Introductory statement of the Chairperson of the European Banking Authority (EBA), Committee on Economic and Monetary Affairs (ECON) of the European Parliament

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Written Statement

José Manuel Campa, Chairperson European Banking Authority (EBA)

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Honourable Chairwoman, honourable Members of the European Parliament,

I am grateful for the opportunity to exchange with you on the EBA's achievements over the last year.

2021 is an important milestone for the EBA as it marks the ten years' anniversary of our organisation. 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. Likewise, the EBA as an organisation has evolved. Starting from a small committee of supervisors, we have become a guarantor and facilitator of effective banking regulation, supervision, risk analysis and consumer protection. I am proud to chair an organisation which has become more diverse, transparent and accountable and I am looking forward to celebrating together with you during our official 10-year anniversary conference on 26 October.

COVID-19: the need for close cooperation and coordinated relief

The past twelve months have remained challenging as we all tried to cope with the public health crisis which brought extraordinary human suffering and economic fallout. Fortunately, as we exchange today, the immediate health challenge seems to be improving with vaccinations accelerating and the phasing out of containment measures.

As EBA, we have joined the coordinated relief efforts to prevent a shock with long-standing consequences to the economy. Our guidelines on legislative and non-legislative moratoria on loan repayments[1] helped to preserve liquidity for debtors as they provided for flexibility in the default classification. In view of the dynamic rollout of the pandemic and its successive waves, the EBA provided for the re-activation of those guidelines with a new deadline for end of March 2021. Likewise, the EBA reiterated its call on banks to apply a conservative approach on dividends and variable remuneration of material risk takers so as to preserve lending support to the economy and its citizens.[2]

At the same time, we continued to balance our operational and supervisory relief measures against the important priority of upholding the transparency of banks' balance sheets by continued monitoring of key metrics. We established a reporting requirement on the prevalence of moratoria and public guarantee schemes (PGS) in banks' balance sheets. From our reporting data we saw that the loans under moratoria reached their peak in September 2020 with EUR 935 billion. As of June 2021, loans benefitting from EBA-compliant moratoria declined to EUR 123 billion and loans amounting to more than EUR 700 billion had their moratoria expired. Loans subject to PGS remained concentrated in a few countries and peaked in March 2021 with EUR 378 billion. Overall, loans under support measures show a deteriorated credit outlook and the share of stage 2 loans benefitting from moratoria is particularly high (25% vs 9% for total loans). In addition, the non-performing loan (NPL) ratios for moratoria loans stand well above the average (around 4.7% vs 2.3%). A similar deterioration is observable in PGS loans. Around 18% of them are classified under Stage 2, and their NPL ratio, albeit below the average (2%), has been increasing continuously.

We also provided additional analysis on the pathways to normality of the prudential system.[3] In that effort, we continued to scrutinise the threshold for distressed restructuring[4] carefully throughout this period and provided for benchmarking of expected credit losses and the potential increase in credit risk.[5] We also frontloaded regulatory work such as the RTS on prudential treatment of software assets

EBA stress test exercise: robustness of the banking system

The EBA stress test exercise in 2021 provided most valuable input to assess the resilience of the EU banking sector during the COVID-19 pandemic.[6] The stress test covered an expanded sample of 50 banks from 15 EU and EEA countries with a total of 70% EU banking assets under a very adverse scenario of a prolonged COVID-19 health crisis and the continuation of the low for long interest rate environment. Under this scenario, we modelled a drop in EU GDP by 3,6% over three years with an unemployment peak in 2023 at 12,1%. This year's exercise also had a specific focus on loans under moratoria and PGS. Despite this harshest scenario ever, the stress test results portray a slightly optimistic picture on the macro level. Adverse capital drawdowns were high at an average of -485 basis points but the resulting CET1 remained resilient at 10,2% with a capital depletion of EUR 265 billion against a starting CET1 ratio of 15%. Credit risk was the main driver for this depletion.

