EBA BSG 2017 041

Banking Stakeholder Group

5 July 2017/9:30-16:30

Location: London

EBA-Unrestricted

Banking Stakeholder Group Minutes

Item 1.: Welcome and adoption of the agenda

1. The BSG Chairperson together with the EBA's Executive Director welcomed BSG Members. The EBA's Executive Director apologised for the absence of the EBA's Chairperson on account of another high-level commitment.

2. The agenda and the minutes of the previous meeting held on 2 May 2017 were approved. BSG Chairperson informed that one topical item was added to the agenda regarding the recent resolution and liquidation cases in Spain and Italy.

Item 2.: BSG update on the latest developments

A) BSG Chairperson to update on recent developments and to allocate the work on the EBA's Consultation Papers

3. BSG Chairperson informed that the ESAs' Stakeholder Groups had sent a joint letter on the ESAs' review to Commissioner Dombrovskis and it was published on the ESAs' websites.

4. BSG Chairperson recalled the BSG responses to the EBA's consultation papers issued since the last BSG meeting and allocated the preparation of responses to EBA's papers under consultation amongst the various BSG Technical Working Groups.

B) Update of BSG Technical Working Groups' Activities

5. The respective leaders of the BSG Technical Working Groups presented their work.

6. The BSG response to the European Commission's public consultation on ESAs' review was mentioned as well as the BSG response to the consultation on procedures for complaints on alleged infringements of the PSD 2.

Item 3.: EBA update on general developments

A) EBA Executive Director's update on general developments

7. On the ESAs' review, EBA's Executive Director informed that the European Commission was currently assessing over 200 responses and expected to come forward with a legislative proposal in September. According to the European Commission's feedback statement, responses received suggested i) no major changes proposed to be implemented in the governance structure of the ESAs, ii) possibility of extending/clarifying some of the ESAs' powers, iii) very little changes envisaged in terms of funding, iv) request for more transparency regarding Level 3 texts in particular Guidelines and Questions and Answers (Q&As). .

8. He also mentioned the Brexit-related work within the EBA. An EBA Opinion is likely to be published in September touching upon several issues such as back-to-back transactions, outsourcing, internal models and authorisations.

9. It was noted that the EBA continued to work on the issue of how to tackle Non-Performing Loans (NPLs). The Executive Director mentioned three pillars of the overall European policy efforts namely i) supervisory pressure from national authorities to encourage institutions to reduce their stock of NPLs, ii) restructuring via changes to the institutional framework in order to allow for fast resolution of NPLs, iii) tools to address failures of the secondary market for NPLs in which the EBA should be more involved. The possible implementation of an EU-wide Asset Management Company (AMC) was also raised, as well as a common blueprint for national AMCs which would also prove extremely useful in moving the adjustment process forward.

10. He indicated that the EBA had hosted a technical informal meeting to discuss the results of the second EBA impact assessment on IFRS 9.

11. It was also noted that the EBA held a public hearing to update on the progress it has made so far on the possibility of developing a new prudential regime for investment firms. Preliminary results of the EBA's data collection and the calibration of the underlying methodology were presented. The public hearing aimed at gathering additional feedback, which will be taken into account in finalising the EBA's response to the European Commission's call for advice.

12. BSG Members asked some questions about Brexit, recommending the consistency of approaches taken by supervisors within the Single Market. Some others questioned about the possible setting up of a European bad bank. The EBA's Executive Director clarified that there were other options and that the idea of an EU-wide AMC was not broadly supported at this stage.

B) EBA's update on risks and vulnerabilities in the EU

13. In its overview EBA staff observed that the EU banking sector saw an improvement in profitability despite remaining below the pre-crisis levels, as well as still subdued levels of asset quality.

14. In terms of CET 1, the ratio was reported to be on an upward trend reaching 14.1%. With regard to banks' profitability, the weighted average return on equity (RoE) in the first quarter of 2017 increased to 6.8%. In parallel, RoE dispersion between Member States has slightly narrowed. The cost of equity (CoE) was described as roughly unchanged, the majority of banks estimating their CoE between 8 and 10% according to the EBA's Risk Assessment Questionnaire (RAQ). Some institutions saw some improvements of their profitability, supported by increasing net interest income.

