EUROPEAN BANKING AUTHORITY

Introductory Remarks of the Chairperson
of the European Banking Authority (EBA)
at the EBA's 10th Anniversary Conference

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Welcome and Introductory Remarks

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Check Against Delivery
Seul le texte prononcé fait foi
Es gilt das gesprochene Wort

Dear ladies and gentlemen,

I am very honoured to celebrate with you today this EBA anniversary as Chair of the European Banking Authority.

The creation of the EBA was part of the EU answer to the great financial crisis. For those among us old enough to have lived through it, the events unfolding during the great financial crisis etched in our memories.

Early in the crisis, The High-Level Group on Financial Supervision in the EU put forward a bold answer for the EU. An answer that has been common to most of the crises that the EU has confronted over the last decades. "More Europe, not less" is needed. In this case, to foster supervisory and regulatory repair of the EU financial sector.

The "de Larosière report" recommended to establish an integrated European System of Financial Supervision. This is the moment where the idea of the European Banking Authority was born. And while we have grown in size and tasks, the EBA's mission remains to serve EU citizens to ensure an efficient, transparent and stable EU single banking market.

What happened since?

The list of challenges was long when the European Banking Authority took up its mission in 2011.

By then, the global crisis had eroded the trust on the solvency and liquidity of counterparties. The panic made banks stop lending and the economy tumbled into a deep recession. Subsequent bailouts of banks with taxpayers' money prevented the crisis from further unfolding. However, a negative loop between banking and sovereign solvency concerns was threatening the stability of an increasing number of EU members. Citizens' trust in politics and supervisors also faded away as they were confronted with rising unemployment and social hardship.

First and foremost, the EBA had to restore trust. Trust in the status of the banking sector, but also on individual banks, trust among the banks to operate with each other, between banks and financial markets and trust among supervisors, with the goal to restore the functioning of financial markets within the Single Market.

To rebuild that trust the EBA relied on two pillars: stronger rules and enhanced transparency.

In line with the "more Europe, not less" guiding principle, maximum regulatory harmonisation with enhanced quality of supervision became the new objective. The EBA embarked on this venture by consolidating the Single Rulebook. Since 2011, we have consolidated this consistent set of rules on prudential and resolution aspects with more than 230 technical standards. We provided additional guidance with more than 120 Guidelines and answers to over 2000 Q&As on its supervisory implementation. All this has helped the supervisory community to develop common practices leading to more coordination and ultimately convergence.

To enhance transparency, the EBA stress tests and transparency exercises became crucial elements to ensure better monitoring of risk build-up and increased market discipline.

A lot has been accomplished in the 6 stress tests exercises that the EBA has performed in these ten years. Predictability, transparency and accountability on the way the stress tests are performed have all helped to also enhance the credibility and use of the outcome of these exercises.

Beyond stress tests, the work to enhance information disclosure through the provision of reliable, comparable bank level information has made the banking sector more transparent. Our regular releases of bank data and information are valued as essential to improve overall market transparency and we should continue on this provision to all stakeholders of the data that we collect from banks and other financial firms. The work on NPLs with the introduction of a harmonised definition of NPLs across European countries and the subsequent EBA work have also driven the reduction in the stock of NPLs.

Where do we stand a decade later of financial reforms?

The EBA was only a part of the regulatory enhancement arising from the crisis. In these ten years, the international and European community have set standards, which made the financial system less leveraged, more liquid and better supervised. Progress is even more nuanced in the banking sector. Not only capital and liquidity positions of banks are much more resilient but also corporate governance as a buffer against excessive risk taking has been strengthened. Supervision has also been enhanced, it is more intrusive, more risk based and more forward-looking.

In Europe, the developments of the banking union have harmonised the level playing field for large institutions in terms of supervision and resolution. The creation of the banking union, with the Single Supervision at the ECB has provided stronger supervision and harmonized supervision for large significant institutions.

The establishment of the Single Resolution Board has been a strong continuation on this agenda. We have built a recovery and resolution regime that has helped shield the public sector from bank failures. Banks pay for their own safety net as enshrined in the Deposit Guarantee Scheme and Single Resolution Funds.

The further integration steps in the euro area with the banking union made it even more important to ensure coordination and cooperation between banking union and non-banking union members to preserve the single market and the level playing field. The EBA is the forum for this exchange on supervisory and resolution practices across the Single Market and all 27 member states.

During this decade the EBA mandate has also been enlarged to include a prudential regime for investment firms, oversight in payments, consumer protection and to coordinate the EU framework for AML in financial institutions.

Is COVID-19 putting the system to a new test?

The last 18 months have been very disruptive. Like health, financial stability is a global public good, which we need to preserve.