The results of this exercise underline that – also thanks to prior regulatory efforts – EU banks have continued to build up their capital base. However, we should not get complacent against the backdrop of this overall picture of resilience. First, the results show dispersion with banks more focused on domestic activities or with lower net interest income having a higher depletion. Second, the baseline scenario of the EBA stress test accounts for a gradual exit from the pandemic and thus does not consider any cliff effects or more complex return to normality. As we have observed during the pandemic, not every crisis can be modelled on past information. In reality, banks, corporates and sovereigns are still operating in uncertainty in the aftermath of the COVID-19 crisis and unprecedented public support is still part of our system. There is also high variation across member countries and sectors as we exit from the crisis.

Structural weaknesses in the banking sector persist

Pre-crisis structural 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. The EBA is currently supporting the European Parliament's efforts in preparing the framework for an increasing number of NPLs as result of the COVID-19 crisis. The EBA is reviewing its NPL transaction data templates, which will increase granularity, quality and comparability of NPL data and facilitate the exchange of information between banks and investors when selling NPLs on secondary markets.[7] The EBA is also looking at regulatory impediments for banks purchasing NPLs[8] and continues to scrutinise the preparedness of supervisors for dealing with NPL increases in a dedicated peer review.[9] With the phasing out of pandemic support measures, banks will not only face potentially increasing NPLs but also the return to market-based funding. In that regard, the EBA's ongoing work on risk retention in synthetic securitisations will provide further potential to ease banks' balance sheets.[10]

The return to normality will take place in the absence of a banking union due to lack of political agreement. As a result, the banking market remains fragmented along national lines. Besides commercial considerations, regulatory obstacles continue to be an important factor impeding the emergence of a true single market for financial services in the European Union. The EBA showed in its insolvency benchmarking report[11] that insolvency frameworks also display significant variability across member states regarding their effectiveness in terms of recovery rates and times to recovery. Some of the EBA recommendations for best practices would underpin the quick recovery in the aftermath of the pandemic and flank the negotiations on the finalisation of the banking union.

The European deposit insurance scheme (EDIS) remains far from completion, too. Nonetheless, the EBA continued to support the EU Commission in its review of the EU Deposit Guarantee Schemes Directive (DGSD). The three EBA Opinions will help improve the protection of EU citizens' deposits and enhance the level playing field across the EU. Many of these proposed improvements would be beneficial, not only for the DGSD but also for EDIS.

Sustainability at the heart of the recovery

The European Union has put sustainability at the heart of its recovery. From a supervisory perspective, we must ensure that banks correctly identify, measure and incorporate the ESG-related risks. In the pilot exercise on climate risk[12], the EBA mapped climate risks on a sample of 29 volunteer banks from 10 jurisdictions and heterogeneous business models. The pilot exercise explored, for the first time, banks' capacity to classify their corporate exposures with reference to the EU Taxonomy and to estimate their green asset ratio. Bottom-up estimates by banks were accompanied by the use of a top-down tool, according to which, and considering all the constraints of the exercise, the EU aggregated green asset ratio for corporates stands at 7.9%.

With the EU being committed to a net zero pathway, the EBA is also dedicated to preventing a disorderly transition. Therefore, the EBA has set as a priority to integrate ESG risks in banks' risk management and governance arrangements.[13] ESG risks will also be incorporated into the revised SREP guidelines which are currently out for consultation[14] and the EBA will further contribute to foster market discipline by strengthening the disclosure requirements for large banks.[15] The EBA's green asset ratio will help to monitor and assess over time banks' efforts in financing sustainable activities over total exposure, and public Pillar 3 disclosures on exposures towards carbon intensive counterparties and towards assets exposed to physical risk will further foster market discipline.

