

1-001-0000

**COMMITTEE ON ECONOMIC AND MONETARY AFFAIRS****PUBLIC HEARING WITH ANDREA ENRIA  
CHAIR OF THE SUPERVISORY BOARD OF THE ECB****BRUSSELS****THURSDAY, 12 DECEMBER 2019**

1-002-0000

**IN THE CHAIR: IRENE TINAGLI***Chair of the Committee on Economic and Monetary Affairs**(The hearing started at 9.11)*

1-003-0000

**Chair.** – Good morning everyone. I would like to welcome Andrea Enria, Chair of the Supervisory Board established at the ECB in the framework of the single supervisory mechanism (SSM). This is the second ordinary hearing with Mr Enria before the Committee on Economic and Monetary Affairs (ECON) in 2019. The last hearing took place on 4 September.

Today, we would like to discuss with you, inter alia, risk reduction measures in the banking sector, finalisation of the Basel III framework and the future of the banking union. In addition, the following topics will also be discussed: financial technology and innovation in the banking sector and state of play of the preparatory work for Brexit.

Mr Enria, you have the floor for an introductory statement of about 10 to 15 minutes.

1-004-0000

**Andrea Enria**, *Chair of the Supervisory Board of the European Central Bank.* – It is a pleasure to be back in front of your Committee to discuss the work of ECB Banking Supervision and fulfil our accountability and transparency obligations.

We continue to make good progress in reducing risks in the banking sector. The capital position of banks under direct ECB supervision has further improved. Banks in the euro area have, on average, also reduced their leverage, and their liquidity positions are now well above minimum legal requirements.

The volume of non-performing loans, or NPLs, held by banks under our direct supervision stood at around EUR 560 billion at the end of June 2019. When the ECB assumed its supervisory responsibilities five years ago, it stood at around EUR 1 trillion. This means that the NPL ratio went down from 8% at to 3.6% over that same period. When we look in more detail, we see that the NPL reduction has accelerated over the past two years and has been particularly rapid in countries with high levels of NPLs. The fact that this trend started with the publication of the ECB's NPL Guidance in March 2017 illustrates the impact of supervisory action.

Despite good progress to date, the aggregate level of NPLs in the European banking sector remains elevated by international standards, putting a drag on bank profitability. We consider it essential that more progress is swiftly made on this front while economic conditions are still benign. Banks have to maintain high focus in meeting the supervisory expectations about the coverage of the stock of non-performing exposures. We are also working with the national competent authorities on various initiatives aimed at further reducing NPLs held by less significant institutions.

Our targeted review of internal models (TRIM) is nearing completion. Confidence in the robustness of internal models suffered in the wake of the crisis. They were perceived as increasingly complex and giving results that were significantly different across banks. TRIM was launched to check whether internal models used by banks under ECB direct supervision delivered reliable and comparable results. After four years of intense effort, we recently completed the final phase of the on-site investigations. We made 200 such inspections. For banks, TRIM has raised the bar. Institutions are now being asked to remediate the shortcomings identified by our inspectors. TRIM investigations of models for retail and small and medium-sized enterprise portfolios, for instance, concluded with an average of 20 findings on the estimation of key parameters for credit risk modelling (the probability of default and loss given default). Banks will need to improve how they implement and use their internal models to address these findings and also meet the new requirements set out by the European Banking Authority. Work in this direction is already under way. For supervisors, TRIM has also confirmed that we need to continue investing resources in our ongoing supervision of internal models, especially to on-site examinations, to maintain high quality and consistent standards going forward.

Looking forward, fully implementing Basel III will bring the global reform process to a close and contribute significantly to risk reduction. Basel III reforms seek to close the gaps in the regulatory framework that were uncovered by the crisis. It is essential that Basel III is implemented faithfully, consistently and in good time. The EU should not take the lessons of the past lightly; it should not forget the huge impact of banking crises on our economies and on society at large; and it should not renege on its international commitments.

Banks are concerned about the impact of the finalised Basel III rules on their capital requirements. But the new standards do not aim at raising the bar for all banks. They target those banks that have unduly benefited from the use of internal models to calculate their capital requirements. The impact of the new international standards varies widely across banks. So the right question to ask is not whether the aggregate impact is high, but whether such an increase is justified from a prudential and level-playing-field perspective.

One important element of the upcoming reforms is the introduction of the output floor. The output floor acts as a backstop that ensures that banks using internal models cannot end up with a dramatically lower level of capital than banks that do not use such models. It will complement our supervisory work on TRIM which I mentioned earlier. Acting as a backstop to ensure a minimum level of risk weights across banking groups, the output floor complements other, more risk-sensitive initiatives such as our supervisory reviews. For our international partners, the output floor was essential to achieve an agreement. It was a red line for many of them.

When considering the impact of Basel III, we should also consider recent legislative changes that will lead to more lenient requirements. For instance, the Capital Requirements Directive (CRD) V contains new rules on the quality of capital for Pillar 2 requirements, which will impose a change in the policy the ECB has pursued until now – that of focusing only on Common Equity Tier 1 (CET1), the highest quality of capital, for Pillar 2. When this change was being negotiated, ECB Banking Supervision and the European Parliament voiced their

concern about this change, warning that high quality capital was essential. According to our calculations, the change will generate an average reduction in CET1 requirements of 90 basis points, as banks will be able to rely on lower quality additional Tier 1 and Tier 2 capital, which is now available at favourable conditions.

As supervisors, we can work to prevent any unwarranted consequences of Basel III for bank-specific Pillar 2 requirements. For example, model risks will in future be addressed under Pillar 1. We need to ensure there are no overlapping charges in Pillar 2. Also, we could sterilise the purely arithmetic effect of the increase in risk-weighted assets generated by the output floor in the computation of Pillar 2 charges. If the underlying risks – say concentration risk or interest rate risk – now covered under Pillar 2 are not changed, an increase in capital requirements would not be justified.

But the effects of the new standards cannot, and should not, be fully compensated, as this would jeopardise the prudential objectives of the reform. We are aware of, and concerned about, the low profitability of European banks. But relaxing regulation and deviating from international standards is not the solution. Instead, banks should focus on their business models, pursue enhanced cost efficiency and take advantage of opportunities offered by new technologies.

