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# Regulatory Reform Developments in Europe

Banking Challenges and Opportunities in an Era of Global Crisis

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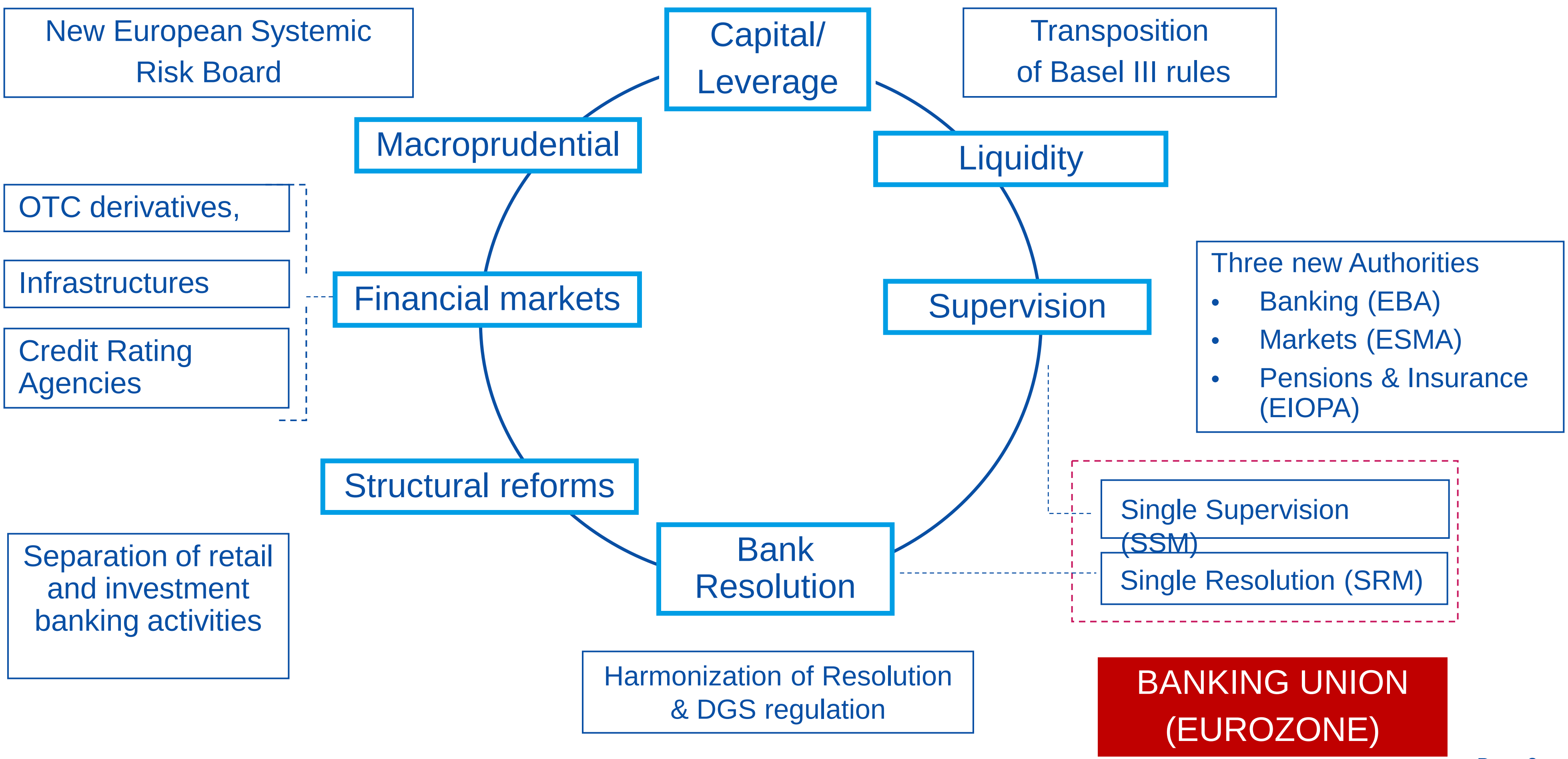
20th November 2013