15. In terms of asset quality, the ratio of NPLs has decreased to 4.8% in the first quarter of 2017. In parallel, the coverage ratio was improving. However, the EBA staff viewed that the dispersion of NPLs remained wide across Member States. The EBA staff also noted that banks' portfolios were expected to grow and improve in terms of asset quality. However, the high stock of NPLs was considered to be driven by lengthy and expensive judiciary processes and a lack of secondary NPL markets, as evidenced by the responses to the EBA's latest Risk Assessment Questionnaire.

16. EBA staff also pointed out several ad-hoc risks / vulnerabilities related to US household loans and auto loan exposure. Further, the EBA staff highlighted the possible risks driven by the energy sector and concluded that there were no particular elevated concerns about EU banks. In addition, the EBA staff showed that EU banks' exposures to Middle East countries were limited.

17. Some BSG Members asked questions about:

- Methodology used by EBA staff, highlighting that the seasonal effects made it difficult to value the performances of the banks. The EBA staff confirmed the existence of seasonal effects.
- Considerations on using AT1 to define lower bound for CoE. The EBA staff took note of the proposal and will consider it in further CoE work.
- Additional risks not covered by EBA staff, in particular regarding operational risks (cyber-attacks).
- Profitability analysis, flagging that the sources of profitability might either come from credit sources/interest margin or financial sources linked to banks' activities. The EBA staff confirmed that further work would be needed to better identify those drivers. It was also noted that no specific business models were more profitable than others and drivers are often bank specific.

- Level of consolidation used to calculate the banks' profitability. EBA staff explained that they calculated a weighted average for RoE including subsidiaries, except for data concerning the whole EU.

18. Two BSG Members presented respectively the recent cases of resolution of a Spanish bank (Banco Popular) and liquidation of two small Italian banks (Banco Populare di Vicenza and Veneto Banca). Regarding the first case, the presenter considered that the involved European and national authorities applied the BRRD strictly so as to avoid any use of public money. By using the sale of business tool, holders of equities, AT1 and T2 suffered full loss, while senior bond holders and depositors were protected. However, looking back on the circumstances, the presenter was of the view that the handling of the case raised issues about the credibility of the European authorities with respect to a number of matters including, uncoordinated public communications, transparency over whether the collapse being caused by liquidity or solvency problems, the capacity of Banco Popular to pass the recent stress test and the impact of leaks about the bank. Regarding the second case, it was flagged that the two banks were put into liquidation rather than into resolution. In terms of cash injection, the Italian State committed to finance 19.785 bn euros to the operation, including 12 bn euros in guarantees. In both cases, shareholders and subordinated bondholders participated in the cost sharing, while senior bondholders did not. Retail holders of subordinated debt will be compensated.

19. One BSG Member warned the EBA about the moral hazard triggered by the bail-in tool as previously observed in a Slovenian case. He noted that a European Users Group had complained to the Spanish supervisor about possible market manipulations that occurred ahead of the resolution of Banco Popular. However, no response has yet been received to this complaint. He urged the EBA to look at this issue - as shareholders and junior bondholders bear currently all the risks. Another BSG Member observed that the Banco Popular case illustrated the weaknesses of the stress test methodology as the EBA does not stress liquidity. He also mentioned the loopholes of the BRRD, as the Italian taxpayers are going to support a significant part of the liquidation costs of the two banks.

20. EBA's Executive Director pointed out that it was incorrect to say that Banco Popular passed the 2016 EU-wide Stress Test, as the methodology did not contain a pass/fail test. Instead, the stress test was used for identifying possible vulnerabilities for banks in case of the materialisation of a hypothetical adverse scenario. Supervisors then used the results of the stress test to assess banks' forward looking capital planning and as an input to the Supervisory Review and Evaluation Process (SREP). He recognised that, to date, the stress tests did not analyse the liquidity situation but focused on capital adequacy. However, the stress test had pointed to the vulnerability of this particular Spanish bank. Additionally, it was important to note that the outputs from a stress test were dependent on the quality on the inputs received. In the case of Banco Popular, there had been a very substantial increase in NPL provisions by new management, in the period after the test. This clearly had impacted on the bank's financial strength.

21. Regarding the Italian cases, the EBA Executive Director pointed to the importance of consistency in the proper functioning of the BRRD. At this time there were still issues to be clarified; however, there were questions around the interpretation of the 'public interest test' and how this was viewed by the SRB under the BRRD and the Commission through the perspective of the State aid rules. The EBA had discussed these and other issues arising, and the EBA's views on the need of maintaining consistency had been communicated to the Commission.