Digitalisation poses significant challenges for banks and supervisors. Fintech firms wishing to engage in banking business must obtain a banking licence. We have published a guide explaining how we will assess banking licence applications from fintech firms, taking into account the specificities of their business models. In general we will publish our risk assessment of less-significant institutions, where we will have a special feature on newly-authorized fintech banks. In May this year, we hosted the first fintech industry dialogue, which focused on the risks and supervisory treatment of artificial intelligence-based credit scoring, robo-advice and cloud computing. It is very difficult to predict exactly how digitalisation will change the business of banking and the structure of the market. We will therefore remain vigilant and continue to engage with banks and industry players in order to adequately tailor our supervisory approach – and we are focussing our attention on a technology-neutral approach.

While progress is being made in reducing risks and finishing the regulatory reforms, we must not forget the need to complete the overall architecture of the banking union.

The crisis management framework still needs to be improved; it remains fragmented and some crisis management tools are missing, or cannot be employed effectively. Concretely, the early intervention framework should be revised in order to simplify the use of such measures and clarify their relationship with other supervisory measures.

Some challenges could be addressed by learning from other jurisdictions. Resolution is a single European process, whereas bank liquidation is governed by 19 different national processes. These national legal frameworks differ greatly, for example on the conditions for starting insolvency proceedings, the ranking of claims and the tools available for managing banks in a crisis. For a truly level playing field in the banking union, we need truly unified liquidation procedures for banks. We could learn from the US Federal Deposit Insurance Corporation (FDIC) when considering new administrative liquidation powers for the Single Resolution Board.

As you are well aware, the European deposit insurance scheme (EDIS), which represents the third pillar of banking union, is still missing. A fully-fledged EDIS would ensure that people's confidence in the safety of their deposits is equally high in all Member States. In addition, it would remove any justification for the rules and policies that are still preventing the full integration of banking business within a single, truly unified domestic market under the banking

union. We trust that we can count on the support of the European Parliament in pursuing this crucial objective for our monetary and banking union.

As I conclude, I must of course also mention Brexit. We have continuously stressed that banks need to get operationally ready as soon as possible, and we expect banks to make further progress regarding the implementation of their target operating models, which we agreed with them, in line with the previously agreed timeline, so by the end of 2020.

1-005-0000

**Lídia Pereira (PPE).** – Mr Enria, Europe faces economic challenges that are of a varied nature and very complex. In the eurozone in particular, we face a growth deceleration that we must tackle in a swift and effective way. A 1.1% growth estimate for 2019, which represents 0.7% below last year's outlook, is far from being sufficient. In order to adapt our economies to today's challenges from climate action to digitalisation we need more financing, and more financing can only result from greater and sustainable growth.

The banking sector has a structural role to play in this effort to revert the deceleration path. We were able to reform the sector all over Europe after the financial crisis, but there is still a lot to be done. It is urgent to complete the banking union, as we just mentioned, with the Pillar 3, for example, but every Eurogroup meeting is inconclusive about the European deposit insurance scheme (EDIS). We have more announcements than actual decisions.

However, my question today is about the resolution and about certain banks that are still in troubled conditions. This is another hot topic because we know that eurozone banks are acting in a low interest rate environment that some consider a risk to profitability targets, and in this framework banks that emerged from resolution schemes are facing even harder circumstances.

In Portugal, for example, the resolution fund is being called on to finance Novo Banco again, after more than EUR 5 billion of support since 2014.

So my question is: in which way do you believe that resolution schemes, or particularly banks that have been under resolution, can still have, or benefit from, the conditions of the market to reinvest public money in reproductive investment in the economy?

You mentioned that there are different frameworks – 26 different national frameworks – but how can we manage to have more productive and successfully operating banks, after going through such hard times?

1-006-0000

**Andrea Enria, Chair of the Supervisory Board of the European Central Bank.** – Indeed, if you look at the European banking sector, one of the problems in dealing with the legacy of the crisis is that there has been too little restructuring and this restructuring took place too late, in a sense. It is essential that we have a system that allows intervening early in the banks, pushing restructuring processes and bringing in a process by means of which the banks that are exiting the process are able to support the economy.

If you compare the adjustment in the European banking sector and in the US banking sector, I would say that the benefit there was that there was much faster progress in cleaning the banks' balance sheets, for instance, in recapitalising the banks and also in reducing the number of banks – 500 banks exited the market in the first three years after the crisis. This mopped-up the excess capacity in the system, and made banks more profitable and more able to support the economy. I think that what we have not been as good at in the European framework is to have this type of set-up.

We have made progress, to be honest, including in Portugal, in having banks that eventually were restructured. This has been, in my view, positive for dealing with the legacy of the crisis, cleaning the banks' balance sheets, simplifying structures and becoming again able to support the economy. We see a growth in lending in these last years that is also reflective of the better functioning of the European banking sector. But still, I would say, we are not fast enough in dealing with these issues. So, in my view, the real challenge will be in that space.

Also, let me say, as I mentioned before, I made the reference to the FDIC, to the US system. In the US you have an authority which is taking charge of the banks which are failing or likely to fail and then being able to purchase an assumption, as it is called, to transfer assets and liabilities of these banks to other banks, usually from other states also, which also helps in terms of integration. So having a move to an administrative tool for liquidation that is the same across Member States would also help significantly achieving these goals. At the moment, we do have, for instance, situations in which there are banks which are declared failing or likely to fail by us; they don't pass the public interest test or they're not put into resolution by the Single Resolution Board and they do not, under national legislation, fulfil the conditions for national insolvency, so they remain in a sort of limbo. There have been banks that for two years have remained there, failing or being likely to fail, with a banking licence frozen. So we need really to find a better and more European solution for these cases.

1-007-0000

**Jonás Fernández (S&D).** – Welcome. Firstly, I have to say that – in the final analysis – I agree with your vision for the Banking Union and the problems of consistency.

I very much agree with your view of the situation today as regards banking union and the current lack of a unified approach, in that we still do not have a fully fledged EDIS that can be incorporated into the resolution and settlement system with a degree of consistency, and with what you said about the need to harmonise the regulation of banking insolvency.

I agree, but would like to ask you to what extent you think the indirect supervision of certain entities in the current banking union might also be generating a lack of consistency, in so far as we have witnessed some public intervention aimed at preventing entities from going into liquidation – and here I am basically talking about Germany. I would like to ask you whether you think the indirect supervision of some entities within the Banking Union, which you supervise directly, could be generating certain inconsistency within the model.

