

Regulatory Reform Developments in Europe

Banking Challenges and Opportunities in an Era of Global Crisis

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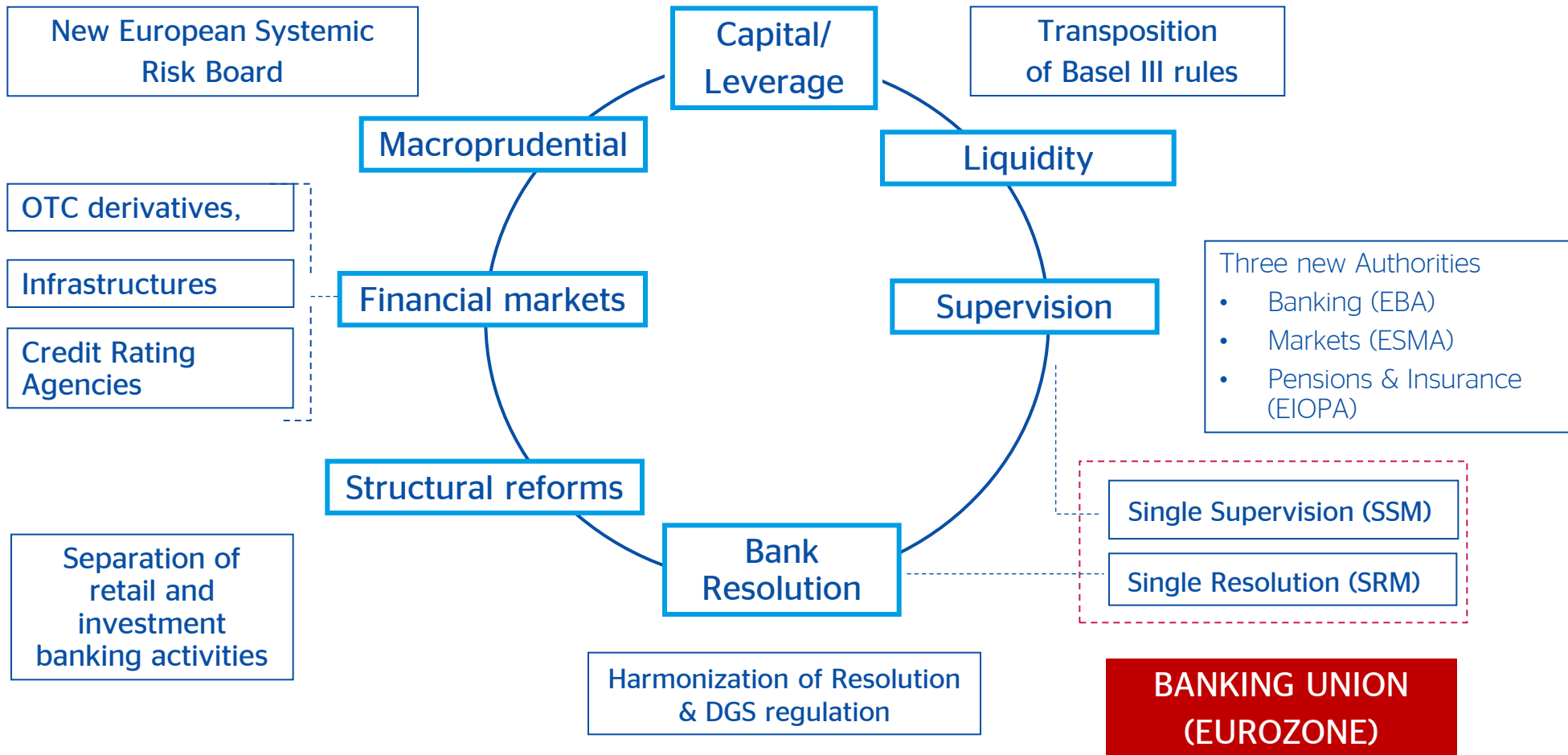
20th November 2013

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 Member 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
- **Countercyclical buffer:** up to 2,5% (national discretion)

Systemic risk

National **discretionary powers:**

- **Systemic risk** buffer (financial sector): 1 - 3%
- **SIFI Buffer** (institutions): G-SIFI (1-3,5%); Other-SIFI (0-2%)

Leverage

- **3% minimum** (binding since 01/2018)

Liquidity

- Pending calibration of **LCR**
- 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