22. One BSG Member raised the issue of consistency of the implementation of the new resolution framework regarding the involvement of taxpayers' money which was avoided in a systemic case like Popular but used in non-systemic cases like the Venetian banks. He also noted that banking regulations are designed to avoid banks failing because of liquidity problems, and that solvency judgements of ailing banks often fall in a grey area.

23. Another BSG Member considered that it was an unavoidable result as the new resolution framework was implemented too fast and that the timing was not appropriate because of the subdued financial situation of the majority of the Member States.

C) EBA's draft 2018 Work programme

24. EBA staff presented a list of strategic areas focusing on the development of the EU Single Rulebook, promotion of crisis management of credit institutions, investment firms and financial market infrastructures, convergence of supervisory methodologies/practices, assessment of risks and vulnerabilities, strengthening of the EBA's role for the collection of data, consumer protection. Some overarching inter-department activities were identified for the 2018 EBA's work, including data analysis and infrastructure, impact of the UK leaving the EU, Fintech challenges, trainings offered to supervisors. It was also noted that the final EBA's work programme will be finalised by September 2017.

25. Some BSG Members voiced their concerns about the collection of data, requesting a common approach when institutions have to submit the same data to different EU institutions. They broadly supported the development of the Single Rulebook.

26. One BSG Member remarked that one of the EBA's duties was to collect, analyse and report on consumer trends, and that this should be better emphasised in the work programme. In terms of supervision, some BSG Members raised their concerns about the differences in obligations that various market participants have to comply with in respect to the conduct risk framework. Another BSG Member viewed that the EBA should better facilitate engagement between the banking industry and supervisors to improve the quality of supervision. Given the different approaches to innovation by national supervisors, it was noted that the support to Fintech was significantly different across the EU jurisdictions. Consequently, the EBA should work more on harmonisation of the objectives of supervision.

27. On supervisory reporting and data collection, the EBA's Executive Director recalled the sequential approach to data collection. EBA collects data through the national authorities, and

through the SSM for the Member States participating in the Banking Union. He confirmed that data were requested by various EU institutions and better coordination should be implemented. In addition, he also mentioned the need to adjust data collection to the size, complexity and the risks borne by institutions. He also explained that the EBA's data hub project will enable the EBA to collect data for the whole population of banks in the EU. This data collection will serve several purposes, including thorough impact assessment, disclosure of Pillar 3 information for smaller banks, better analysis of financial trends in particular in light of the need for better consumer protection. On the differences of supervisory approaches, he noted that there was a need for a more balanced approach. He mentioned the difficulty the EBA faced each time it wanted to harmonise supervisory approaches.

Item 4.: Progress of EBA work in Consumer Protection, Financial Innovation and Payments

28. EBA staff listed the 11 deliverables expected to be issued by the EBA under the revised Payment Services Directive (PSD2) and explained the milestones reached for each of them as of July 2017. EBA staff concluded that the EBA's work was on track according to PSD2 requirements. Two additional consultation papers were expected to be published by the end of July, the draft RTS on Central Contact Points and the draft RTS and ITS on EBA register, and possibly two more depending on progress over the next month or so.

29. One BSG Member questioned about the publication date of the guidelines on professional indemnity insurance and authorisation of payment institutions. EBA staff clarified the timeline and explained that the content of the guidelines on authorisation of payment institutions which was significantly amended and streamlined to address the proportionality concerns raised by some consultation responses. A few changes were also introduced in the guidelines on professional indemnity insurance, in particular with respect to the criterion on the size of business that is part of the calculation formula.

30. Another BSG Member raised concerns about the development of Application Program Interfaces (APIs) for building software applications and asked whether the EBA intended to develop some recommendations in this area. EBA staff indicated that the EBA had discussed this issue during the development of the RTS on strong customer authentication and secure communications, when a decision had to be made between the competing demands of facilitating innovation (which suggested an RTS that is not very detailed and void of technological specification) and contributing to the single EU market for retail payments (which suggested the opposite: to specify in detail how the API interface would look like). In the Consultation Paper, the EBA proposed a middle ground, which many respondents thought was still too specific, which is why the EBA subsequently removed several technological reference before publishing the final RTS. The EBA therefore does not plan any work on APIs. Several BSG members supported the EBA approach to this RTS, in particular on the question of not requiring a fall-back solution to the APIs, as opposed to the Commission proposal relying on a compulsory screen-scrapping mechanism as a fall-back option.