My second question has more to do with the whole debate on sustainable financing. As you will know, the Commission yesterday presented its agenda for a framework for achieving this in the next few years. We can expect the Commission to come forward with a proposal on sustainable financing in the third quarter of next year and there is some form of possibility of that proposal including different capital requirements for green credits (the green factor). I would like the supervisor's opinion on that.

1-008-0000

**Andrea Enria, Chair of the Supervisory Board of the European Central Bank.** – On the first problem, first of all let me say that in the case I suppose you were referring to in particular – the case of NordLB – is not one of a less significant institution. NordLB is under the direct supervision of the ECB; it's a significant institution.

The problems of consistency which I see in this area are not that much the issue. I mean, in the case of less significant institutions in any case, we have monitoring and oversight of the actions taken by national authorities. Whenever there is a bank that is bordering on crisis, we need to be informed, we start getting engaged, and we work closely with the national authorities.

The problem is that sometimes you have different legislation, at the national level, and different structures at the national level that can interact differently in the case of crises, which was the point I was mentioning before. I mentioned before the rules for liquidation, but the same applies for instance on the rules of engagement of the deposit-guarantee schemes in restructuring and in crisis management. You have cases, and this has happened for instance in Italy in the case of Carige, where there is intervention of both the voluntary and compulsory part of the deposit guarantee scheme. Also in Germany, in the case of NordLB you had a mixed, let's say, DGS and institutional protection scheme, in the same scheme, that intervened in this case. The criteria with which the deposit guarantee scheme can intervene is very different across Member States.

There are Member States in which this possibility to intervene in a preventive fashion is not available in legislation. In other cases, it is very extensive. So I think that we should take the opportunity of these cases, and maybe also of the ruling of the European Court of Justice on Banca Tercas, to maybe come to a more uniform way of codifying the intervention of deposit guarantee schemes in a crisis. Of course, the establishment of EDIS would even further improve this aspect.

On the point of sustainable financing, my position has always been that prudential requirements should reflect risks. So if there is a field of activity which is less risky, it should carry less capital charges, and if it is riskier it should carry more. I don't think we are in a position now to establish whether there is a precise connotation of certain green finance, for instance, to allocate less capital to that.

In general, let me also take this opportunity to say that there is some time a misleading perception of capital requirements, which is that capital requirements are always a drag on growth and on finance in the economy. Actually, it's a way in which the banks finance themselves, and the more banks are capitalised the better they can support, and take risk to support, innovative parts of the economy. So if we have to support a significant transition from a brown to a green economy, there will be risks in this transition, and maybe a better capitalised banking sector could be very important. So I think that when discussing the use of prudential requirements in this respect, we should take decisions based on solid evidence.

1-009-0000

**Luis Garicano (Renew).** – Mr Enria, we have been very surprised by DG Competition's decision to wave through the NordLB rescue as non state aid. I wanted to ask you a little bit about that.

We've seen what happened with the Veneto Banca, where there was very large state intervention, with a EUR 4.8 billion cash injection and with state guarantees totalling EUR 12 billion. Now we see that NordLB has received EUR 6 billion – EUR 4.3 billion in injections and EUR 1.5 billion in asset guarantees over the last few years by taxpayers. My question is whether the persistent deployment of public funds to rescue these banks puts stress on the state aid system and calls into question the credibility of the Banking Union.

In the end, if the resolution system is not credible, then the doom loop is not going to be avoided. We have found ourselves with a worrisome paradox, which is that creditors are often better off under national liquidation – where there is taxpayers' money – than under resolution. In some sense the banks are better dead than alive, if you get these fancy burials with diamond coffins and so on, which is what is happening now.

So my question is what should supervisors do to tackle these problems? Are you reassured that NordLB has been properly dealt with? And then one short question about something you raised which was very interesting, about zombie banks, in between dead and alive, failing or likely to fail but continuing with a banking license. What could we do about them?

Recently, the SRB Chairwoman mentioned something that she thought could be pretty easy, which is just to allow the SSM and the ECB to withdraw the banking licence. In the same way as they grant banking licences, they could just withdraw them when they deem it appropriate. Would that be a solution?

1-010-0000

**Andrea Enria**, *Chair of the Supervisory Board of the European Central Bank*. –This is a very difficult question. First of all, let me say that I cannot respond on behalf of our colleagues in the Commission on the state aid aspects, but I would like to say that we have worked closely with them because we looked at the case from a supervisory perspective, giving the authorisation that the legislation requires us to give in this situation. The area in which we worked particularly closely with colleagues in DG Competition was on the assessment of the capital and business plan of the bank. We look at the capital and business plan from the point of view of sustainability from a prudential perspective, so whether the bank would be able to sustainably respect capital requirements and, of course, the colleagues in DG Competition look at things from the perspective of state aid. But our assessment of the plan was very coordinated and consistent in this respect.

I also understand the perception that the resolution framework might seem as not been delivering the expected results. But let me clarify a few points here. First of all, the point that you correctly mention – that creditors might be treated better under national liquidation than under resolution – is definitely something that should not be the case. You have the ‘no creditors worse off’ principle in resolution, which also means, in my view, that you should have no creditors better off in liquidation, as a mirror condition. And this is the point that I was mentioning before, that you need a much more harmonised framework for liquidation.

Let me also take this moment to say that sometimes I hear of initiatives to harmonise insolvency procedures at the European level. That would be the first best ideal, but it would be extremely difficult. In my view, what would be better is to carve out banks for the ordinary insolvency procedures and develop an administrative liquidation to harmonise at the European level for the SRB, as I mentioned before.

In terms of the deployment of public funds, of course you have also to understand that this case, the NordLB case, is a case of a bank under public ownership. So, basically, when a bank is breaching requirements, the supervisor generally asks the bank to develop a plan to restore compliance with the requirements and the bank generally goes to the shareholders to ask whether they would be willing to provide capital to restore compliance with the regulations. That is what has happened in this case and what becomes crucial are the conditions that DG Competition, our colleagues in the Commission, set for the plan to be market conform. So that’s the key point.