Regulatory and supervisory repair throughout the last decade has boosted the resilience of the EU banking sector. And this enhanced resilience was a true asset when the COVID-19 health challenge hit the financial system.

The EBA joined the coordinated relief efforts to prevent a shock with long-standing consequences to the economy. We provided guidance to banks and supervisors in how to apply the regulatory framework, developed new guidelines on the application of moratoria, and balanced our operational and supervisory relief measures against the important priority of upholding the transparency of banks' balance sheets by continued monitoring of key metrics.

Fortunately, and to a large degree thanks to the exceptional monetary and fiscal policy measures, the COVID crisis has not been so far severe in the banking sector.

The EBA stress test exercise last June also confirmed the enhanced resilience of EU banks. Despite the harshest macroeconomic stressed scenario ever. The CET1 ratio of the EU banks in the exercise remained above 10%.

However, as a major lesson learnt from the starting phase of the EBA, we must not get complacent against the backdrop of this overall picture of resilience. The stress results show dispersion, with banks more focused on domestic activities or with lower net interest income having a higher capital depletion.
In this sense I think we should be cautious in seeing the last 2 years as a full test of our regulatory framework. We should also be careful in drawing conclusions on what part of the regulatory

framework has worked or not. Capital and liquidity has remained ample, banks have not used most of their buffers, and there has been limited need to use our recovery and resolution framework.

In addition, the structural challenges affecting the banking industry have not gone away. On the contrary they have become more salient.

On a macro level, the financial system has become even more interconnected as we are exiting the COVID-19 pandemic. The government support measures have created new connections between corporates and governments. That may raise further concerns on the stability of the financial system.

The banking industry today is solvent and has stable capital ratios but structural challenges remain. Pre-crisis challenges are still part of the EU banking sector and credit risk will be a key concern going forward in the persistent environment of uncertainty.

Defaults and insolvencies of non-viable businesses may bring a growing number of NPLs, which will in turn weaken the banks' balance sheets and drag on banks' profitability. Future outlook on banks' asset quality is another reminder to finally overcome the lack of political agreement and to finalise the banking union.

Banks' profitability is widely dispersed, often driven by local and business model aspects, but questions exist on the ability in large parts of our banking system to achieve adequate, sustainable profitability.

Poor profitability of EU banks is also reflected in low market valuations. And this is not a recent trend. Since the creation of the euro in December 1998, the MSCI Europe Banks Index shows a negative net return performance of - 0.36%. Despite the most recent rally in equity markets, listed European banks keep on trading below their book values and at half the price-to-book-value multiple of their American peers (0.6x for European banks vs 1.4x for US banks).

The main drivers of improved profitability in the short term such as substantially increasing fee income and net trading income, and reduced impairments, appear not to be sustainable in the longer term. Going forward, major additional improvements for EU banks in their profitability are essential and involved broader thinking in the sustainability of their business model, the existing market structure and the need for substantial restructuring.

However, in the last decade the world around us has also significantly changed. As a result, the banking sector is confronted with new opportunities and risks. The mission of the EBA has evolved and adjusted to a certain extent, and will have to continue adjusting, to address the challenges of the world around us.

Where do we go from here?

Let's start with finishing what we know needs to be finished.

One of the immediate tasks ahead is to finalise the **Basel III implementation**. The completion of the Basel agenda – including the output floor - is an essential part. We must preserve the global compromise and uphold trust in the European side by implementing the remaining reforms timely, consistently and in a faithful manner.

In the same manner, the continuous commitment to work and collaborate in global regulatory standards and international fora to ensure open and stable global financial markets should remain one of the core drivers of our activities.

Second, faster **progress on the banking union**.

As regulators we know that our work to foster an integrated single market in banking services is at best incomplete. The evidence is in front of us. Banking union has helped in reducing costs of funding differentials for banks across the EU, partially attenuating the link between banks and their sovereigns. However, cross-border banking activity in the EU which had significantly reduced during the global financial crisis never recovered. The share of EU/EEA banks exposures (loans and advances and debt securities) towards counterparties in other EU/EEA countries has remained stable (and around 24%) since 2004.

We know that significant difficulties remain in the provision of cross-border banking services within the union. We know what many of the challenges are and where the difficulties exist. We know the value of completing the banking union, of harmonizing insolvency regimes, and other areas for reform, and we should continue to signal to the co-legislators that urgent progress is needed.

We also need to continue to push for an adequate integration of banks. To ask them for change and restructuring as needed to enhance their business models, their risk management, their sustainability and their competitiveness.

But we also need to reflect and act on what we can do as regulators and supervisors to help solve the problem. To enhance supervisory convergence, to continue to enhance our trust and cooperation, to alleviate many of the home/host issues, and facilitate the further development of the single market and private risk sharing.