Continued efforts to complete the Single Rulebook

The work coming from the COVID-19 health emergency has not distracted our efforts in enhancing and completing the Single Rulebook. The EBA has substantially helped to build up the new regulatory framework for investment firms by creating appropriate and suitable requirements taking into account their size, the services they provide, the activities they perform and the risks they are either exposed to themselves or that they pose to others. In total, the EBA developed a package of seven regulatory technical standards relating among others to the classification and authorisation of investment firms. The EBA also developed the methodology for measuring other, quantitative indicators for calculating the own funds requirements, the so-called K-factors.[16] In our further work, we specified the methods and conditions for consolidation of investment firm groups[17] and we gave guidance on the calculation of thresholds which will be required to apply for a credit institution authorisation.[18]

The EBA completed the submission of the risk reduction package's regulatory mandates in the area of resolution. At the same time, we are expanding our guidance on the resolvability of institutions[19] while monitoring and promoting convergence on recovery and resolution planning[20] or early intervention measures.[21] The EBA is also involved in the European Commission's work on the Crisis Management and Deposit insurance framework, as it is currently finalising its response to a specific Call for Advice from the EU Commission.

The EBA also kept adjusting the Single Rulebook to new developments and emerging risks. One example is the ongoing consultation on the revised supervisory review and evaluation process (SREP) guidelines[22] which takes into account AML/CFT risks[23], regulatory developments in the area of interest rate in the banking book (IRRBB) and liquidity risk as well as operational risk on ICT. And it is still putting great effort in promoting European traction on supervisors' action, with the annual identification of key priorities for the supervisory cycle.[24]

In addition, the EBA has remained engaged to provide recommendations to co-legislators. For example, the EBA provided further insights on regulatory concerns of ESG bonds in the context of the eligibility criteria for own funds and liabilities instruments[25]; and the EBA has issued recommendations by taking stock of the increased activities of third-country branches[26] in the context of regulatory fragmentation of the EU. The EBA also advised the Commission on KPIs and disclosures by financial institutions on the level of taxonomy alignment and sustainability of their activities.

Looking ahead, we trust that the updated ad-hoc impact study on the implementation of Basel III in the EU in response to the EU Commission's Call for Advice from December 2020 may help in your upcoming discussions on the legislative banking package. Let me remind you that the updated impact is meaningfully lower than previously estimated with high dispersion across banks. The updated impact of a full implementation of all Basle III reforms translates in EUR 52.2 billion total capital shortfall in contrast to EUR 109.5 billion in the prior study. Phased in over a long transitional period and taking into account the likely adjustments in banks strategies and ongoing supervisory requirements, this is not a significant increase in capital. Ultimately, the full and compliant implementation of Basel III is the final piece of a structural reform with clear macro-economic benefits, which will restore trust and level playing field.

Data strategy and proportionality

The EBA continues to work on its data strategy in order to become a data hub, with the purpose of gathering and processing prudential data from institutions and to allow internal and external stakeholders, including competent authorities, EU legislators, and users of Pillar 3 information, to access more timely and comprehensive evidence-based analyses and information. The building blocks of this strategy include improving standardisation, harmonisation and integration of regulatory and Pillar 3 data.

Throughout last year, the EBA progressed substantially on its proportionality agenda. With the study of the cost of compliance with supervisory reporting, the EBA proposed substantive changes and improvements, which may reduce costs primarily for the small and non-complex institutions with a net impact of up to 15-24% equating up to EUR 188-288 million and a reduction of reported data points by up to 7000. The information collected in the context of the cost of compliance study currently feeds into the feasibility study on a consistent and integrated system for collecting statistical data, resolution data and prudential data.[27] The feasibility study scheduled for year-end will certainly refer to the identified cost drivers of reporting. It will also provide insights leading to an improvement of the future reporting design by investigating how such integration of reporting can be organised, how it could improve the coordination between stakeholders imposing reporting requirements or requesting ad hoc information and how it could reduce or avoid duplication of reporting and information requests.

Finally, the EBA Advisory Committee on Proportionality just released a discussion paper on a proportionality assessment methodology[28] which will help to inform the development of EBA products.

The EBA's mandate on AML/CFT

Let me now move on to anti-money-laundering and countering the financing of terrorism, which remains one of the EBA's core priorities.

Last year, the ESAs' legal AML/CFT mandate was consolidated and extended. For the EBA, this meant a fundamental shift in how we approach the fight against financial crime. Since January 2020, we have been working to embed AML/CFT in all areas of our work; to strengthen cooperation between all financial sector stakeholders, including Financial Intelligence Units (FIUs); and to provide hands-on support to competent authorities to ensure the effective implementation of AML/CFT controls in line with the EBA's guidelines.

