through the regulatory reform next year will be fulfilled. In any event, in the supervisory realm we must make further efforts to specify with greater precision and permanence the solvency requirements for each bank based on its risk profile, and to establish certain clear guidelines on the application of restrictions on the remuneration of capital instruments and on directors' variable remuneration.

At the same time, as I previously pointed out, we must continue to work on the convergence of supervisory practices, moving towards better standards, and on smoothing the differences that still persist across the different SSM jurisdictions. For example, while some national authorities have traditionally focused on reviewing management procedures, others have placed particular emphasis on reviewing the classification and valuation of assets on financial statements. These differences in supervisory practices involve, in turn, heterogeneity in the professional profile of the employees of the various authorities now sharing missions within the SSM.

Against this background, the Banco de España has a tradition – one that I think it is comprehensively successful – of conferring high importance in its supervisory work to monitoring the rigour of financial information and of the models used to calculate risk-weighted assets. Naturally, it is our wish that these elements, which crucially affect the supervisor's capacity to properly measure banks' solvency situation, should be part of the common model adopted by the SSM and applied uniformly to all banks.

A third significant challenge concerns achieving a fruitful framework of interaction between the SSM and the Single Resolution Mechanism. The regulations have set in place a complex structure in Europe, which includes the creation of a resolution agency (the Single Resolution Board) separated institutionally from the supervisor. This agency has been granted wide-ranging powers both in respect of the definition of resolvability requirements – which include the determination of a minimum volume of instruments capable of absorbing losses – and of the activation of resolution procedures for non-viable banks, as well as the selection of the most suitable tools to implement them.

Resolution actions have direct consequences for financial stability, which is a public good that the SSM seeks to protect, and they turn on the more vulnerable banks, which are precisely those that require greater attention from the prudential supervisor. Accordingly, the defining of effective information and analysis co-operation and exchange procedures between the Supervisory and Resolution Boards is crucial for preventing dysfunctions, overlaps and frictions that hamper the proper functioning of the Banking Union. A Memorandum of Understanding between both agencies is currently being drawn up and will, I hope, contribute to achieving the necessary coordination.

Lastly, we should sustain our efforts in order to achieve the degree of cohesion between the various components of the SSM that effective supervision requires. The SSM directly supervises 122 European banking groups, encompassing some 1,200 institutions. This is done with supervisory teams that draw on staff from various institutions, with highly diverse skill sets, seniority, experience and working conditions. Evidently, we must strive to fully develop a sense of mission to which all the component parts must contribute, under the leadership of the ECB and its Supervisory Board, without exclusions or unnecessary subordination. That is vital for maintaining the motivation and commitment of all SSM supervisory staff, irrespective of the authority to which they are attached. Indeed, they have to date shown exceptional professionalism.

Final remarks

In concluding, I will say that the past year has seen major headway in setting the Banking Union in place, but we still have some way to go. We must move ahead in a setting that will be complex for the European banking industry.

Specifically, economic activity remains relatively sluggish, price stability is subject to significant risks and, as a result of this, interest rates are holding at very low levels. Against this background, banking business is feeling the effects of the difficulties in reactivating credit, of modest net interest income and of the impaired assets still on their balance sheets. And compounding this are growing regulatory demands which, though they should be conducive to the industry's stability in the medium term, are raising the pressure in the short term on profitability.

It is essential in this setting for managers and supervisors to revise the soundness of banks' business model and, in particular, their capacity to generate resources in a stable manner that will ensure satisfactory levels of profitability and solvency in the medium term. That may require a correction of the European banking industry's excess capacity apparently prevailing at present. It is important that the authorities involved should attempt to facilitate the process – which should in any event be led by banks themselves – so that the correction comes about in the most orderly fashion possible.

Thank you very much.