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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Introductory statement by Andrea Enria, Chairperson of the EBA

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

Honourable Chair and Members of this Committee,

Thank you for inviting the European Banking Authority before this Committee, today, to discuss the proposal of reform of the global prudential standards that the Basel Committee intends to finalise by year end. I would like to take this opportunity to briefly bring to your attention some of the main merits of the reform proposal (something that at times seems to be forgotten in the discussions about the Basel Committee work), the firm principles that have consistently guided the EBA’s participation to the design of the reform as well as the challenges that this process entails.

Following a review of the consistency in banks’ calculation of regulatory risk-weighted assets (RWAs), the Basel Committee has shed light on the excessive variability in the outcomes of banks’ internal models and engaged in an ambitious plan of additional regulatory adjustments. In a nutshell, this plan envisaged: (i) introducing constraints on the internal modelling of credit risk to address RWA variability stemming from model error and arbitrage - i.e. variability not reflecting actual differences in exposures' risk; (ii) reviewing the operational risk framework, where internal models have in several instances performed poorly; (iii) reviewing the scope of internal modelling for CVA risk and counterparty credit risk and (iv) improving the risk-sensitivity of the standardised approaches.

Also, to properly address the risk of excessive leverage, the reform proposal included targeted amendments to the leverage ratio framework, among which a surcharge for globally-systemic institutions.

Addressing the issue of RWA variability is essential to restore the reliability and consistency of international standards. If the use of internal models by banks and the supervisory guidance and approval practices of authorities are driving to significantly different results for similar exposures to risk, the legitimacy of international standards and their ability to support cross-border banking is compromised. In the area of credit risk, both the EBA and the Basel analyses have shown that parameters estimation is particularly volatile for those low-default-portfolios for which insufficient statistical evidence is available. In the area of operational risk, AMA models have led to instances of undercapitalisation, and the legal/conduct risks that have crystallised in the last few years represent a concrete concern. Improving the risk-sensitivity of standardised approaches is equally important, as these approaches become a more credible fall-back option whenever internal models are not adopted. This last aspect is particularly important - provided that the principle of proportionality is given due consideration in the implementation phase - for the large population of small and medium-sized lenders mostly relying on SA approaches in Europe.

In a nutshell, the consultation documents of the Basel Committee identified very important regulatory objectives and outlined a reasonable direction of travel.

Having said this, the EBA has consistently advocated for revising some elements of the proposal submitted for consultation. In the first place, the initial proposal was not compatible with the objective set by the Governors and Heads of Supervision (GHoS) and the G20 Leaders not to generate a significant increase in capital requirements. Secondly, what is truly essential in my view, adjustments were needed to ensure we deliver a framework that is fair and risk-based. Any increase in capital requirements need to be justified on the basis of the underlying risks.

Throughout the discussion and negotiation on the design of the reform, which is still open, the EBA's position has been guided by four clear principles: (i) risk-sensitive internal models should remain the first driver of capital requirements in the EU, whereas the combined constraint of non-model based metrics – such as the leverage ratio or the output floors – should act as a backstop; (ii) the RWA variability stemming from IRB models should be addressed looking at its main drivers, for instance lack of data for LGD estimation in low-default portfolios; (iii) a more reliable solution to compute operational risk capital requirements is highly warranted, due to the failure of advanced measurement approach (AMA) to quantify risks in a sufficiently prudent and comparable fashion; (iv) last, but not least, standardised portfolios, which are immune from the RWA variability problem, should not see an increase in capital requirements.

I am confident that substantive revisions to the original reforms package will be given due consideration in the final proposal, which in my view improves the quality of the reforms from a European perspective. However, it is clear to both market participants and regulators – and I believe to the Members of this honourable Committee – that the reform under discussion is likely to have a very different impact on different regions of the world, with Europe more impacted than other jurisdictions. This is in part due to the fact that the Basel standards have been gold-plated in certain jurisdictions or that the EU implementation, for instance on Basel I output floors, has often departed from the current international standards.

Designing global standards for structurally different financial markets has always been a challenge. I won't have to remind you that in Europe the corporates' reliance on bank lending is higher than in other jurisdictions; mortgage loans, and I should say very often low risk residential mortgage loans, are one of the most important components of European banks' balance sheets, whereas in other jurisdictions this is not the case. The extent to which external ratings are used in regulatory requirements and banks rely on internal models are higher in Europe than in other jurisdictions. Recent events have also shown different judicial approaches to conduct and operational events across countries.

Some of the European specificities I have just mentioned are enough to explain why, from a European perspective, proposals such as the output floor would have a significant adverse impact on low risk business – of which residential mortgages are only a well-known example. This is one of the main concerns we have to keep in mind in the final rounds of negotiation.

We should also remember that the figures that have repeatedly been shown to discuss the supposedly low density of capital of European banks vis-à-vis other jurisdictions may be partly inaccurate, due to differences in accounting standards.

We have a duty to do our utmost to achieve an agreement and restore an international level playing field. All parties have to make an effort to understand the specificities of other models of financial intermediation and avoid triggering unwarranted disruptions. An agreement is particularly important at the current global juncture, characterised by fragile trade and growth prospects and high vulnerability to shocks. The lack of a global agreement risks reflecting badly on EU banks, particularly if other jurisdictions go in the direction of tightening standards, whereas the EU decides not to address the issues at hand. The cost of not having an agreement may in the end be just as high in terms of market requirements for capital as the increases required by the agreement.