The results of our efforts are tangible. We have now put in place a regulatory framework with close to 15 common standards, guidelines and opinions that set out how supervisors and institutions should address ML/TF risks holistically across all stages of an institution's life cycle, from authorisation through to resolution, and from a prudential, payments, innovation and consumer perspective.[29] Examples include our revised guidelines on internal governance[30] that clarify that identifying, managing and mitigating money laundering and financing of terrorism risk is part of sound internal governance arrangements and credit institutions' risk management framework, or the revised SREP guidelines[31] which set out how prudential supervisors should take account of ML/TF risks in their work. We have taken the lead and coordinated supervisors' responses to key emerging risks, including those arising from Covid-19. And we have supported competent authorities that implemented our guidelines to set up the world's first AML/CFT colleges to strengthen cross-border supervision. Close to 80 AML/CFT colleges already operate across all the financial sector, and the number is growing and should reach 300 by January next year.[32]

As a result, AML/CFT supervisors are better equipped to identify and assess the ML/TF risks associated with their institutions, and to intervene in good time before ML/TF risks crystallise. This is also apparent from the findings of our ongoing implementation reviews of competent authorities' approaches to the AML/CFT supervision of banks. Since we started these reviews, which consist of an in-depth, intrusive assessment of individual competent authorities' AML/CFT framework and conclude with bilateral feedback and advice to individual competent authorities on how to strengthen their approaches where necessary, we have found that most AML/CFT supervisors have taken steps to improve their information sources and establish close links with their domestic and European counterparts. Nevertheless, significant challenges remain, and this is why we are continuing to focus on capacity building and bilateral support where necessary to protect the EU's financial system from financial crime. The demand for this remains high: in the first half of 2021 alone, close to 1500 EU supervisors participated in our AML/CFT training events.

It is now important that we build on this momentum and these achievements and that collectively, we do not slow down as negotiations of the new AML/CFT package get underway. We welcome this package, which addresses many of the issues that we highlighted to the Commission in our response to the Commission's call for advice on the future EU AML/CFT framework[33], and we remain fully committed to protecting the EU's financial sector from AML/CFT now, and in close collaboration with the new AML/CFT Supervisor once it is established.

Digital transformation in times of pandemic and beyond

The pandemic has accelerated the digital transformation for banks and consumers alike. At the same time, we witness the growing number of incumbents and new providers of financial services, which raise the issue of the level playing field. Going forward, we need to ensure the operational resilience and robustness as well as the integrity and uniformity of the regulation in the system.

In times of rising levels of online banking and remote working following the pandemic as well as increased reliance on third party providers related risks, banks' information and communication technology (ICT) systems remain vulnerable to significant disruptions in their operations. Cyber incidents increased during the pandemic even though no major disruption in the EU/EEA banking sector has been reported so far.

The EBA continues to monitor and assess the risks to operational resilience and supervisory concerns and the EBA believes that the currently discussed DORA proposal will help to ensure efficient governance and operational processes of the oversight framework for critical third-party providers (TPPs). The EBA stands ready to deliver on any tasks that may arise from this regulation. But whatever mandate may be assigned, new tasks and responsibilities must be matched with adequate resources.

Turning now to crypto-assets, the EBA has been stepping up its monitoring of market developments and taking steps to enhance the sharing of knowledge and experience between competent authorities in this fast-evolving area of the market. The EBA released reports looking at the innovations of RegTech[34] and platformisation[35] to foster supervisory understanding. Going forward, we intend to leverage on the European Forum for Financial Innovation (EFIF) as a place to build up the expertise on digital among supervisors. In addition, we reached out to the customers of crypto assets as we issued, in March 2021, a statement with the other ESAs to remind of the risks attached to this asset class, reiterating the previous ESA warnings.[36]

The EBA supports the proposal for a Regulation on Markets in Crypto-assets (MICA) as a means to establish a robust pan-European framework to regulate crypto-asset issuance, including so-called stablecoins, and crypto-asset service providers. The proposal will address the risks identified in the EBA and ESMA 2019 reports whilst enabling the opportunities to be leveraged.