31. EBA staff also noted that the guidelines on professional indemnity insurance might be reviewed earlier than is usually the case, with a view to addressing any issues that may or may not arise in respect of the application of the formula and the adequacy of the coverage levels to respond to claims.

32. EBA staff then presented the EBA's latest Consumer Trends Report published on 28 June 2017. It was noted that the report collected data gathered through National Competent Authorities (NCAs), national consumer associations, and the BSG for the specific issue of Dynamic Currency Conversion (DCC). EBA staff also commented on the structure of the report which is split into two parts, including i) the retail banking products and services in the EBA's scope of action, and ii) topical issues identified by the respondents.

33. One BSG Member noted that the statistical part of the report had been dropped and voiced his concerns around the achievement of the EBA mandate in this area. Regarding the topical issues raised in the report, he regretted that there was no reference to deposit rates that he viewed as a major concern due to the sustained low levels of interest rates and the resultant loss of purchasing power for consumers. He also considered that the EBA should be more involved in the assessment of compliance with the fair rules of information regarding new risky financial instruments issued in the EU.

34. Two BSG Members supported the insertion of DCC issues in the report but regretted that it had not been considered as a topical issue by the national competent authorities as it is an important issue also raised by the European Consumer Consultative Group (ECCG). On payment accounts, one BSG Member encouraged the EBA to collect the detailed information on complaints through the national Ombudsmen in the different EU jurisdictions.

35. The BSG Vice-Chair expressed his surprise that there was a low level of complaints about mortgages and raised some concerns about the application of the Mortgage Credit Directive (MCD) only to new borrowers. He viewed that selling practices and foreign currency loans were major issues that the EBA should further monitor.

36. EBA staff clarified that, for the purposes of the light version of the 2017 report, the EBA did not collect data through the European network of Ombudsman. On the deposit issue, the EBA staff reiterated that NCAs did not report this issue as significant and also clarified that the EBA has no remit to set interest rates, and is therefore unable to address any issues arising from continuing low interest rates, and gives preference to those consumer trends and issues that the EBA has a remit to address.

37. EBA staff mentioned the report on innovative uses of consumer data that the EBA had published on 28 June 2017 which reflects the EBA's conclusions following the assessment of the responses received to the Discussion Paper published last year and the more in-depth analysis carried out by the EBA on this matter. It was noted that there is already an extensive set of requirements under the EU law, in particular under the General Data Protection Regulation, which mitigate many of the risks identified by the EBA. Cooperation between supervisory authorities across the

various policy boundaries and raising consumer awareness on this topic were mentioned as key factors in mitigating the risks identified. EBA staff acknowledged that further work will be carried out in 2017 together with ESMA and EIOPA on the topic of Big Data.

38. EBA staff debriefed BSG Members on the latest ESAs Joint Consumer Protection Day held on 23 June 2017 in Prague. It was flagged that attendees showed satisfaction for the organisation of the event. However, it was also mentioned that the move from the financial centres of Paris, London and Frankfurt coincided with a drop in attendance of 30% compared to the previous years, in particular from the industry representatives.

39. BSG Members who participated in the event summarised the intervention of the MEP Sven Giegold and welcomed his proposals on the implementation of a “mystery shopping” by ESAs, a better visibility of the consumer corner on the ESAs’ websites, further work to encourage the practice of whistleblowing. From their perspective, they viewed it as the best organised Joint Consumer Protection Day, with a very good participation of consumers’ representatives as speakers in the panels.

40. One BSG Member welcomed the initiative to organise the event in an Eastern country. He insisted that a greater attention on detrimental consumer issues such as mortgage loans should be paid.

Item 5.: Discussion on topics presented by BSG Members

A) BSG thoughts on Regulatory Sandboxes

41. One BSG Member presented a draft paper on regulatory sandboxes which might be of relevance for the EBA in light of its own assessment of FinTech activities. He defined regulatory sandboxes as controlled ‘safe spaces’ in which innovative products, services, business models and delivery mechanisms can be tested without immediately being subject to the whole regulatory burden. One of the objectives of this paper is to alert about the risk of fragmentation existing in the EU as some EU countries might establish fragmented ecosystems of national sandboxes with different regimes.

