EBA BSG 2017

Banking Stakeholder Group

3 May 2017/9:00-12:00

Location: London

EBA-Unrestricted

Joint Meeting of the EBA's Board of Supervisors and the Banking Stakeholder Group – Draft Minutes

Item 1: Welcome and approval of the agenda

1. EBA and BSG chairpersons welcomed BSG and BoS members. The agenda and the draft minutes were approved.

Item 2: Report on the activities of the BSG

2. BSG chairperson provided details on recent BSG activities, in particular the responses provided to EBA's Consultation Papers such as the supervision of significant branches.

3. He also mentioned contacts with other stakeholder groups from EIOPA and ESMA, especially with a view to making common responses to joint ESAs Consultation Papers. He informed on the setting up of an Ad-Hoc Working Group on regulatory sandboxes with a view to publishing a BSG position paper on this topic.

Item 3: Banks' network of subsidiaries and branches: latest developments in the Single Market and global challenges for EU supervisors

4. EBA staff presented the different choices banks may make in terms of operations between branches, subsidiaries, or cross-border services. It was flagged that the establishment of large systemically important branches required more enhanced cooperation between home and host competent authorities (CAs).

5. In legal terms, EBA staff referred to the CRD and BRRD to explain the framework for the establishment and supervision of branches, focusing on supervision and active cooperation between CAs for significant branches. EBA work on supervision of significant branches was

highlighted, in particular the draft Guidelines on supervision of significant branches (currently under finalisation post-consultation).

6. EBA staff concluded that the current legal framework in CRD and BRRD was relatively clear and that the draft EBA Guidelines on supervision of significant branches introduced proportionate approach to supervisory cooperation. It was noted that the EBA would be monitoring practical implementation of the Guidelines as part of its ongoing supervisory convergence work. However, it was also reported some remaining challenges in relation to reporting and financial stability. With regard to reporting, it was observed that in the CRD there was limited scope of direct reporting from the branch. Regarding financial stability concerns and application of macro-prudential measures, EBA staff saw some merit of developing further coordination. It was also indicated that the CRD and draft EBA Guidelines covered scarcely supervision of third countries branches.

7. One BoS member presented the network of branches in Finland, flagging that market share of all branches was approaching nearly half of the entire banking sector. In light of the number of subsidiaries and branches with a potential impact on the local economy and its financial stability, the limited tools to mitigate the risks carried by these branches that host authorities have were considered as a source of concern.

8. The BoS member also mentioned the signature of a Nordic Memorandum of Understanding (MoU) on prudential supervision of significant branches signed in December 2016 between Nordic countries (Finland, Sweden and Norway) and the ECB as a tool of supervisory cooperation between home and host authorities in this area.

9. In terms of regulation, it was flagged how important the EBA's efforts in the field of supervisory convergence was to promote cooperation in supervisory colleges. The EBA draft Guidelines on supervision of significant branches was also welcomed as a good example of this convergence work.

10. The BoS member provided some views on the lack of supervisory powers for the host supervisors of systemically important branches, in particular due to the latest developments in the banking sector. Possible amendments were highlighted including additional supervisory powers of branch host supervisors regarding group-level decision-making and branch governance and risk management, asset quality and issues related to liquidity risk, joint supervision of the bank by the home and the host supervisors.

11. One BSG member presented views from the industry's perspective. The EBA draft Guidelines on supervision of significant branches was considered as a useful tool although further clarification was required with regard to transformation of subsidiaries in branches and home/host authorities cooperation. Another topic concerning resolution issues and diverging views between home and host authorities was mentioned. Diverging interests between resolution and supervisory authorities were reported as a major concern from the industry's side, which might

be aggravated due to the forthcoming SRB resolution strategy decision and the review of the CRR package.

12. BoS and BSG members had mixed views on the possible changes to the current legislative framework for supervision of branches, but the need for further cooperation was considered essential. Some members explained the current trends in the banking system, highlighting that there was a trend towards "branchification" in the EU and "subsidiarisation" in third countries. Some other issues were raised regarding the advantages of branch-based business models, the issue of third countries' cooperation, or the increasing alignment between business model and resolution strategy.

13. EBA chairperson raised several issues from an EU regulator's perspective. With a view to reinforcing the Single Market, he flagged the importance to consolidate an EU-wide framework supportive of the Single Market and facilitate good cooperation between home and host supervisors. Amongst the challenges the EBA should further assess the trends towards branches in the EU and the impact of macro-prudential measures on the decision of banks to establish subsidiaries or branches.

14. EBA staff noted that from the EBA's perspective, there was no point in changing the current legal framework in CRD. Regarding the resolution aspects raised by some members, EBA staff considered that it was more an issue for non-euro-area than euro area countries.

Item 4: Disruption in the banking industry / challenges for banks and regulators

15. One BSG member explained the characteristics of the ongoing transition in the financial industry. On the one hand, he viewed the digital customer interface as a major change and considered it to be of high benefit for customers compared to traditional banking due to its variety of functionalities, its instant access and its very low costs. On the other hand, digital innovation (FinTech) was perceived as a new challenge for traditional banks as it affects the whole value chain of retail financial services, like payments, lending, asset management and insurance.

16. He also presented the performances of banks under the current regulation framework, insisting on the difficulties encountered by banks due to the increased regulatory capital requirements. According to the presenter, banks were facing unfair competition by FinTech companies because of an unlevel playing field related to regulatory capital and buffer requirements imposed to them that would erode their position in this emerging digital world. He also mentioned challenges for institutions in terms of business models and profitability. He continued referring to regulatory challenges and underlined in this respect that the current regulation focused on entities and that it would be desirable to move towards a function-related regulation. He continued referring to a desirable phasing out of capital requirements relating to the earning capacity of banks, a due management of the consolidation process in the banking industry in

order to prevent financial losses and to the establishment of a financial industry serving all corners of the economy.