This is urgent and if we not do it, we risk to fail in delivering on our ultimate objective: a safe single market of banking services to serve EU citizens and corporates and enhance risk diversification across the Union.

Let me quickly focus on other parts of the regulatory framework that needs to be developed further, which would not surprise you.

Before, I mentioned the poor return on equity of the EU Banking sector over the last two decades. In contrast, the five big tech giants account for combined market value of over five trillion U.S. dollars. New technology firms and big tech firms are scaling up their business lines in financial services. Big techs worldwide are key operational suppliers to the industry. They have already gained a substantive footprint in payment services and started to enter lending and wealth management services.

This **technological disruption** and transformation of business models brings about new policy challenges. Some are already known to us, such as mitigation of cyber risks or oversight of operational resilience, as well as consumer and crime protection. Other risks are new and relate to the provision of old and new financial services, market concentration, data governance and privacy. Banks will need to invest in digitalisation to keep up with these challenges.

The second is **sustainability.** The transformation of economic activity that is expected will not take place without financial stability and a well functioning banking system. The banking sector and we as regulators have a key role to play here. First, to ensure financial stability, the transition to a sustainable economy will take much longer if we confront another period of financial instability, or banking crisis. Adequate measurement and management of risks arising from climate and sustainability related risks should be the driving force behind all of our efforts in this front. We also need to ensure that the industry is ready to channel financing and provide advice to their clients in this transition. Banks can also act as a catalyst for the transition by requiring its customers to enhance the quality of the information and risk management of their activities in this front.

As regulators, we will need to invest in knowledge, talent, and upgrade our internal and external processes to address these challenges. At the EBA we are actively engaging in many of these issues and collaborating and helping other competent authorities to build resources and expertise.

Let me finish with two final thoughts on the implications that these two trends, technology and sustainability, will have for our regulatory environment.

The opportunities offered by technology imply that the value chain of financial services is being redesigned, from payments, to funding, to crypto investments and liquidity holdings. We need to reconcile that product offerings are more and more offered in a cross-sectoral (and global) basis.

This environment suggests to me **that competitive dynamics should be much bigger going forward**. New competitors that proof successful and good incumbent banks should excel, and less successful banks orderly exit. Consolidation could play a role in this process. Through mergers and acquisitions (M&As), banks might be able to eliminate redundancies in operating expenses, enhanced their management and competitive position. Consolidation might also take place through restructuring or liquidation of incumbent banks unable to modernise their operating structure. We should not be afraid of those changes. On the contrary, we should be prepared to accept them and even encourage them to the extent that they foster efficiency, financial stability, and better customer services in the future.

The second is that these trends are not specific to banks, not even to the financial industry, but affect all economic sectors. The future will likely bring the provision of financial services in new ways, across existing sectoral barriers and with new interconnections. This will require that we enhance our ability to assess the risks, both institution specific and systemic, from a broader perspective than the sectoral implications. It will also require important institutional upgrades in our framework, like we are seeing in AML or non financial reporting for sustainability related issues.

Over the medium-term, cross-sectoral regulation will increase. The institutional architecture will become more complex, and partly rightly so, because the interactions in economic activity will also become more complex. But we will need to make sure that this increased complexity does not impede our ability to react quickly and effectively.

For existing sectoral regulatory bodies such as the EBA, this will also require further and much deeper coordination with other institutions. Within the context of the financial sector, we are already seeing the need for further coordination among the three ESAs in the context of the Joint Committee. As I look at the near future, we will need to strengthen this coordination much more to address some of these challenges. But I feel this is just a small part, further coordination with other financial authorities, national competent authorities, and non-financial regulators in the areas of cyber risk, crime prevention, data protection and competition will arise. We need to reflect on the way we operate, our governance and our existing mechanisms for collaboration to ensure proper and effective regulation.

Ultimately however, no matter how the banking sector may look like, we remain at the service of EU citizens. The EBA will continue to ensure transparent, unified and safe regulation and supervision in the provision of banking services to the benefit of consumers and the EU economy.

Conclusion

A decade ago, the banking sector and the supervisory landscape looked differently: less European and less coordinated. Since then, mutual trust as basis for the Single Market in banking has flourished.

The EBA has been a key player in that progress achieved. I would like to thank all current and past EBA staff for making this organisation a truly unique place to work. The commitment of EBA staff and staff from competent authorities was essential to our common success.

As we look forward, the job needs to continue. The trends transforming our society and the financial industry pose new challenges to ensure that proper financial regulation and supervision allows the EU to reap the benefits that the future holds. That is an exciting future to work for.

Thank you very much for your attention, for joining us in this celebration, and I am looking forward to the discussions in the next panels.