42. He listed the international examples of regulatory sandboxes implemented and documented the UK case. He flagged BSG views on minimum requirements the EBA should take into consideration to harmonise the practices within the EU, in particular the entry requirements, possible requirements while the new business is operating in the sandbox, exit conditions.

43. He put forward some suggestions, especially on the issuance of EBA guidelines in order to achieve a harmonisation in regulatory practices as well as supervisory criteria on nationally established sandboxes. He viewed that those guidelines should try to establish clear and harmonised criteria for entering, staying, and leaving, the regulatory sandboxes. Appropriate consumer safeguards should also be an important harmonisation aspect to be covered in the guidelines, as well as limiting the scale of activities to be performed in the sandboxes, on

grounds of consumer protection and financial stability. He insisted that an important notion to explore might be "cross-border sandboxes".

44. BSG Members expressed different views regarding the content of the paper. They deemed that further work should be done to streamline it and find a common position. It was agreed that the leader of the Ad-Hoc Working Group on regulatory sandboxes will circulate a revised version of the paper by September 2017.

45. EBA staff informed that, in addition to the EBA response to the EC consultation on Fintech, already submitted to the EC and published, the EBA is currently developing a Discussion Paper where preliminary observations on sandboxing regimes would be outlined, and welcomed BSG members to provide feedback to the Discussion Paper during the 3 months consultation period.

Item 6.: EBA Update on other regulatory deliverables

A) EBA's 2018 Stress Test Methodology

46. EBA staff presented the draft methodology and templates published in June for discussion with the banking industry. BSG Members were informed that a workshop was also held in June with industry representatives and the EBA was expecting written feedback from banks. It was indicated that the EBA's work on stress test methodology started much earlier than the previous years to better take into consideration big changes triggered by the implementation of IFRS 9 and to give enough time to test the templates.

47. The EBA staff described the sample of banks, including 49 institutions of which 35 will be from SSM countries. He characterised the key points of the 2018 stress test methodology and elaborated on the main changes with respect to the previous exercise carried out in 2016. He clarified that some points had been left open for consultation with the banks.

48. In light of the recent resolution and liquidation of Spanish and Italian banks, one BSG Member regretted that the 2018 stress test exercise was still too focused on solvency whilst liquidity was not stressed. EBA staff admitted that liquidity stress tests were important but not included in this exercise. However he confirmed that liquidity was covered in other stress tests.

49. Another BSG Member supported the inclusion of level 2/3 instruments in this stress test exercise as they might improve transparency of the asset side of banks. However he saw inconsistencies in valuation of level 3 assets which are very much dependent to market parameters. He regarded this point as a major issue as banks might provide different estimates due to the difficulty to assess and price level 3 assets. EBA staff noticed that the purpose of including level 2/3 assets was to give more information to CAs for their supervisory tasks and to add an additional stress to take valuation uncertainty into account.

50. Another BSG Member asked whether the EBA considered moving from static balance sheet assumptions to dynamic balance sheet assumptions. He also regretted that the timeline overlapped with IFRS 9 implementation. He viewed this overlapping as an additional source of

complication. With regard to timeline issues and potential simplifications, it was noted that the EBA was open to further comments from the industry but that the timeline depends on the SREP schedule. It was also mentioned that transitional arrangements for IFRS 9 had been included in the methodology but they may still needed further work depending on the final proposal.

51. One BSG Member questioned about the use of internal models in the context of zero interest rate and how to compute capital shortfall. Regarding the latter issue, it was noted that there will be no thresholds as in the 2016 stress test. The approach for zero rate deposits was part of the open questions in the draft methodology.

Participants:

Chair – Santiago Fernández de Lis, BSG Chairperson

Mike	Dailly	Govan Law Centre
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Alin	Iacob	Association of Romanian Financial Services Users (AURSF)
Michel	Bilger	Crédit Agricole
Gerda	Holzinger-Burstaller	Erste Group Bank
Giovanni	Petrella	Catholic University, Milano
Christophe	Nijdam	Independent
Giedrius	Steponkus	Lithuanian Investors association
Monika	Marcinkowska	University of Lodz
Jesper Bo	Nielsen	FSU-DK
Simon	Hills	UK Finance (formerly BBA)
Dominic	Lindley	Independent
Thaer	Sabri	European Money Association

Angel	Berges	Universidad Autonoma Madrid
Dermott	Jewell	Consumers' Association of Ireland
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