BBVA | RESEARCH

Europe: Progress in bank resolution and banking union

Shaping the New Framework for Global Financial Regulation

LACEA & LAMES

2013 Annual Meetings

Mexico City, 31 October 2013

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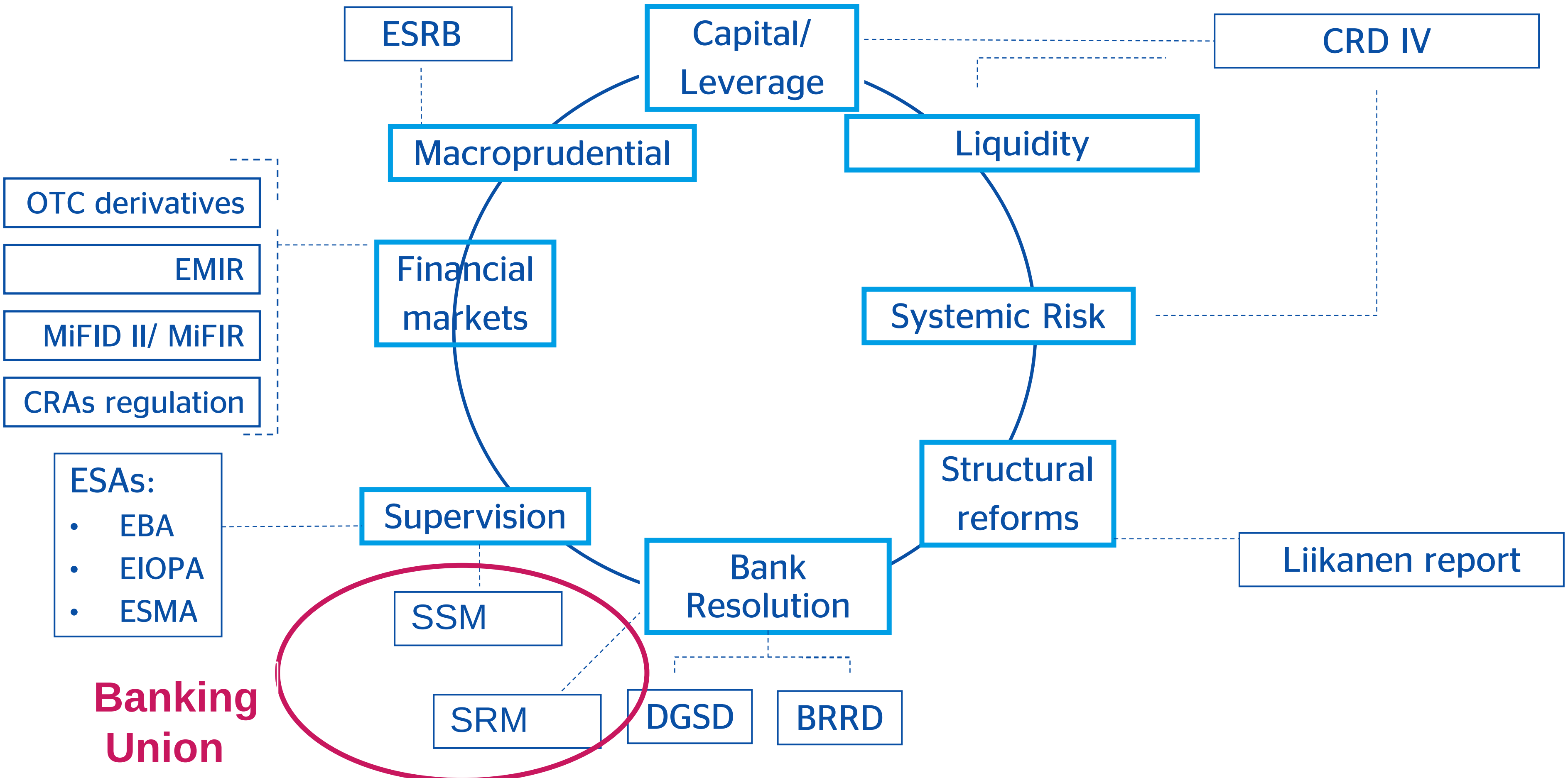
Section 1