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 Members 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<br>• Countercyclical buffer: up to 2,5% (national discretion) |
| **Systemic risk** | National discretionary powers:<br>• Systemic risk buffer (financial sector): 1 – 3%<br>• SIFI Buffer (institutions): G-SIFI (1-3,5%); Other-SIFI (0-2%) |
| **Leverage** | • 3% minimum (binding since 01/2018) |
| **Liquidity** | • Pending calibration of LCR<br>• 100% target in 2018 (BIS: 2019). Earlier implementation possible at national level |
| **Remuneration s** | • From 2015 bonuses capped to fixed salary (1:1) (2:1 with shareholders approval) |

Implementation date: 01/01/2014

# Bank resolution: a revolutionary change

| | |
|---|---|
| **Objective** | • Orderly resolution while minimizing cost for taxpayers<br>• Based on FSB Key Attributes (but went much further in tying the hands of the authorities)<br>• European approach: not only about Too Big To Fail |
| **Tools** | • Sale of business<br>• Asset separation<br>• Bridge institution<br>• **Bail-in** (main loss-absorbing tool) |

**Main aspects under discussion by legislators**

| | |
|---|---|
| **Bail-in** | • Harmonized hierarchy of creditors<br>• Minimum internal loss-absorption<br>• Depositor’s protection<br>• Discretionary exclusion of certain liabilities |
| **State aid rules** | • Partial bail-in in since July 2013<br>• Government stabilization tools / Role of European funds under discussion (ESM) |
| **Resolution fund** | • Funded by the industry<br>• Resolution fund/deposit guarantee schemes: joint or separate<br>• Eurozone: Single Resolution Fund under discussion |

# 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**

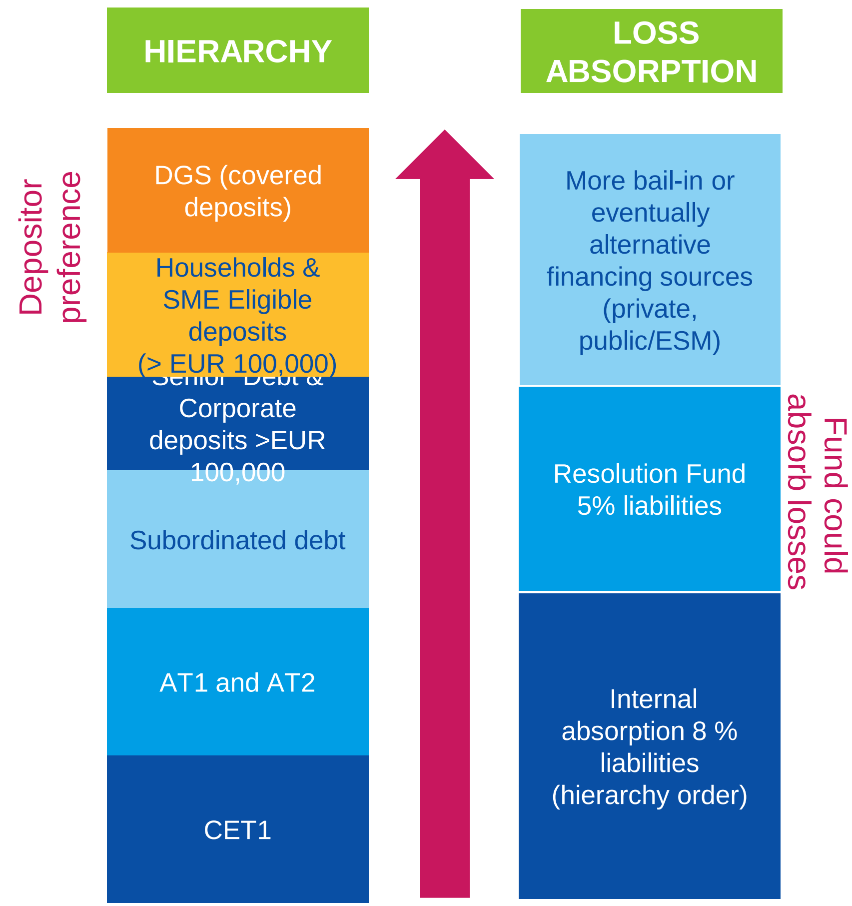
Loss absorption or capital injection up to a limit of 5% of total liabilities