17. One BoS member agreed that the financial challenges for banks were significant and that institutions should invest a lot in terms of technological innovation in order to be more efficient and satisfy consumers. However, he did not agree that the lack of profitability experienced by banks was mostly driven by an excess of regulation but he viewed that low profitability was rather due to high stock of Non-Performing Loans (NPLs) and overall banks' cost structures. From a regulatory perspective, he deemed that regulators should take a functional approach. He also considered that the role of regulators should be to facilitate the digitalisation movement and stay open to new banking business models and neutral with regard to consolidation processes in the banking system.

18. EBA staff acknowledged the fact of the pressure put on banks due to the rapidly emerging digital world and new entrants to the market but underlined that whether it materialised there would be less banks in the future. It would depend on the ability of institutions to reinvent themselves. In EBA staff view, it could rather lead to a win-win situation and that it is currently observed through increasing partnerships between traditional banks and digital players. In terms of cooperation with the new players in the digital environment, it was indicated that banks might take advantage of their long relation with clients and their experience in regulation. However, cooperation was described as complex because of the mistrust between incumbents and new entrants. EBA's work was also mentioned to inform of how the EBA took consumer protection's issues and level playing field between institutions on board through the comparability documents for fees. From the regulatory perspective, EBA staff also viewed that a functional approach might be of benefit, considering that future regulation should not be applied on an entity basis but more focused on services provided by institutions. It was noted that the EBA was currently mapping existing FinTech services and the regulatory status of the entities providing these, with a view of delimiting the regulatory perimeter of FinTech and detecting any potential regulatory arbitrage issues arising from divergent national regulatory approaches. Finally, EBA staff concurred with the BSG representative on that supervisory and resolution authorities should play an active role in the integration and consolidation process.

19. BoS and BSG members agreed that digitalisation challenged banks in all their activities. In the current environment, it was indicated that banks were losing their competitive advantages in certain services, in particular in payment services.

20. In terms of regulation, members had mixed views. Some members considered that FinTech companies could not be regulated in the same way as traditional banks, although some other called for an appropriate and similar regulation. In addition, some members also viewed that regulation should be subject to a functional approach. To this end, regulators should distinguish the functions that would have to be regulated, in particular in the area of governance.

Item 5: Changes in interest rates and micro-prudential responses

21. One BoS member introduced in his presentation the latest developments of interest rates in the recent years and the challenges triggered for institutions to manage their businesses under these conditions. Supervisory actions taken by the ECB/SSM in such a changing interest rate environment were highlighted, in particular the sensitivity analysis on Interest Rate Risks in the Banking Book (IRRBB). The BoS member explained the methodology applied in assessing the risks of changing interest rates as well as the analysis with regard to multiple interest rate shocks (flattener, steeper, parallel shifts up and down). Follow-up actions were also indicated, noting that the results of the interest rate shocks were taken into account in the Supervisory Review and Evaluation Process (SREP). In the 2017, SREP stress tests would be focused on IRRBB – besides other aspects – and would shed lights on banks' IRRBB position, banks' modelling assumptions and derivatives positions.

22. One BSG member emphasised that the effects of significant changes in interest rates may have very destabilising effects on intermediaries, firms and consumers depending on the countries. He discussed possible shocks that the EU may experience. A shock arising from a rapid recovery was seen as unlikely in Europe. He questioned the assumption of a risk premium shock and viewed that this type of shock is rather political. However, in the context of negative feelings towards the single currency and the EU in general, this kind of shock was regarded more likely to happen, even though it was more country-specific. He identified the impacts of the US fiscal policy package on the EU, through a recovery by boosting demand from imports, or more pressure on interest rates. With regard to the ECB/SSM assessment of IRRBB, he considered that the assumptions used by the ECB/SSM of a sharp change in interest rate for the banks' books whilst considering that all else would be held constant was not forward-looking enough, as the scope of what was viewed as constant may have itself direct effects on banks' books. He concluded that the stress test exercise should also cover insurance companies which might be hit badly.

23. EBA staff presented two scenarios of increasing interest rates, namely an increase of monetary policy rates and an abrupt reversal of global risk premia. According to the EBA's Risk Dashboard as of Q4 2016 there is a broad dispersion of the share of interest income in total operating income, so that banks are accordingly differently affected by rising interest rates. Under these circumstances, EBA staff noted that banks assumed a positive impact on their net interest income from rising interest rates according to their disclosures on interest rate sensitivity (financial statements or P3 disclosure). Data shows that rising net interest margins (NIM) might have the potential to improve banks' profitability. According to funding plan data, most of the banks plan an extension of their funding volumes, driven by market based funding and client deposits. It was also indicated that funding plan data showed a mixed picture, with varying client spreads depending on the countries. Banks also expect declining interest rates for long term debt securities according to this data.

24. One BSG member questioned the methodology of the IRRBB assessment presented. He viewed that not all risks were taken into account. Indeed, effects on the asset side would deserve to be

further elaborated as a change in the interest rate may also affect this component. He added that in case of rising interest rates the assets included in “carry trade” deals might be affected too. The perimeter of the exercise was seen as not fully consistent due to the non-inclusion of derivatives in the banking book. Another BSG member asked about the relation between low interest rates and flat yield curve. He also flagged that the derivatives were a source of risks in terms of changing interest rates as they amounted for 10 times the GDP of the EU.