Overall European regulatory initiatives



Section 1

CRD IV: Transposition of Basel III

Capital requirements & capital buffers	• **In line with Basel III**: 4,5% CET1 + 2,5% conservation buffer • **Countercyclical buffer**: up to 2,5% (under national authorities responsability)
Systemic risk *("flexibility package")*	Members States have **discretionary powers** in its implementation: • **Systemic risk** buffer (financial sector): 1 – 3% • **SIFI Buffer** (insititutions): G-SIFI (1-3,5%); Other-SIFI (0-2%)
Leverage	**Minimum ratio of 3%** (compliance since 01/2019, a year later than in US)
Liquidity	• Pending **LCR** definition • Reach 100% in 2018 (BIS: 2019). MS could request earlier implementation!
Remunerations	• From 2015 **bonuses** capped to fix salary (1:1) • May be doubled (with shareholders approval)

Implementation date: 01/01/2014

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Section 2

Resolution: main elements

Objetive

- Avoiding that bank resolution has a cost for taxpayers
- Based on FSB Key Attributes
- In Europe fixing bank resolution is not only about Too Big To Fail

Tools

- Sale of business
- Asset separation
- Bridge institution
- Bail-in

Main aspects under discussion (Trialogue)

Bail-in

- Harmonized hierarchy of creditors
- Minimum internal loss-absorption
- No Creditor Worse Off liquidation principle
- Discretionary exclusion of certain liabilities

Competition policies (State aid)

- State aid temporary rules
- Government stabilization tools

Resolution fund

- Resolution fund/deposit guarantee schemes: joint or separate
- Target level of 0.8 % of covered deposits if separated (if joint 1.3%)
- Access to alternative financing arrangements (i.e. ESM)

Resolution: creditor hierarchy and constrained discretion

8% of internal loss absorption

8% of total liabilities to be absorbed by shareholders & creditors before RF can be used

Use of Resolution Fund (RF)

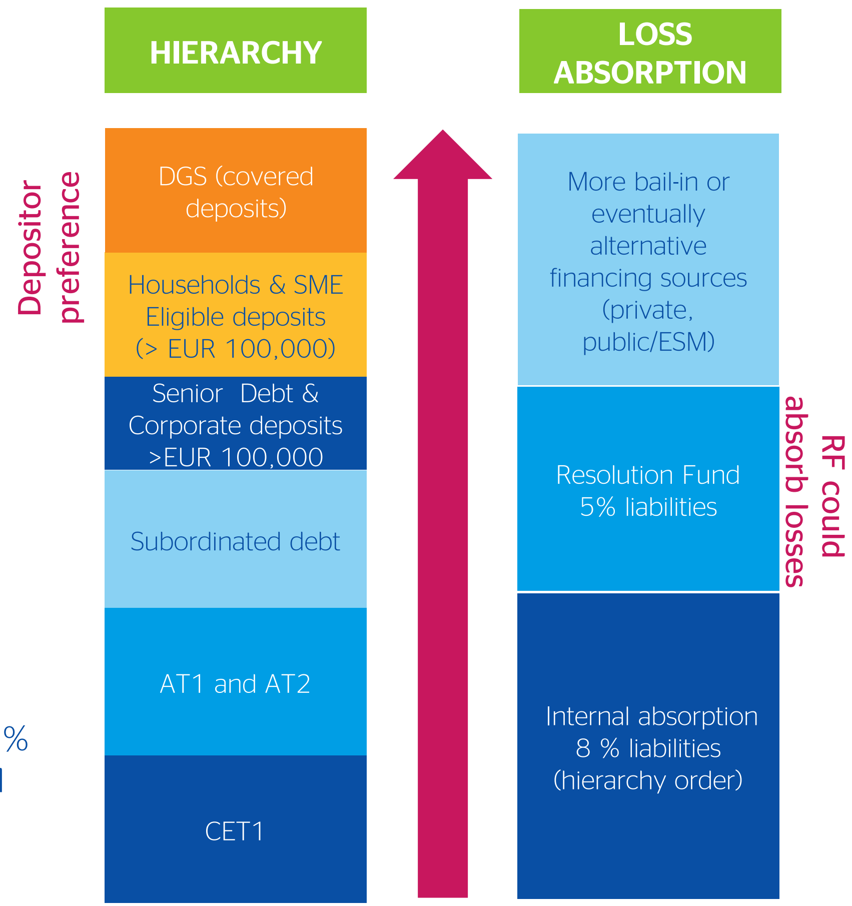
After 8%: RF could be used to absorb losses or recapitalize the bank. This contribution is capped at 5% total liabilities.