All in all I think the point you were mentioning – the key issue – is that in many cases you have banks which still respect the requirements but have a business model which is not really viable. That is an area of intervention for us as supervisor which is particularly difficult, because we challenge the business models of banks, we ask them to intervene in some cases and, as we have done in the case of Banca Carige, we can deploy very intrusive measures such as temporary administration. But in many cases it is difficult because we cannot act as a substitute for the management of the bank while the bank is still respecting the requirements. Again, I think that withdrawing the licence is an extreme measure that usually comes even after the insolvency of the bank. We’re now dealing with the case of the former Anglo-Austrian Meindl Bank, which had a fail or likely to fail decision by the Austrian supervisor. We were in the process of withdrawing the bank’s licence and the European Court of Justice stopped the process because they wanted to check that there was no other option than the withdrawal of the licence. So you see, from a legal point of view, it’s very complicated.

1-011-0000

**Sven Giegold (Verts/ALE).** – Last week, I spent some time in La Valletta in Malta, and on that occasion I saw, of course, the Reuter’s report about the poor state of one of the large banks there – the Bank of Valletta. I also got hold of the report by the European Central Bank.

Of course you cannot comment on the case, but it was a damning report and I thank you for following up on these cases. It’s shocking that something like this can ever evolve in a bank under your supervision.

Therefore, I’m asking one question. You have the obligation to give fit and proper assessments to those in leading positions in the bank. Can you tell us how often the SSM has ever said no to the fitness and properness of anyone since the creation of the SSM?

1-012-0000

**Andrea Enria, Chair of the Supervisory Board of the European Central Bank.** – Well, I don’t have that statistic with me, but to be honest I don’t think the statistic would be really relevant, because it happens quite frequently that we challenge members of the board which are proposed and then the bank basically does not pursue that appointment.

So that’s the most frequent case, and I can tell you – I don’t have statistics unfortunately – but it happens in quite a number of cases.

What I would like to tell you, and that’s a relatively new tool that we are starting to experiment with right now, is that the ‘fit and proper’ concept is not a one-off assessment that the supervisor performs when somebody is appointed to the board. It is something that needs to be in place on a continuous basis, which means that we can also review whether somebody is ‘fit and proper’ on the basis of new findings. When there are cases of misconduct for instance, or of poor performance in the area of money laundering or poor internal controls and the like, we are committed to use more and more board reviews to check who were the board members responsible for those functions, and checking whether they still fulfil the ‘fit and proper’ criteria. We are undergoing a specific review in these days.

1-013-0000

**Sven Giegold (Verts/ALE).** – I would like to ask a follow-up. Firstly, I’m aware that there are these challenges. Nevertheless, according to what I know, basically it never happens that the SSM says no to a candidate.

So you ask difficult questions, but you don’t say no.

It would be helpful to share with us the figures of the number of candidates which you have approved, the numbers of candidates you have said no to, and the number of candidates of which you are aware that they were withdrawn after your questions. So that would be really helpful.

But I would like to ask a question which follows up from a speech by Sabine Lautenschläger in January 2016, where she stressed that there is a lack of harmonisation when it comes to the legal basis for the ‘fit and proper’ assessments.

It seems that you are right that your challenges are also having an effect, but that the poor record of saying no to anyone is also a consequence of a lack of harmonisation.

Could you really tell us what you wish us to harmonise in order to do your job better?

1-014-0000

**Andrea Enria, Chair of the Supervisory Board of the European Central Bank.** – Thank you very much. I had missed the opportunity to take up this point in my reply – thank you for



allowing me to do so. Yes, indeed, that's a major issue for us. We are applying 19 different implementations of the directive and this does not allow us to guarantee that the same person would be considered fit and proper or not fit and proper if he were to apply to banks in different Member States. And that's something which is unacceptable. We have a very diverse implementation of the directive and actually we also have a case in Italy in which the directive has not been fully implemented, which again makes it very difficult for us to apply the same tools. So, to be honest, in this area the answer is simple: moving to maximum harmonisation and putting these criteria into a regulation rather than in a directive. We are in a Banking Union and the same criteria should apply to everybody.

On the statistics, we should also maybe clarify that, in many cases – actually, in a large majority of cases – we approve the appointments with conditions. So when we find issues, for instance, of a potential lack of knowledge or of a lack of sufficient time to devote to the tasks, we often put conditions to step out from other tasks or get under a sort of training programme to make the people really fit for the job.

1-015-0000

**Sven Giegold (Verts/ALE).** – Please send us the statistics.

1-016-0000

**Eugen Jurzyca (ECR).** – Thank you for the floor, Mr Chair. The significant banks have lately seen declining average profitability. To the best of my knowledge the ECB has not done yet a proper detailed analysis of the negative side effects of its loose monetary policy. One of the possible side effects, the effect of which is increasing with time, is the low profitability of the banking sector.

My first question is whether, in your position, you would put pressure on the ECB to regularly analyse and report the side effects of its unconventional monetary policy. At the March 2019 ECON Committee hearing you committed to taking supervisory measures in relation to banks holding sovereign exposures. Recently the holdings increased, even in the case of some controversial government bonds.

My second question is whether you can detail the concrete measures you have taken to combat this development.

1-017-0000

**Andrea Enria, Chair of the Supervisory Board of the European Central Bank.** – On low profitability, indeed the interest rate environment is putting pressure on banks' margins. That is undeniable, but if you want to properly assess the overall impact, you should also look at the other factors.

I mean the low interest rate environment is, of course, benefiting the increase in volumes of bank loans and is also supporting, of course, the capability of borrowers to repay. So it is benefiting the asset quality of banks. I would say that if it were not for the very accommodating stance of monetary policy probably it would have been difficult for banks to make the progress which has been achieved in the last couple of years, in terms of the reduction of non-performing loans.

But it is true that there is indeed an effect on profitability that is now visible, and the ECB, I must say – my colleagues on the monetary policy side – are indeed conducting thorough analyses. There have also been papers and analyses published on this. The recognition of these side effects has also been seen in recent measures, which have implied a tiering of the treatment of reserves at the central banks in terms of interest rates. So there is quite a lot of attention on that side.

On the treatment of sovereign exposures, we are also, within the current legislative framework, looking at the risk of sovereign exposures in our Pillar 2 framework. This is covered for instance in the stress test that the EBA develops every other year, and there will be a new one in 2020.