Protecting EU consumers from financial harm

Throughout last year, the EBA has implemented the additional powers in consumer protection stemming from the ESAs' Review. For example, we issued a report on mystery shopping activities outlining the lessons learned from national initiatives in this area[37], issued a methodological guide how NCAs could carry out mystery shopping[38], and started to prepare a mystery shopping exercise, which we will coordinate in the first half of 2022.

We have also started to use our new mandate to carry out thematic reviews on the transparency and levels of fees and charges of retail banking products. Lastly, we put in our work programme for 2022 the development of retail risk indicators and look forward to having these established by the end of the year.

We also fulfilled our supervisory convergence mandate in consumer protection as we issued a report with good and bad practices we have seen in firms' compliance with a key set of Guidelines the EBA issued in 2016, on the Product Oversight and Governance of retail banking products.[39] We were also encouraged to learn this summer that the Court of Justice of the European Union has confirmed the validity and importance of these Guidelines to protect consumers and reduce conduct risks in the EU financial system.

Our work in the area of payment services has continued to focus on making retail payment services in the EU more secure, more innovative and more competitive, as envisaged by, and set out in, the PSD2. So, while we are pleased to see that more than 300 payment and electronic money institutions in the EU have, by now, a license to provide the new payment initiation and account information services that the PSD2 established, we were much less happy about the degree of non-compliance by banks and other payment service providers with regulations set out in PSD2 and the related EBA technical standards.

In an Opinion we published in February[40], we called on national authorities to take all the necessary supervisory and enforcement action against banks that continue to place obstacles in the way third-party providers access the payment accounts held by banks.

Similarly, we closely tracked the progress that payment service providers and NCAs were making throughout the year to enforce the requirements on strong customer authentication for card-based electronic transactions. We published a report in June[41] that showed significant progress, but we are continuing to monitor the situation, to ensure that consumers can make secure payments and all types of payment providers comply with the relevant requirements.

Conclusion

Let me conclude. As I look back, I believe that the regulatory and institutional framework built over the last decade has contributed to the way banks behaved over the last year in the difficult times during the COVID-19 health challenge.[42] As I look forward, I think we should continue in those efforts. These include implementing the outstanding Basel III reforms in a timely, consistent, and faithful manner as I underlined in a letter together with the ECB Vice President and the Chair of the ECB Supervisory Board of Banking Supervision. But also moving swiftly to address the emerging challenges that lie ahead of us, from climate change to cyber resilience.

The EBA - from senior management to all staff - is thankful for the fruitful cooperation with you on all different subject matters. I am convinced that our open exchange and clear communication has enhanced the effectiveness of policy measures. We all need to keep investing in an ongoing dialogue for the next decade of the EBA to come.

Thank you for your attention.

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[3] EBA operational and supervisory measures in response to Coronavirus (COVID-19), available here.
[4] EBA Thematic Note: The EU banking sector: first insights into the COVID-19 impacts, EBA/REP/2020/17, available here.
[5] EBA ITS package for 2022 benchmarking exercise, available here.
[6] EBA 2021 stress test exercise, overview and documents, available here.
[7] EBA Response to the European Commission's action plan to tackle NPLs in the aftermath of the COVID-19 pandemic, overview and documents, available here.
[8] EBA Consultation Paper on draft Regulatory Technical Standards on the specification of the calculation of specific credit risk adjustments, EBA/CP/2021/25, available here.
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[24] EBA Report on convergence of supervisory practices in 2020, EBA/Rep/2021/09, available here.
[25] EBA Report on the monitoring of additional tier 1 (AT1) instruments of the EU – update, EBA/Rep/2021/19, available here.
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[28] EBA Discussion Paper on proportionality assessment methodology, EBA/DP/2021/03, available here.
[29] Overview on EBA AML work, overview and products, available here.
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