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COMMITTEE ON ECONOMIC AND MONETARY AFFAIRS

PUBLIC HEARING WITH ANDREA ENRIA
CHAIR OF THE SUPERVISORY BOARD OF THE EUROPEAN CENTRAL BANK

BRUSSELS
THURSDAY, 30 JUNE 2022

1-002-0000

IN THE CHAIR: IRENE TINAGLI
Chair of the Committee on Economic and Monetary Affairs

(The hearing opened at 09.08)

1-003-0000
Chair. – Now we start our public hearing with the Chair of the Supervisory Board of the ECB. So I would like to welcome Andrea Enria to this public hearing.

In your introductory statement held during your last appearance in ECON on 31 March 2022, you stated that the war in Ukraine dominates our thoughts these days. And unfortunately, three months later, this terrible war is still ongoing and continues to dominate our thoughts. In March you underlined that the banking sector is well prepared for the impact of the Russia-Ukraine war, thanks to its strong capital and liquidity position. And so today we would like to hear from you updates on the impact of the war in Ukraine on the banking sector and your supervisory work.

I would also like to invite you to elaborate further on the reform agenda for banking legislation, in particular on the banking package 2021 – namely the CRR III and the CRD VI – and on the further developments of the crisis management framework and of the banking union. The co-legislators are already working on the banking package 2021, aiming at the implementation of the internationally agreed finalised Basel III standards into Union law.

In mid-June 2022, the rapporteur presented his draft report to ECON on the CRR III and CRD VI proposals. Concerning the further developments of the banking union, on 16 June the Eurogroup issued a statement on the future of banking union, which was subsequently welcomed by the latest Euro Summit. So I think it would be really interesting for us also to hear your thoughts on these as well.

So Andrea, you have the floor for an introductory statement of around 10 minutes.

1-004-0000

Andrea Enria, *Chair of the Supervisory Board of the European Central Bank***.** – Thank you very much, Madam Chair, and good morning to all of you. These are indeed exceptional times. Our recovery from the COVID-19 pandemic is crossing with the disruptions caused by the Russian invasion of Ukraine to create a very uncertain macroeconomic outlook. And of course we are focusing quite a lot on the challenges that this puts to the safety and stability of the European banking sector. And today, I will try to tackle some of these issues with you.

The gradual increase in interest rates is beneficial for banks on the whole. In the first quarter of 2022, increasing yields, together with continued lending growth, supported positive levels of net interest income. Moreover, net fees and commission income and trading results were solid, leading to positive trends in operating income and improved cost efficiency. As a result, most banks have been posting profits and even the few banks that have large direct exposures to Russia avoided making losses. We saw continued progress in resolving legacy non-performing loans, which has helped improving banks' resilience.

However, the current environment is marked by increased volatility and lower equity valuations, as markets anticipate that the profitability and asset quality of banks may be affected by adverse macroeconomic developments. The June 2022 Eurosystem staff projections for the first time include the possibility of a recession in 2023 as a result of disruptions to euro-area energy supplies.

Higher credit risks originating from some banks' exposures to Russia and to sectors hit hardest by the war, combined with weakening growth prospects, have already led to an upwards revision in loan loss provisions. Furthermore, the implications for asset quality of a disorderly exit from the low interest rate environment would offset the benefits from rate increases, especially for residential mortgage lending, highly leveraged segments and sectors particularly sensitive to energy and commodity price inflation. According to preliminary data for the first quarter of 2022, the aggregate NPL ratio continued its downward trend. So that's a positive, of course, but in the meanwhile, if you dig a bit deeper into these high-level figures, you'll notice that this has been driven mainly by those banks that have continued cleaning their balance sheets, so the few banks with high-legacy NPLs, while for several other banks there has been actually a slight increase in the NPL ratios. The share of stage 2 loans – loans with an increased credit risk – has increased slightly, both in the fourth quarter of 2021 and the first quarter of 2022, and default rates also grew somewhat for corporates and households at the beginning of this year. So again, low levels, small upticks, but still signals that we should not ignore.