So usually there is a specific shock that affects the sovereign spreads and through that channel affects the capital position of the banks. Also we can, under Pillar 2, look at the way in which the banks monitor these particular risks, and we look also at the concentration risk in the sovereign exposure, so that's something that we do quite frequently. When we see a particular issue we can also put specific requirements on the bank. So that's the way in which we address it.

A point that I made in the past, and that I would like to make again here, is that from my experience in the past at the EBA too little attention is being paid to the accounting treatment of sovereign exposures. Banks have this practice, which I particularly don't like, of moving exposures from mark to market books, so trading book and available for sale, to be held to collect whenever there is an increase in the sovereign risk. That doesn't allow the proper recognition of losses on sovereign portfolios, at least for the assets that banks hold, to fulfil the liquidity requirements. So these would need to be ready to be sold fast on the market if there is a liquidity shock, and there should be, in my view, a requirement to hold them at market value.

1-018-0000

**José Gusmão (GUE/NGL).** – Mr Enria, I would like to go back to the idea of reducing capital requirements for so-called 'green bonds' – because I have already witnessed your reaction to this idea. I also witnessed Commissioner Dombrovskis' reaction. He thought it was an idea that needed to be explored. But I have to say that I find the arguments that you put forward to be valid. The idea of weakening, returning to riskier banking activity, is a bad way to promote green investment, which we obviously need.

It seems to me that this argument that you used, which I consider reasonably valid, does not apply to an inverse policy of demanding bigger capital requirements for bonds connected with highly polluting economic activities. Therefore, the secondary argument which you used – that capital requirements should serve an exclusive role and should not be used for additional purposes like this – would not be applied to this type of policy. I would like to hear your opinion on this matter.

The second question that I would like to ask you is this: you said – and I think we agree – that the European deposit guarantee system is essential to completing the banking union and even to ensuring that the division of responsibilities corresponds with the division of consequences. Do you believe that the goal that you set – which I consider a good one – that all countries must be equally protected with regard to the deposit guarantee may be achieved through a European deposit guarantee system that is essentially a system of loans? It seems to me that a deposit guarantee system based on loans essentially keeps everything the same, only with one more debt channel.

1-019-0000

**Andrea Enria, Chair of the Supervisory Board of the European Central Bank.** – Thank you for the question. With reference to your first point, let me say up front that the Commission has requested the European Banking Authority (EBA) to make an analysis of this issue of the supporting factor and the EBA is working on that, so there will indeed be in any case an analysis from the supervisory committee and we are contributing to this work within the EBA framework.

As I mentioned before, I think that this debate should be based on actual empirical evidence – so is there evidence that risks are lower in certain activities as compared to others? We need to look into that and if there is evidence, as was the case for the SME supporting factor, by the way, when there was proper analysis that a diversified portfolio of exposure to SMEs was less risky than an individual exposure to a large corporate of the same type, of the same size, and this led to a reduction in the capital charge for small and medium-sized enterprises. This has eventually been recognised also in the Basel framework. So that is the type of empirically-based analysis that is required.

Also, the point that you mention is correct. If there is going to be a transition from brown to green, it is clear that certain sectors can become riskier in the process and some others may be less risky. So how to reflect that?

The point that I welcome in this debate is that the debate on sustainability pushes also supervisors and banks to look at the longer-term risks, in a sense. Now, for instance, when you look at the internal models, the estimation of risk parameters generally has a time horizon of a one-year maximum for some banks through the cycle, so we are talking about three years. So, pushing banks to look at the risks in a longer-term perspective and possibly identifying counterparts that would be riskier if you look at the longer-term perspective because that sector is going to be penalised in the transition from brown to green. That is something that I think should be factored into the supervisory process and we are, for instance, developing supervisory expectations that we plan to communicate to banks on how they should start looking in their risk management to these aspects. Whether this can be reflected into a specific and blunt supporting factor for green or penalising factor for brown, again I think that we don't have yet enough evidence.

On the point on EDIS, I agree with you. If you look at the lending point, the final point of EDIS, the best setting is one in which you do have actual pooling and which the perception is that there is actual diversification of risks, also for the joint deposit guarantee scheme, so there is exactly the same amount of money which is protecting depositors.

Let me say also that sometimes – and this is often lost in the discussion – these are funds which are paid by the banks through risk-based contributions. Even if there is a support from the state, in case the deposit guarantee scheme is not capable to support, this would eventually be made up by the banks to ex-post contributions, so it's a private scheme. But still I think that starting with something which has liquidity support or lending would be a good first step, at least. It would at least keep the train moving. So I would be supportive of having a first step maybe with reinsurance, as a signal that we are moving in the right direction.

1-020-0000

**Fulvio Martusciello (PPE).** – Three very quick questions. Firstly, the Italian Parliament yesterday adopted a resolution which, precisely, makes approval of the European Stability Mechanism Treaty conditional on a package of rules on the Banking Union, excludes restrictions on the sovereign bonds of all banks and make reference to general deposit insurance.

What is the value, do you think, of that resolution? Do you not feel that this debate is in essence liable to create fear among savers who, when it comes to debt, let's say, might come to believe that Italy is a country in debt?

Secondly, you recently stated that in order to foster consolidation in the banking sector, the supervisory authority will no longer require additional capital in the case of mergers. That statement has, of course, been viewed as an incentive and not as a brake on mergers. Is the

supervisory approach of the European Central Bank on European banks changing with regard to capital requirements?

Thirdly, as we know and have read in the press, Banca Popolare di Bari has requested that an interbank deposit protection fund be activated so that it can be part of a rescue plan which, by way of Mediocredito Centrale, will directly involve the state. The whole operation would cost EUR 1 billion. Do you not think this should be viewed as state aid?

1-021-0000

**Andrea Enria**, *Chair of the Supervisory Board of the European Central Bank*. – Let me start with the easy one, which is the last one.

It is not our competence to define state aid, so it would be very inappropriate of me to express an opinion on this from the state aid perspective.

Of course, Banco Popolare di Bari is a less significant institution, under the direct supervision of the Bank of Italy, but we are closely interacting with the Italian authorities to follow the developments.

On the point on the European stability mechanism (ESM), I am very much concerned about the way in which the whole debate on the completion of the Banking Union is framed. I mean, when you have a debate which is framed through red lines set by different Member States, you will never get to a final agreement.