Financing of RF

- Ex-ante contributions of banks
- Ex-post contributions of banks
- If the two previous options are insufficient, alternative financing sources (private or public)

Alternative financing sources

Under extraordinary circumstances, only after 5% of RF has been reached and **all unsecured and non-preferred liabilities other than eligible deposits have been bailed in**



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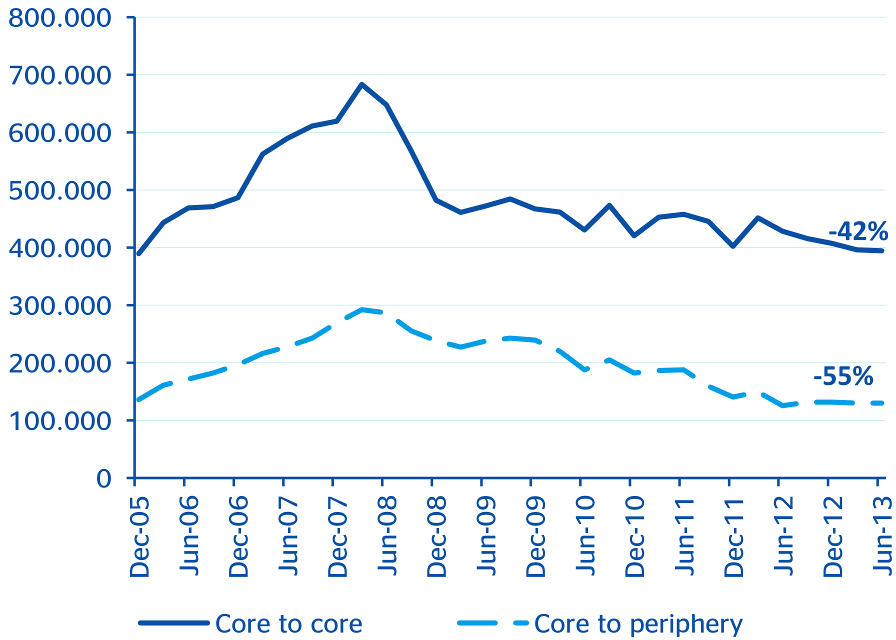
Section 3