In the current situation, the supervisory priorities that we laid out last year remain relevant – actually they are more relevant than ever. We focused very much on banks emerging healthy from the pandemic, and this focus was very much on credit risk controls. And I think that these focus remains highly topical already, also now. Maybe the sectors on which the supervisory focus is centred are changing somewhat. We're focusing very much on services sectors, the accommodation and food services sectors, transport, aviation sectors, which are now actually in a boom phase. And we are now focusing more on the more energy-sensitive sectors, such as manufacturing, and on the rate-sensitive sectors, such as residential real estate.

Another priority was monitoring those risks which could be linked to a bumpy exit from the low-interest-rate environment, such as the exposure to leveraged lending, high-yield segments and non-bank financial institutions – the Archegos case was a sort of flashing light for us – and in the current environment these can lead to disruptions with wider spillovers in the banking and financial sector. So we have therefore stepped up our efforts to ensure that banks manage the corresponding risks accurately. We issued a letter on leveraged lending to the banks following up on our guidance of 2017, asking them to make sure that their risk management practices are sufficiently robust. And we are following up on that letter. For non-bank financial institutions, we conducted an initial review and in spring 2022 we issued detailed supervisory expectations on prime brokerage to the relevant banks. We are also in the process of conducting a broader thematic review on counterparty credit risk and will perform on-site inspections at a later date focusing on this risk and covering prime brokerage and investment fund activities.

The fallout from the war also reinforces the need to speed up the green transition. There is global consensus that supervisors' attention should focus on climate risks, and the Basel Committee published a couple of weeks ago the 'Principles for the effective management and supervision of climate-related financial risks'. We will publish on 8 July the results of our supervisory climate stress test. This will be the first bottom-up stress test in which banks are asked to provide input. And in contrast to our ordinary bottom-up supervisory stress test, the goal here is not to assess the banks' capital adequacy, but rather to assess their climate stress test capabilities. The results will focus on the banks' preparedness to measure and manage climate risk under different scenarios and the sustainability of their income sources under a green transition.

We are also intensifying our supervisory activities to address IT risk and outsourcing practices of banks. We have had several cases recently that brought our attention to an increase in this area, and with the acceleration of banks' digital strategies and increased reliance on information technologies in the current geopolitical environment, we must make our best to ensure the banks are resilient also in the face of cyber threats. So we are ramping up our supervisory activities in these areas as well, also with on-site inspections.

In terms of sustainability of business models, which was one of our important priorities we set out for ourselves, we are putting a lot of emphasis on the digital transformation strategies of banks, in the steering capabilities of their management bodies, so the governance, which is an area in which we identified several shortcomings in the past. We are currently conducting a survey on banks' digital transformation strategies, which will be followed by benchmarking analysis and on- and off-site investigations. We are also performing a targeted review of the effectiveness and diversity of banks' management bodies, and working to develop a policy aimed at enhanced diversity within banks.

Moving now to the reform agenda, I really believe that in these difficult times we should redouble our efforts to strengthen our regulatory framework and complete the agenda.

The legislative process to incorporate the remaining set of Basel standards into European law is well under way, and your committee's draft report provides a sound basis, we think – we are very appreciative – for making swift progress in this legislative process. And implementing the proposals made in the draft report would bring the EU closer to the faithful implementation of Basel III, which would be enhancing the resilience of our banking sector. We also welcome the fact that the draft report upholds the Commission's ambitious proposals to close existing gaps in the framework, notably with respect to environmental, social and governance risks and third-country issues. And this also applies to the provisions for conducting fit and proper assessments of bank directors, where the proposal will allow us to perform our role as gatekeeper of the banking sector in an effective and proportionate manner, and more consistent, especially.