I think that we should all agree that, at the end of the process, we need to have a deposit guarantee scheme and probably also – although I know that this is more sensitive in terms of the sovereign exposure – we need to have probably a sort of common framework. Ideally, also, you should have portfolios of banks which are more diversified, not having all the Italian banks with Italian sovereign bonds and all the German banks with German sovereign bonds, but having more diversification in their portfolios.

So I think that we need to really come to the discussions at the European table with a view to moving this process forward. I think that from the banking point of view, which is my responsibility, what is in the ESM package which is in my view very valuable is the common backstop for the single resolution fund. This would provide an ESM backstop and would give credibility to the ability of the European Union to manage the exit from the market also of large and complex banks. I think that would be achieving an important objective of the Banking Union and the reform process.

On the issue of bank mergers, let me correct a bit your quotation of my position. I've never said that we are not going to require capital in case of bank mergers. What I said is that there is a perception in the market that whenever two banks merge, automatically the ECB would ask for an increase in capital requirements that goes beyond the individual capital requirements of the two banks before the merger.

What I am saying is that we would actually look, on a case by case basis, at the project and the capital plan of the banks and make sure that in the medium term – so not only upfront on day one, but in the medium term – there is a process that enables respect of minimum requirements.

This would allow you to manage the dip in the capital position that you usually have when you have a merger and you have a restructuring process, and then you reap the benefits when the merger delivers some upsides. I think that we do have excess capacity in the European banking sector, and some concentration might be a good way forward – though not necessarily to create

behemoth big giants, as sometimes concentration is needed more in the mid-size and small part of the sector, where business models are sometimes not viable.

1-022-0000

**Pedro Marques (S&D).** – Thank you, Mr Enria, for the information you have provided up to this moment. My question will be in two parts. First, about your priorities for 2020. You have stated clearly that the priorities will again be balance sheet repair. My point is that obviously the banks take this into account for their activity foreseen for the next year. Taking into consideration that the banks have come to a situation in which they have a more or less stable 7% return on equity at this moment for two years – more or less, they are around 7% – in a much less risky environment with much less risky balance sheets, shouldn't we start also looking more to the balance sheet structure and not just focusing again and again on balance sheet repair? Isn't it a bit worrying, for instance, that credit to private consumers' households has grown much more than credit to SMEs in the latest figures that were provided? Shouldn't we be starting, from the supervisory side, looking much more to the balance sheet structure and in fact, in the end, doing what we should, which is to provide the correct incentives for the banks to be supporting more economic activity and for productive investment? That's my first question.

Second, about the Banking Union and completion of the Banking Union, it is, I concur, a bit worrying that we are again in this red-line environment day on day. That's something that will not be helpful, surely, for us to complete anything. I think, basically, most people would concur that we have been doing a lot of risk reduction – and we do need this risk sharing pillar to be completed – but in the integration of the banking sector at European level there is so much to be done. It's not just about EDIS, though EDIS is very critical, obviously. The safe portfolios issue and national sovereign bias is critical for sure, but there is more that can be done on other issues such as the liquidation regimes and all that. Can you bring to the table today, for instance, maybe also sending to this committee in the future, the reflection of your institution on other steps that can be taken to integrate the European banking sector much further, not just focusing on the very critical issue of EDIS?

1-023-0000

**Andrea Enria, Chair of the Supervisory Board of the European Central Bank.** – On your first point, let me say again that we are prudential supervisors, so we are by mandate focussed on risks. This doesn't mean that we concentrate our attention only on balance sheet repairs and legacy assets. Of course, until legacy assets are there, we need to pay due attention to them, and to push to complete the clean-up, because if you have a new recession coming, and if you still have banks – as is the case – in the Banking Union, with 40% or 30% NPL ratio, then these banks would be in a very difficult position. So that's a focus that we need to have, but we also look at risks in other areas.

I mean, indeed, banks now – especially with the low interest rate environment – are shifting their portfolios; trying to get profitability from new areas. I mean you correctly say that consumer credit is growing a lot, and this is an area which is more profitable because it also sometimes carries more risk.

We have seen an increase in leveraged lending, for instance, which is another area to which we have been paying quite a lot of attention. So we are not looking only to the legacy portfolios, but we are also looking at the new risks that the banks are taking and making sure that banks measure them and manage them properly.

Let me also say, because that was resonating in several interventions, that again as prudential supervisors we cannot and should not do industrial policy. I mean it is not about our responsibility to put incentives for banks to finance this or that sector of the economy.

What is important for us is that when they take their own decisions, they manage their risks properly. That's our main focus.

On the integration of the banking sector, you raise a very important point. Indeed, there is a lot hanging on EDIS, because without having a deposit guarantee scheme, I mean this is used as an argument to segment capital and liquidity in individual countries, because eventually if something goes wrong it will be the deposit guarantee scheme in that country that would have to foot the bill.

But that's something that we will have to live with for a while, because I don't think that EDIS will be in place tomorrow. So, as you correctly say, we need to work on integration in any case, pulling on other levers. There are a number of other issues which are also in the legislative debates. We have had lengthy discussions on liquidity waivers, capital waivers, whether you can allow banks – at least in the Banking Union – to manage their assets and liabilities in a more integrated fashion. I know this is a difficult discussion. But, for instance, we are working on the possibility of a greater use of intra-group guarantees, to give sufficient reassurance that if a shock hit a subsidiary in one country, the parent would be supporting and that therefore ex-ante capital and liquidity can be more managed at a group level. So finding ways, also from the legislative point of view, of supporting this type of solutions would be very helpful, I think.

1-024-0000

**Danuta Maria Hübner (PPE).** – Mr Enria, I would like to ask you about three issues for further comment. You have already responded on these issues but I would still like to go to other aspects of the issues.

First of all, I fully agree with you that if we have a plan that we should just have one off full harmonisation of national insolvency loss then we are lost, and we will never have it probably. So you propose to do it in parts or instalments and to identify the areas where we should go faster, and you have already proposed one related to liquidation. So my question to you is, could you just identify two or three more areas that could be the beginning of harmonisation and would help us, maybe not today because I understand it will take some time, but something future-oriented that we might need. I don't know: groups or cross-border or home host. I don't know, but just if you have any thoughts on this and where we should go.