Eurozone needs a banking union

To stop fragmentation and separate sovereign and banking risk

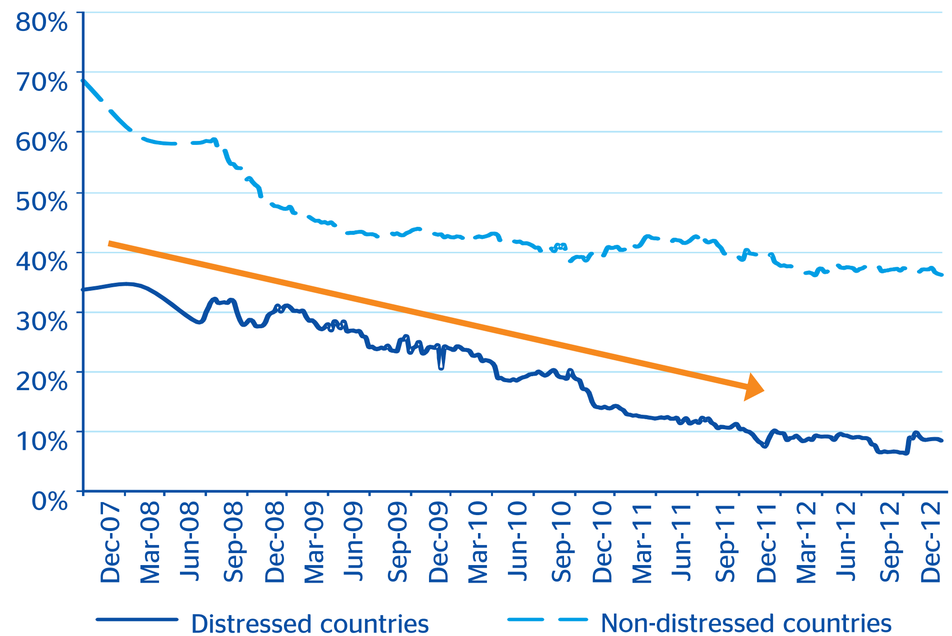
European Banks: Average exposures to banks located in other EU members USD (dollars).

Source: BIS



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

Source: ECB



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

Section 3

The banking union project

Single Rulebook

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

Single Supervision

- **Single Supervisory Mechanism:**
  1. European Central Bank
  2. National supervisory authorities
- First of all, a comprehensive asset review (**AQR**)

Single Resolution

Single Resolution Mechanism:

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

Single Deposit Guarantee Scheme

- **Not in the roadmap yet**
- **Possibly requires a reform of the Treaty**

Under implementation | **Under implementation** | **Under negotiation** | **To be negotiated**

Section 3

Single Supervision

On 12/09 the European Parliament approved the Single Supervision Mechanism legislative package and is expected to be fully operational in November 2014

A **Why?** Restore confidence in the euro currency by stopping financial market fragmentation

B **How?** Two tier system:

- **Mandate:** Eurozone-wide financial stability
- **Authority**: ECB legally responsible for all banks in the eurozone
  - ECB direct supervision (130 significant banks)
  - Indirect supervision through national supervisors (the rest: 6,000 entities)
- **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 **Prerequisite?** Deal with legacy issues → **Asset Quality Review** (during 2014)

Single Supervision: ECB Vs NSAs

ECB

- **Banking license**
- Assess acquisitions and disposals of holdings in banks
- **Ensure compliance with prudential ratios**
- Set higher prudential requirements under Union law
- **Set additional capital buffers (countercyclical buffer or other macroprudential tools)**
- **On-site investigation**
- Ensure robustness of **banks governance** agreements
- Individual supervisory stress tests
- **Early intervention** powers
- Coordinate & defend common position of EU17 before EBA
- **Participate in Supervisory Colleges and Crisis Management Groups**

National Supervisory Authorities

- Receive requests for provision of banking services
- **Supervision of payment systems**
- **Assist ECB and day to day verification linked to supervision**
- **Consumer protection**
- Fight against **money laundering and terrorist financing**
- **Supervise 3rd country branches**

Section 3

Banking union: Final remarks

1. **The EZ needs a fully fledged banking union** (SRM as a counterparty for the SSM)
2. **Dealing with legacy problems is key**: comprehensive assessment including (i) Supervisory Risk Assessment; (ii) Asset Quality Review and (iii) Stress Test.
3. **Backstops**: private, public (national), public with ESM support (but no direct recapitalization before SSM)
4. **Bail in** will contribute to **separate the sovereign and banking risk**
5. **Negotiations on SRM are at stalemate.** Fiscal union by backdoor? Reform of the Treaty? Uncertainty on the German stance
6. **Keep making progress.** Both authorities and the industry have to work on the design of the transition

Thanks!

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