As far as the banking union is concerned, we should not take our foot off the pedal and should continue to seek improvements in the functioning of our institutional arrangements. The pillars that we have put in place so far work well. The Basel Committee's recent recognition of the banking union in the methodology for global systemically important banks shows that our international partners also recognise the massive progress achieved. Notwithstanding the inability of the Eurogroup to reach an agreement on a comprehensive roadmap, I think that the commitment to move forward with improving the European crisis management and deposit insurance framework is a very positive step in the right direction. The ECB has made a number of proposals in this regard and we look forward to contributing to your future legislative work in this area.

We also welcome the progress made by the co-legislators in the proposals to strengthen the anti-money-laundering / combating the financing of terrorism framework, and to establish an AML authority at EU level, and we very much look forward to cooperating with this authority in the near future.

Thank you very much for your attention. I look forward to your questions.

1-005-0000

Danuta Maria Hübner (PPE). – Mr Enria, it's a pleasure to see you at this ECON meeting, and I would also like to thank you very much for all the responses that you gave to my questions at our in camera meeting at 8.00 this morning. I would like to ask you now actually one big question related to the risk-sharing mechanisms relating to the banking sector.

My question is actually whether we can have an efficient, ex ante private mechanism of risk sharing without deeply integrated European financial and banking markets, because the lack of this mechanism is often used by Member States which are at the same time against the integration of the banking market as an argument that we cannot just allow for certain solutions because of the risk of this risk sharing.

So I understand that what we have is an existing risk-sharing private mechanism, but it is not really sufficient or sufficiently efficient. This, of course, finally leads to the importance, when the asymmetric shocks come, of the ex post public risk-sharing mechanism and we have this vicious circle that paralyses the changes to the financial system of European Union. So I would like to ask for your comment, actually: is this link between the risk-sharing private mechanism and the integration of the banking sector, consolidation of the banking sector, indeed that important?

Sorry, but I have a second question as well: which elements, in your view, of national legislation that still exist and are used by NCAs or governments, are the main obstacles for the consolidation of the European banking sector, or reducing the fragmentation of the European banking sector?

1-006-0000

Andrea Enria, *Chair of the Supervisory Board of the European Central Bank***. –** Thank you very much. Well, difficult questions. Let me try to start from the private risk-sharing. Let's take the US as an example. In the US you had the banking crisis in individual states of the US because of the real-estate bubble blowing up in that state. So the private risk-sharing mechanism works through the channel that, of course, by having banks that are present in several states, of course they can absorb the losses in one state with the profits they realize in other states. So having cross-border diversification is an important mechanism of risk sharing.

The other important element, which is very relevant for the CMDI package, for the crisis management package, is that when a bank in one state enters into a crisis, the FDIC, so the federal agency, steps in, does purchases on the assumption of the assets and liabilities of that bank and starts selling them out to banks also from other states. So also through this channel you have the shock in that state absorbed through a federal arrangement that distributes losses. As a result, the customers of the banks that go into difficulty in that state suffer much less because they are covered in terms of deposits and because they know, also in their lending capacity, that the banks can continue supporting them.

Now, if you look at the indicators of integration in the European banking sector, you see that we reached the peak in 2006 and then, after the great financial crisis, all the quantity and pricebased indicators declined, also for banking. There has been a slight increase in the banking sector more recently, but we are still below the peaks of 2006. So we have not managed to recreate, via the banking union, a truly effective private risk-sharing mechanism. Also, going to the second leg, the crisis management leg, I published a speech recently – if you are interested in more detail – at the Institut Montaigne, in which I show that we have the same amount of funds in Europe, combining the Single Resolution Fund with its backstop and the National Deposit Guarantee schemes, that can actually be deployed in a flexible way, potentially, to support with these types of purchase and assumption transactions and redistribution of assets and liabilities a system in a crisis, but actually part of this is national and the difficulty also in engaging with the Single Resolution Fund makes the situation such that we don't have the same flexibility and the ability to use this private risk-sharing through the funds at the same level as in the US.