My second issue is when you were commenting on the American side, how they coped with cleaning up the post-crisis banking sector problems there. You mentioned the possibility of having this central tool and you said it would be useful also here. Have you any more deeper thoughts on this, because it would have to be within the Banking Union, I think? Whatever you could comment on this would be greatly appreciated by me.

The third issue: you talked about the less significant institutions and your role in the complex supervisory process also there. My question to you is actually do you look at it in a more systemic way? Do you think forward to how maybe we could change the scope of the supervisory framework, to include some of those? Is there any thought about that being done under your responsibility?

1-025-0000

**Andrea Enria, Chair of the Supervisory Board of the European Central Bank.** – On insolvency, I will take your first two questions together if you allow me. First of all, if you look at the current set up for bank liquidation, you have some countries which do insolvency procedures for banks in exactly the same way as any other corporate. So there is no protection of depositors, no administrative tools, nothing. We have had cases also, for instance, in the case of ABLV, which was a bank that was declared by us as failing or likely to fail because of liquidity problems that followed concerns raised by the US authorities on money laundering. We declared failing or likely to fail and the local authority was not able to start the insolvency

procedure, so the bank had to go into voluntary insolvency because there wasn't even a possibility to trigger a tool there. Then you have cases in which we have administrative tools for bank liquidation, so separate legislation for managing the insolvency of banks, and again you have cases in which this local administrative liquidation can be coupled with state aid as we have seen in the case of the Veneto bank that MEP Garicano mentioned before. So this spectrum is too wide. You need to harmonise and, in my view, you should have an administrative regime for bank liquidation, harmonised the same across Member States. The FDIC could be a great inspiration because it allows the authority to basically take control of the failing banks. So they step in, sometimes during a weekend, and then they take control. The depositors know that they will not lose a single cent of their deposit so they don't move, so there is no outflow of deposits because there is a guarantee, also from the US Treasury, from the FDIC. The bank can be restructured and then assets and liabilities are sold to other banks. So you reduce the number of banks, you have exit from the market, you have consolidation and you have cleaning-up of the bank's balance sheet. That, in my view, is the type of tool that we should have in place. You also have integration, because if this is managed, for instance, in Europe by the Single Resolution Board, which I would advise, you would have no country bias. So you would not only allow national banks to intervene in this process, but it would be a Europe-wide process.

On LSIs, we are already working quite a lot on LSIs. Actually, you know that although the conduct of supervision is basically in the hands of the national competent authorities, as the European Court of Justice has recently mentioned, we maintain overall responsibility for these banks. So we are interacting more and more. We have divided the LSIs in level of priorities: high priority LSIs, medium priority and low priority and, of course, we have more intensified interaction on the high priority LSIs, but whenever there is a crisis approaching of course we are brought into the picture and we interact closely with our colleagues locally. We do look into these with a more holistic approach, also a system-wide approach. For instance we are looking into the function of these institutional protection schemes that we mentioned before that sometimes bind together cooperative banks or saving banks, how they are working. We are doing now a deep dive into the functioning of these schemes and what we have learned in the recent crisis. We are also especially harmonising supervisory tools, so we issue guidelines or sometimes also instructions if need be, to competent national authorities on how they should, for instance, manage certain areas. On the management of non-performing loans, for instance, we develop policies at the euro area level and now we are making sure that these policies are applied also at the level of LSIs.

Finally, there is the tool of pulling back supervision to us, and this has happened, for instance, this year in the case of PNB Banka in Latvia, in which we took over the supervision of the bank and we managed, through an on-site inspection, eventually we declared it failing or likely to fail. We are now in the process of withdrawing the licence.

1-026-0000

**Neena Gill (S&D).** – Mr Enria, some weeks ago you spoke at the retail banking conference, about Basel III and proportionality for banks and sustainable finance. But then you appeared to shy away from the idea that banks could – and should – be more incentivised to direct capital to environmental projects and assets, essentially lowering capital requirements for green assets, because you stated that your mandate is to make banks safer, and hence exposure should be based on risk. I know you've acknowledged in earlier exchanges that there is systemic risk posed by climate change to the financial system. However I don't think the consequences of the physical and traditional risks are widely recognised.

Yesterday we had President von der Leyen speaking at Parliament about the Green New Deal and the impact on all sectors of society. My concern, essentially, is that the ECB and other central banks across the EU are still very much in the early days of considering their

responsibility in addressing the impact of climate change on the financial sector, because your focus is still on stability and preventing another financial crisis like the one we saw ten years ago.

My question is: what mechanisms do you believe the central banks and the ECB need in order to assist in guiding the banking sector and the financial system on a more sustainable path?

Do you accept that addressing the risks that climate change poses to the financial sector is actually a priority in your mandate?

1-027-0000

**Andrea Enria**, *Chair of the Supervisory Board of the European Central Bank*. – Thank you very much. This allows me to clarify this point as I really would not like you to leave this room with the impression that the ECB is not engaged with one of the top priorities for the European Union. I mean it is in the mandate of the ECB according to the Treaty and we perceive this to be in our mandate as well, to foster and support the objectives of the Union. Definitely, environmental and sustainability issues are very high on the European agenda, and are very high on our agenda as well.

My point is simply, what are the best tools to achieve these objectives? For instance, I mean there is in the Commission's action plan, and also in the action plan developed by the EBA recently, a lot of attention on disclosure. Once you have a taxonomy on green assets for instance, having an important framework for disclosure for banks could be an incredible support to sustainability. We see recently there have been rumours that banks in some countries were particularly poor in terms of their green credentials and this was followed after a few hours by all those banks going public and setting publicly their objectives in terms of transition to green. So I think disclosure can be a very powerful tool in this respect.

Furthermore, we are working quite a lot on how banks should manage their climate-related risks and the physical risk of having more natural disasters, for instance. That's an important element to support the economy, also in front of these developments, and also in terms of transition. As I mentioned before, we are deeply involved in developing supervisory expectations and what to expect banks to do in devoting more attention to these aspects.

So if you are accepting collateral on a 25-year loan, which is going to be heavily depreciated because it is, for instance, containing asbestos, let's say, it's clear that the pricing of this collateral and the evaluation of this collateral should not be based on today's values but also considering the fact that there is no tolerance anymore going forward for this type of assets.