**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**



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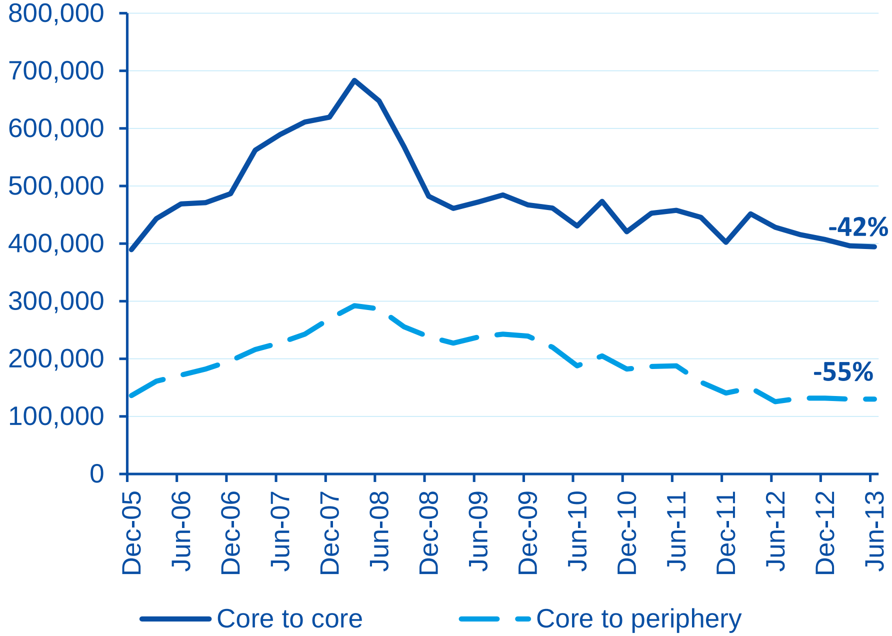
Section 4

# The Eurozone needs a banking union

## To stop fragmentation and separate sovereign and banking risk

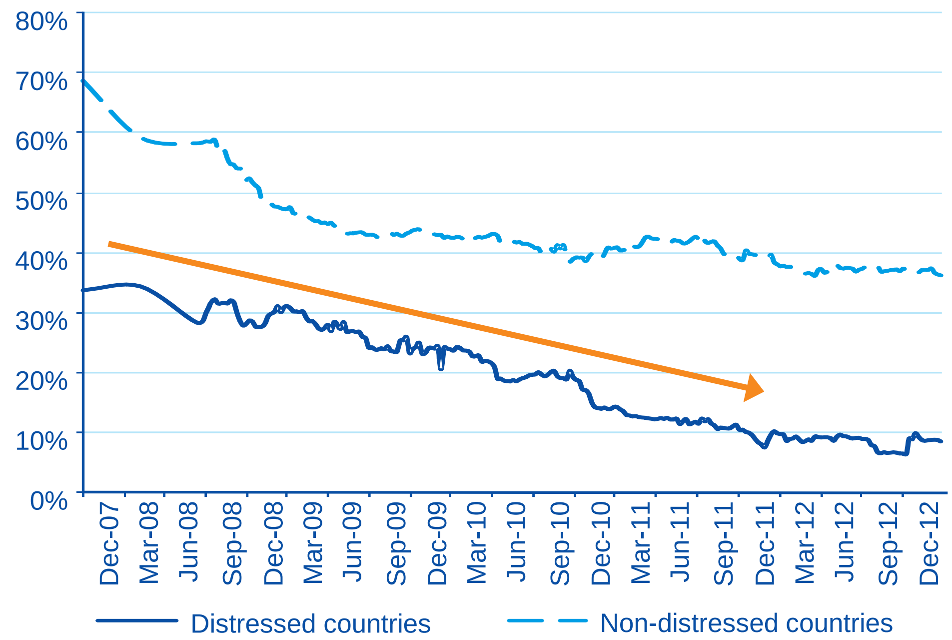
### European Banks: Average exposures to banks located in other EU members USD (dollars).

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)

# The banking union project

## Single Rulebook

- Capital Requirements Directive (CRD IV)

Under implementation

## Single Supervision

- Single Supervisory Mechanism:

1. European Central Bank
2. National supervisory authorities

- Precondition: comprehensive asset review (AQR+ Stress test)

Under implementation

## Single Resolution

Single Resolution Mechanism:

1. Single Resolution Authority
2. Single Resolution Fund

Under negotiation

## Single Deposit Guarantee Scheme

- Not in the mid term roadmap
- Treaty reform required

?

To be negotiated

# 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: hydrids 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?

# 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 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** Prior to full operation: legacy issue → Asset Quality Review +Stress tets (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**