So I think that the CMDI package would provide an incentive, an opportunity to move forward in this area. Consolidation and, of course, cross-border consolidation also could be a channel. At the moment we don't see banks very interested in these types of transactions. There are a number of reasons. Of course, the low interest rate environment is one of them, though this could be maybe in the near future start becoming less relevant. The inability to pool efficiently capital and liquidity within the banking union and deploy capital and liquidity more freely within a group, is another important obstacle. I must also say that the first wave of consolidation that started taking place a little bit in 2020 was driven more by cost-efficiency objectives. So adding an overlapping of the distribution network was an important condition. So, all in all, this means that the case for increasing integration via consolidation in the very near future is not very likely at the moment, I'm afraid.

1-007-0000

Aurore Lalucq (S&D). – Madame la Présidente, Monsieur Enria, merci d'être parmi nous aujourd'hui. J'ai beaucoup de questions, mais je vais essayer de me limiter.

La première porte sur la normalisation, ou du moins le resserrement doux, de la politique monétaire de la Banque centrale européenne. La remontée des taux sera plutôt profitable à certaines banques – il n'y a pas de débat là-dessus, à mon avis. Ma question concerne l'impact sur la stabilité financière, parce qu'on sait que ça peut entraîner des écarts de taux. Je voulais savoir comment vous envisagiez les conséquences, en termes de stabilité financière, de ce changement de politique monétaire et comment vous pouviez en limiter les conséquences, si elles étaient potentiellement problématiques.

La deuxième question porte sur les banques de petite et de moyenne taille. Vous aviez exprimé quelques inquiétudes à ce sujet. Je voulais savoir si ces inquiétudes étaient toujours d'actualité, ou pas, et comment vous voyez la situation aujourd'hui.

La troisième question concerne le changement climatique. Tous les banquiers centraux estiment que le risque climatique constitue un risque systémique. Mais au-delà de la question des *stress tests*, je voudrais savoir s'il ne faudrait pas adapter le prudentiel à cette nouvelle réalité, et donc adapter les exigences de fonds propres en fonction de l'exposition des banques au risque fossile.

Dernière question, nous avons eu le plaisir d'avoir M^me^ Lagarde la semaine passée ici, et je lui ai posé une question sur les crypto-actifs et le lien entre crypto-actifs et stabilité financière. J'ai l'impression que, malheureusement, ou heureusement, le crypto-crash est arrivé avant qu'il n'y ait trop de liens entre la finance traditionnelle et cette finance non régulée. Néanmoins, je voulais avoir votre vision sur les risques, en termes de stabilité financière, de cette finance non régulée, parce qu'en fait c'est de ça dont il s'agit. M^me^ Lagarde nous a dit qu'elle était en faveur d'un MiCA 2, parce qu'effectivement le MiCA 1 ne va pas assez loin. Ma question est: ne faudrait-il pas rouvrir l'ensemble des textes européens sur la réglementation bancaire et financière et tout simplement y intégrer les crypto-actifs, plutôt que de créer à chaque fois des législations spécifiques qui prennent du temps? Même si j'espère que l'on arrivera à un accord ce soir au Conseil pour avoir un MiCA et avancer sur la réglementation. Voilà, c'était finalement beaucoup de questions, mais c'est un plaisir de vous avoir avec nous et de recevoir vos lumières.

1-008-0000

Andrea Enria, *Chair of the Supervisory Board of the European Central Bank***. –** Thank you very much. Let me start with your question on the normalisation of monetary policy. Indeed, there is a distributional effect across banks, and not all banks will be affected in the same way. But in general, let's say, our assessment is that – if you look at the current baseline expectations, which is that there is a spike in inflation, let's say, in 2022 and that then this is gradually going back to target towards 2024 and normalisation of interest rates, an exit from negative interest rate policy and slowdown in growth, but still positive growth in the near future, and if I remember well the projections in June were a 2.8 % increase in GDP in 2022 and then 2.1 in 2023 and 2024 – that scenario, the interest rate normalisation, would be positive for the banks in general. This is because the positive impact on the interest margins would tend to be higher than the negative impact from the revaluation of fixed-income portfolios and from the potential deterioration of asset quality, because some customers might not be able to bear the increased cost in terms of interest payments. So the baseline scenario is, in my view, generally positive.