Section 3

Bank resolution: a revolutionary change

Objective

- 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

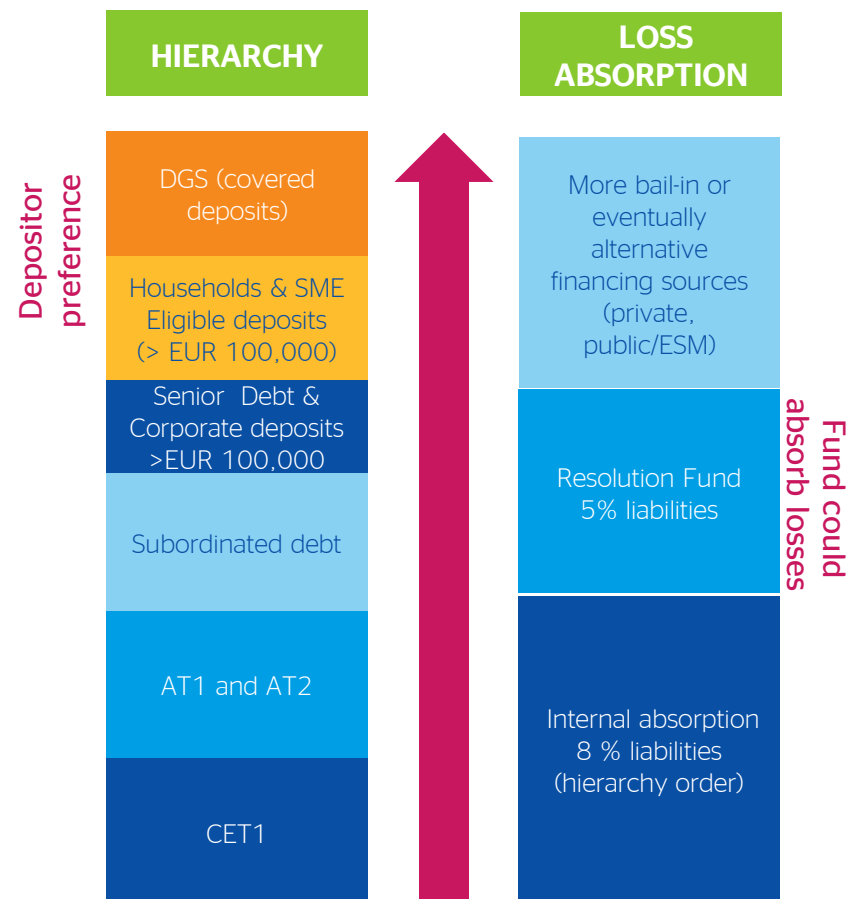
Loss absorption or capital injection up to a limit of 5% of total liabilities

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**



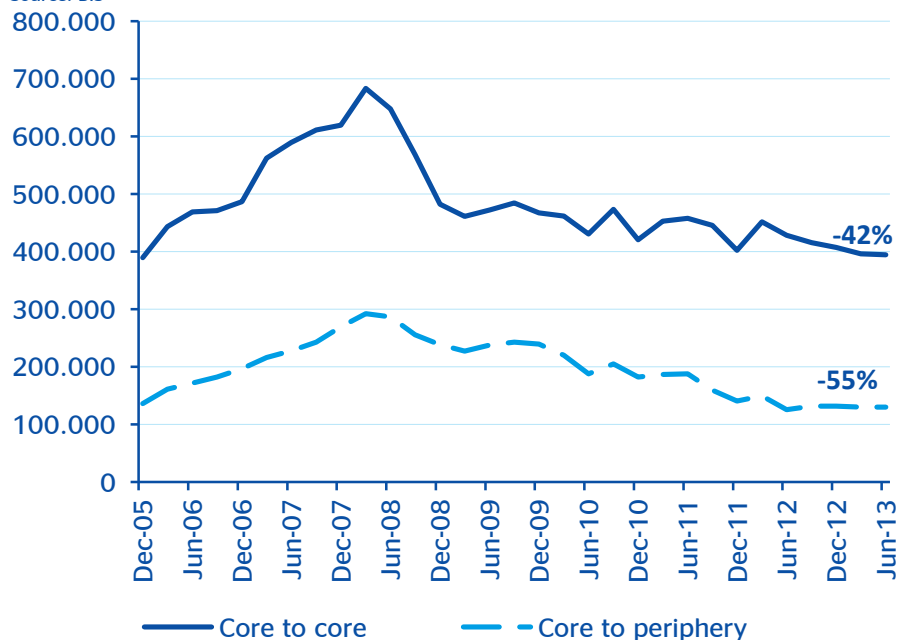
Section 4

The Eurozone needs a banking union

To stop fragmentation and separate sovereign and banking risk

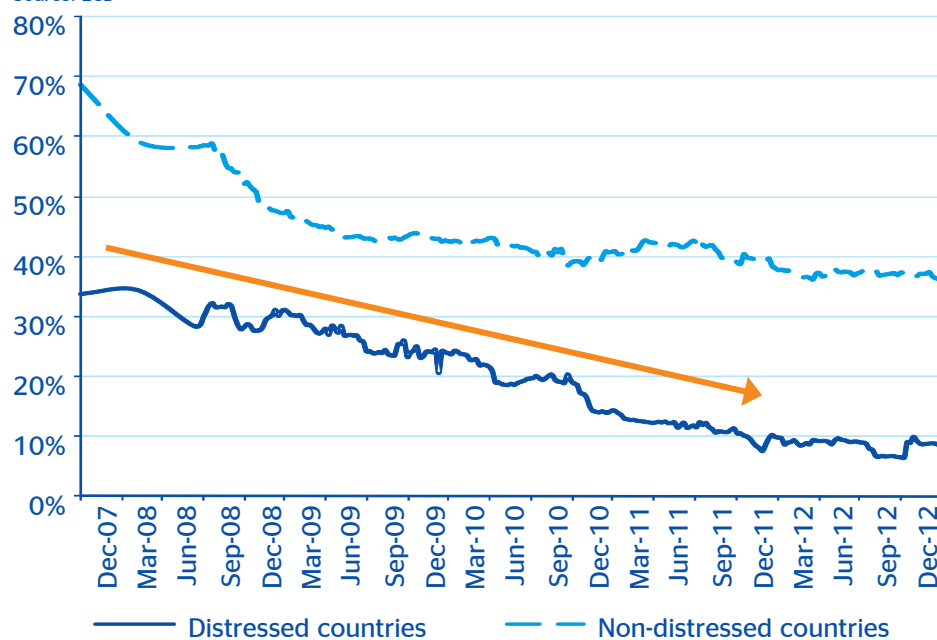
European Banks: Average exposures to banks located in other EU members USD (dollars).

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



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:** hybrids 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 non 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 tests** (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