So that's an important element. There are a number of tools. Another tool which I view very favourably for instance on sustainability, is the use of stress testing. Stress testing is an interesting tool because it allows, as I mentioned before, when we have the ordinary stress test of the EBA, the one we will run next year, we will have a time horizon of three years. So probably if you take a time horizon of three years it is very difficult to understand how climate change can affect the risks in the banking sector. So if you want to really factor these aspects into the way in which the banks manage their risk, you need to do a sort of specific exercise focused on that, and several authorities are already developing tools in that area and the ECB is also working in this respect.

So a lot of work, and a lot of support for the objective. The only point I'm questioning is whether using the capital requirements as a sort of tax incentive to favour financing of one sector rather than the other, irrespective of the underlying risks, would be the right way forward.

What I'm saying is that before doing that you need at least to do an extensive analysis of the underlying risks.



1-028-0000

**Stasys Jakeli nas (Verts/ALE).** – Mr Enria, you alluded to the Fintech banks, that they are coming, they're developing, they're growing potentially, and I'm interested in the licensing process and some risks related to that.

You issue licenses to the Fintech banks but you don't supervise that on a detailed basis, the national supervisors do that, and because of the looming Brexit, now there is some supervisory competition or, I would say, market competition to attract some of the companies from Britain which were licenced there, and that creates sort of problems. I don't know if you accept that this is a problem of supervisory competition in some jurisdictions which are interested in creating Fintech apps for example, and a moral hazard because the licence is issued by the ECB but the supervision is done by the national supervisor. You know from my point of view it is a moral hazard on the supervisors' part. Do you see that as a potential problem?

Both these problems – moral hazard and especially supervisory competition, potentially create market integrity issues. Do you follow that? Are you aware of that? Would you consider that this could be discussed in more detail? Since this committee established a Fintech working group, we will look into that in more detail, engaging with you and other institutions. Also, is it the ECB's responsibility to follow that or is it the European Banking Authority which is the guiding institution for the standards, and which could be involved and engaged in discussing these issues?

1-029-0000

**Andrea Enria, Chair of the Supervisory Board of the European Central Bank.** – Well a very rich question; you raise a very important problem.

Indeed, we are seeing a number of new entrants into the market, especially exploiting new technologies and, as you correctly mentioned, the Brexit process is also implying that a lot of Fintech companies are applying for licenses within the Banking Union to continue providing services also after Brexit.

So first of all, the most important point is that the main task for us in this process was to use the licensing process. I mean that's under our responsibility. We grant the licence, so it was important for us to develop, as you correctly referred to, a licensing framework for new Fintech banks. We put a lot of emphasis on issues such as the composition of the board, the type of expertise we expect to have on the board of these companies as aspects like Cloud and outsourcing are very important elements which are relevant also in the framework of Brexit.

So first of all it is important to have a strong framework for licensing and this I think we have put in place. Then, of course, as long as these banks remain below the threshold for significance, they remain under the responsibility and the monitoring of the national authorities, but this doesn't mean that we do not have any visibility on that, or that we disregard what happens there. In particular, as I mentioned before, we started activating this sort of Fintech dialogue, so we had a first workshop inviting these type of banks and supervisors and discussing key issues in terms of the supervision of this specific business model. As I mentioned before, we have done a sort of what we call it a 'deep dive', so a specific analysis of the features and business models of these banks. We will publish the results of this analysis in a report that will come out in January.

In general, we are very keen that in the post-Brexit framework we don't have room for the establishment of entities that can do arbitrage, know the overall requirements at the European level. As long as these are banks and supervised as banks we should be covered by our framework. Of course, if you have Fintech companies that start competing on banks and do not have the bank licence, then that is the point I was mentioning before. It's a challenge for banks and we need to make sure collectively – and this is also where the EBA has a significant role –

that the framework allows us to be technology-neutral, but also to ensure a level playing field in terms of the application of regulatory and supervisory requirements.

1-030-0000

**Sirpa Pietikäinen (PPE).** – I think that it is a very wise policy not to have the green supporting factor, because environmental risks may carry substantial financial risks also. But then again it was discussed that we would need to judge much better in the long term the climate, and not only the climate but also biodiversity and other risks.

Knowing that the ECB's doing some work, which you referred to, could you elaborate very briefly and state what kind of plans you have to integrate the long-term environmental risk appraisal into your risk assessment and the guidelines of the banks, because there are a lot of these kind of initiatives as you know, so how do you ensure the coherence of estimations between different regimes and link up, for example, the EU taxonomy on one side with for example the circular economy or other platforms that are using the same indicators? The closest is of course the Investment Bank. So there's quite a plethora of work being done at the moment in the different areas.

1-031-0000

**Andrea Enria, Chair of the Supervisory Board of the European Central Bank.** – Well we are, for instance, involved very much in the network on the greening of the financial system, which is chaired by one of our supervisory board members – Frank Elderson from the Dutch Central Bank.

So we are engaged at the global level, trying to understand what are the risks, what are the opportunities and what are the factors that change, let's say, the way in which banks operate.

Now in terms of what is specific, we are also working closely with the EBA. The EBA published, I think last week, a road map on what they intend to do on climate issues and we are very much backing that strategy which entails all the work on, especially, aspects on disclosure, developing stress-testing frameworks and having supervisory guidance on how banks manage climate risk.

What we have been doing so far, and what we plan to do, looking more at our narrow ECB supervisory objective, is that we have identified a sample of significant and less significant institutions, and collected evidence on their awareness, exposures and approaches – to climate risk for instance. We used this to develop a dialogue with banks. I mentioned already the industry workshop, and the alignments between us and the national competent authorities in this area, and we are now deeply involved in developing supervisory tools to address climate risk.

For instance, one issue is how to factor in these issues to ongoing supervision, especially in the Pillar 2 process. The Pillar 2 process looks very much into awareness at board level for instance, governance. I mean is there somebody on the board of the banks that understands these issues? How are they managed? And how does this impact on the capital development of the bank and the like?

So that's very much the focus we have, but in general terms of global policies, we are interacting very much with the network on the greening of the financial system at the global level and with the EBA in terms of policies, and we are focusing on these supervisory objectives.

1-032-0000

**Chair.** – Thank you very much, Mr Enria. Thank you very much to everybody for participating in the Q&A. We can now consider concluded the public hearing.

*(The hearing closed at 10.37)*