The risks are in two areas in my view. One area is the fact that normalisation does not occur in a smooth way, so that you have interest rate or credit-spread shocks that hit that are not expected. This risk, in my view, is particularly relevant for the highly-leveraged segment of customers and the riskier segments of the financial markets. That's why, as I mentioned in my introductory remarks, we are focusing very much on leveraged lending and on counterparty credit risk and on non-bank financial institutions, because this is where the leverage and the concentration of risk has been very much focused.

The other risk is that you might have a macro scenario much worse than we are currently expecting if we enter into a gas embargo, for instance, and you have a recession scenario which was indeed already entering the projections in June. Then, the outcome for banks could be much more difficult. On traditional credit risk, I think we have done very granular work in the last two years, with the pandemic, and I think we made a wise choice not to focus so much on the level of risk, which was very difficult to foresee because the pandemic took away a lot of visibility and there were a lot of government guarantees, so it was very difficult to estimate the level of risk, but we focused very much on the great risk controls of the banks, on the robustness of their credit-risk controls and their ability to manage their customers' deterioration early enough. This will become very useful also in the prospect of a possible recession.

The key point we are doing right now – though this is something on which I should put a caveat because we will discuss it in our Supervisory Board next week – is that we will propose to ask banks to recalculate their capital trajectories under a more adverse scenario, including also potentially a gas embargo or a recession or a recessionary scenario, and use these also for the purpose of vetting their distribution plans going ahead.

Now, I'm already finishing my time, so I need to be a bit faster on your other questions. But they're simpler. On small and medium-sized banks, I would like to clarify that we are not concerned about their stability. Their resilience right now is strong: capital position, liquidity, asset quality. We are concerned about the difficulty of managing these banks with the current institutional set-up. So at the moment we are not concerned about the resiliency of small and medium-sized banks, we are more concerned about the possibility of managing them in a smooth way and the lack of harmonisation, also in the crisis management framework.

On climate risk, at the moment we are leading at the global level in terms of the supervisory efforts and the pressure we are putting on banks to step up their risk management capabilities in this area. Should we change the prudential rules? Well, I think that what we have on ESG in the current legislative package is very good, and the proposal to focus very much on transition plans, I think is crucial. I mean, asking the banks to develop transition plans and empowering the supervisors to intervene if they don't respect their own transition plans, I think is one of the most powerful levers that we have right now. This is also something that I think will come out quite nicely from our climate stress test. So the banks need to focus on their own transition and the transition of their customers, and that will be very important.

On crypto, first of all let me say that I welcome MiCA, so the sooner you close it the better. I think we are now also facing differences in national regimes. So in some national frameworks, if you want to conduct activity on crypto-assets, you need to have a banking licence, which means that now we are starting to see the entry in the sector of crypto-asset providers, while in other Member States this is not the case. So having a sort of level playing field would be important, and we are now focusing very much on internal principles under current legislation to ensure that you have a smooth authorisation and licensing process for banks engaging in these areas.

On the impact on financial stability, as you say, this is now not so concerning because the interlinkage between the official banking sector, let's say, and crypto assets is still very limited. But I notice increased interest by the banks to maybe enter this market as they see the younger population being very interested in products dominated in crypto. I also see, in general, greater instability in these sectors. So I think that the sooner we can regulate and give clear guidance, the better.

1-009-0000

Luis Garicano (Renew). – Mr Enria, I'm very worried about the consequences of the recession scenario, and I see you're not, and so I would like you to convince me that I'm wrong.

I believe that our banking union is still not fit for purpose. Looking back at exactly 10 years ago, I do not believe that we have done what we promised ourselves that we would do. Your institution is there, that's an exception, we have a single supervisor and this is great, But we do not have deposit insurance. A couple of weeks ago, as you know, the Eurogroup abandoned efforts to get a roadmap going towards deposit insurance. So that's just gone.

We still have enormous concentration of sovereign assets in bank balance sheets in Italy, Spain, Greece – the highest level of exposures in the last seven years, relative to capital. So we haven't really used the QE, the PSB, the PPP, all the special QE kind of tools to *de-risk* the balance sheets from the sovereign exposures.

And we still don't have European safe assets. So we are still exposed to flights to safety from south to north of the Union at the click of a mouse.

So the fear that I have is that the conditions for the doom loop that we so much learnt about ten years ago are still there like they were 10 years ago. I mean I wish I could see it some other way, but do you disagree? Have we done enough to take care of those risks? And should we rest easy on those dimensions?

1-010-0000

Andrea Enria, *Chair of the Supervisory Board of the European Central Bank***.** – Thank you for your question. I'm sorry I didn't come across as concerned enough! I mean, it's my job to be concerned, I always look at theories. So I can tell you, I'm always concerned!

In terms of the point that you raise, again, it's clear the banking union will be fit for purpose when it is complete, and the banking union is not complete. And the absence of the deposit guarantee scheme is an important shortcoming that we have. Let's have no doubts about that. I mean, we still have the issue that if we have a crisis, the level of protection of EUR 1 deposit in one Member State is not the same as EUR 1 of deposit in another Member State. And this is an issue not only of stability, it's also an issue of integrity of our single currency, in my view. So for me it's frustrating to see that seven years after the Commission presented the legislative proposal on EDIS, we are still not able to find a way forward for a fully-fledged EDIS. So that's a major shortcoming and I don't want to be misinterpreted here.

The banking union is in any case not a black and white type of construction. So we have done a lot, and that which has been done helps. So that's a point that I want to stress quite a lot.

On the concentration of sovereign exposures, for instance, again, even without the regulatory frameworks, even without, as you say, specific policy use of certain programmes to reduce, there has been a significant reduction on the concentration of sovereign exposures of European banks. Now I hope that I remember the numbers correctly, but I was looking, comparing now with a similar sample of banks, the distribution of concentration of sovereign exposures back in 2012 and in the latest data we have in 2020. And if you take the third quartile of the distribution, so 75 % of distribution in terms of concentration, so domestic exposures on tier 1 capital, you drop from 225 % to 124 %. So it reduced considerably. And 125 % would seem a high figure. But if you consider that the liquidity coverage ratio requires banks to hold on average 110 % of their assets in high-quality liquid assets – so basically treasuries, that's not that bad, I would say. So even the most concentrated banks have reduced significantly their exposure towards the domestic sovereign.

Still, you're right, we miss safe assets. There were attempts to build synthetic safe assets that didn't fly and this is something that remains a drag. But still, the situation has improved.

More generally, let's say, when you look at 2011, 2012, of course the sovereign doom loop was also linked to a massive problem of asset quality of the banks in terms of NPLs, which is not the case any more right now. So that is another positive element.

We have had also, other elements like the TLTROs, so the key channel for the transmission of the doom loop from the sovereign, to the banks, to the economy is via the funding cost for the banks, to a large extent. So you have that the sovereign spreads widen, the banks' funding costs increase because they can fund only at the cost which is higher than the sovereign, and they pass this additional cost to SMEs and customers in terms of higher interest rates, which eventually determine a more negative macro-outlook.

In terms of funding costs with the TLTROs, let's say still there is a very good liquidity position of banks. Funding costs are still very low. Of course the TLTROs are ending in June next year, so we will have to see and we will probably – that will be my proposal to the Supervisory Board for the near future – start increasing the supervisory attention on funding risk, because that could be the most important area where we need to tighten the bolts to prevent the doom loop becoming as disruptive as it was in the past.

1-011-0000

Rasmus Andresen (Verts/ALE). – Thank you, Mr Enria, for attending our committee meeting. You mentioned that the results of the supervisory climate stress test will be published at the end of next week. As we understand the preliminary results, there is still a long way to go, so I would also like to ask a little bit more into this.

Also, in addition to the question of my colleague, Aurore Lalucq, and her question about regulatory changes, I would like to ask you to elaborate a bit more on the tools the SSM already has at its disposal to push banks to take climate and environmental risks more seriously, and also to take action at a higher speed.

The second question is basically on the synergies between green monetary policy and banking supervision. I think it is really important also to have a closer look on this. So how do you see the synergies between green monetary policy and the efforts of the SSM to green the euro area banking sector? How do you think the two elements can support each other, also linked to different kinds of monetary policy tools? I think we still need to go further in the context of greening the banking sector.

1-012-0000

Andrea Enria, *Chair of the Supervisory Board of the European Central Bank***. –** Thank you. Well, I need to find the right balance not to disclose the results of the stress test that will be published in a few days – although, as we said, this is not a capital adequacy exercise and it’s not really the figures of individual banks and there will be no individual results published, for that matter, and it’s more a learning exercise both for supervisors and for banks.

Maybe I would take this angle: I think that when we launched this climate stress test, there was a strong pushback coming from the industry, motivated with the lack of data. So a lot of banks said you cannot perform a climate stress test right now because we don’t have the sufficiently granular information for assessing this risk and our customers are not giving us sufficiently granular information, so it’s too late and you should postpone. Our response then was, first of all, if you don’t have the data then you should try to get it. I mean, if you have to grant a loan to a customer and you are unable to value the collateral, I think you would bother about having the data on the value of the collateral. So the same should apply in this case.

Second, there are a number of proxies that can be used to assess climate risk. We invited the banks to use those proxies. So, on the positive side, banks made an effort, relying on proxies, and we showed that we can measure and manage more proactively climate risk by relying on different data sources. But still, I think one of the main issues that we need to put upfront in the discussion with the banks is that they need to fill the data gap. I mean, there is a risk which is becoming more and more relevant, and the banks cannot accept that they do not have reliable data to manage these risks. So they need to push their customers, collect the information and step up their capabilities to measure and manage this risk.

On the regulatory changes and the tools that we already have, again the way in which we have framed the discussion on climate risk is, I think, very effective, to be honest. It is by setting up clear supervisory expectations that are increasingly taking the front stage in our supervisory review and evaluation process and these are clear expectations in all areas. So having clear governance of the risk, attribution of responsibilities on the board, having a clear capability of measuring and managing a stress test, for instance, allocating responsibility on the management board, but also developing a stress testing framework, which is what we were testing in this exercise, having proper disclosure of the exposures, most importantly – and this, as I mentioned before, is a key aspect to developing transition plans and which would, of course, also require banks to engage with their customers and ensure a proper transition also on their customers side. Once you accept the expectations that the banks are not in line, you have several tools as a supervisor, so you can really ask, and we do so, with the operational letters, to change their practices if they’re considered substandard and this has an impact on the scores that we attribute to the banks in the different areas: governance, business model, capital adequacy, liquidity and this means that eventually this will be reflected in the overall score of the bank and eventually also in the capital surcharge and all the Pillar II capital charges that we will use with banks.

There were discussions in the past, and there are still may be, on green supporting factors and brown penalising factors. I'm a little bit less convinced that these black and white type of tools could be as effective in guiding the transition of banks as a more risk-focused type of tools than the one we are trying to deploy. So strengthening our hand in this area probably is more promising. But again, we of course stand ready to assist you if you have proposals and to provide you with any input.

On the synergy between green monetary policy and banking supervision, the ECB is making a big effort, as you know, for the separation principle. I'm not involved at all on the monetary policy side and I'm not in the loop on the initiatives besides what is being communicated and you are as aware as I am. But what is important is that our supervisory policy is inserted in this overall ECB strategy and they are all consistent and working in sync with one another. That is very important to us. And Frank Elderson, who is my Vice-Chair and sits on our board and sits also on the Executive Board and the Governing Council of the ECB, is indeed keeping the connections very strong.

1-013-0000

Alfred Sant (S&D). – The ECB is predicting, or seems to be predicting, though with caution, that high inflation will peak over the next year and a half and then it's likely to go down to an acceptable 2 %. Many, however, are sceptical about this, and there is a trend of thought that inflation at a higher to much higher rate than what we are used to will persist for much longer, especially if the Ukraine war does not stop shortly, and this independently of energy and other embargoes.

You recently advised that incremental steps towards the banking union are likely the best strategy by which to get the banking union, which you call the 'holy grail', off the ground. Getting the resolution mechanism to eventually apply for banks of lower significance was one suggestion you made. Inflation is going to have an upside and a downside for banks. If it is sustained beyond what is being predicted, it will also affect progress towards a banking union.

Given conditions of persisting inflation, what factors will need to be given priority in the management of the banking union as constituted now? Will incremental steps towards it remain a viable approach, in your view?

1-014-0000

Andrea Enria, *Chair of the Supervisory Board of the European Central Bank***. –** I think I will not surprise you in saying that incremental steps are a second best. I mean, of course, having the full step to the completion of the banking union – I will not surprise you here! – would be my first best, and the banking union could become very important to deal with the challenges that we could face in the coming years.

Let me start with your point on inflation. Again, the baseline projection, as you said, is that after a spike, inflation will go back towards target in the next two years. There are downside scenarios, which the ECB itself is considering, in which inflation remains higher than target for longer, and this might require, indeed, steeper adjustments in interest rates. So it is essential, from the supervisory perspective, that we focus on the ability of banks to manage interest rate risk – interest rate risk in the banking books, but also, as I mentioned before, potential channels for transmission that come in particular from the financial markets and non-bank financial institutions. So that is where we should be in terms of supervisory efforts.

On the incremental steps, my main point is that we should avoid conveying any impression that, as the banking union is not complete, it is dysfunctional. I think the banking union is functioning. The first two legs of the banking union are functioning – banking supervision and banking resolution are functioning. The recent sentence of the European Court of Justice on the Banco Popular case has also confirmed this. So the point is: what are, acknowledging the lack of political will to make bolder steps, the areas in which we need incremental steps right now? I think the two areas in which we need improvements as a matter of urgency are in the crisis management of middle-sized banks, basically, because that is the area in which we don’t have a harmonised framework for exit from the market, and it is important that we do.

The second one would be to create a more integrated market, a more domestic market for our banks in the banking union, and this is still meeting with important constraints which unfortunately don’t seem likely to be removed any time soon. So that is a little frustrating, but at least with the CMDI package I hope that we will progress on the first task.

1-015-0000

Georgios Kyrtsos (Renew). – I would like to ask a question concerning the Greek banking system, because the financial and energy situation in Greece is rather complicated. Energy prices are going up, interest rates are going up, we have some form of real estate bubble and are worried too about the rise of interest rates. So what is your general view, and what are some points you would like to make so that we should strengthen our position as far as the Greek banking system is concerned?

1-016-0000

Andrea Enria, *Chair of the Supervisory Board of the European Central Bank***.** – I have to start by acknowledging the massive progress that has been made by the Greek banks in recent years. Even during the pandemic, the Greek banks continued the process of cleaning their banks’ balance sheets, disposing, securitising important amounts of non-performing loans. They are approaching the European averages in that area, so that this cleaning process has been very important. If we were to enter into a new recession and this cleaning-up process had not been completed, the risks for the Greek banks and for the Greek economy would be much higher. So this is important progress that we have to highlight.

Of course, this progress came at a cost, at a capital cost. The banks had to absorb losses and take a capital hit with the disposal of non-performing loans, and this means that their capital position is now a bit thinner. Of course, the macroeconomic outlook is worsening. So that’s the main risk. But again, let me state strongly that if that progress had not been made, we would be in a much worse position right now. That is in any case an element of resilience that we should always keep in mind.

1-017-0000

Chair. – Thank you very much. Now we can conclude our public hearing, I thank Andrea Enria again for being with us today, and all the Members for participating.

(The hearing closed at 10.03)