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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, 01 JULY 2021

1-002-0000

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

(The meeting opened at 10.07)

1-003-0000
Chair. – I would like to welcome the Chair of the Supervisory Board of the ECB to this public hearing. During your last appearance in ECON on 23 March 2021, you presented the ECB annual report on supervisory activities 2020. In that occasion, you identified the management of credit risk as the key priority for ECB banking supervision in order to prevent the pile-up of bad loans in the context of the COVID-19 crisis. In the meantime, the co-legislators could reach a political agreement on the secondary market part of the NPL Directive, therefore providing further instruments to ensure sound bank balance sheets by ensuring at the same time high level of borrowers' protection. Today, we would like to discuss with you farther the supervisory focus on credit risk in the context of the COVID-19 crisis, but also your work in other areas of supervision, including on fit and proper assessment and on climate-related risks and the completion of the banking union.

1-004-0000
Andrea Enria, *Chair of the Supervisory Board of the European Central Bank***. –** Good morning, honourable Members of the ECON Committee. I am delighted to be with you again today.

I will start with our most pressing supervisory focus, which is to ensure that banks can effectively manage the fallout from the crisis. For this reason, credit risk continues to be a priority, as it has been since the start of the pandemic in early 2020. The latest economic data are encouraging and consistent with our expectation that economic activity will accelerate in the second half of the year. And banks have proven to be resilient so far. They have robust capital positions and their profitability recovered in the second half of 2020 and the first quarter of 2021. However, there is still some uncertainty about how the pandemic will evolve. Moreover, the recovery, and thus the economic impact of the pandemic, may be uneven across sectors and countries. This could have consequences for bank balance sheets.

Therefore, our main goal as supervisor is still to ensure that banks are able to identify and manage any credit risks on the horizon at an early stage. We want banks to remain vigilant and tackle credit risk proactively.

As a follow-up to the letter we sent to banks last December on the identification and measurement of credit risk, we assessed banks' compliance with our supervisory expectations.

While most banks are fully or broadly in line with our expectations, certain banks, including some that now have fairly low levels of credit risk, need to address significant gaps in their risk control frameworks, which are the most important safeguard against a significant deterioration in asset quality in the future. The main areas of attention are the classification of loans, especially when there is a significant increase in credit risk – Stage 2 under IFRS 9, the proper flagging of forbearance measures and the timely and adequate assessment of borrowers' unlikeliness to pay. The joint supervisory teams have shared the findings with the banks and asked for remediation plans. The findings have also been fully integrated into this year's supervisory review and evaluation process (SREP).

We note that some banks started to reduce provisions in the first quarter of this year, something which in past cycles happened close to the peak in bankruptcies, a point that we surely have not reached yet. We have also seen some banks taking on more risks by increasing their leveraged lending activities. While the leveraged loan market came to a standstill in March 2020, it quickly recovered to reach record levels. In fact, investors' current search for yield has pushed spreads below the levels seen before the pandemic. The very low credit quality leaves the market vulnerable to further shocks, including sudden asset repricing. These areas of potential concern are now being addressed, and we are considering possible supervisory measures to ensure that banks take a prudent approach in these matters as well.

At the same time, we need to be prepared to return to normality, as our relief measures were designed to be temporary to mitigate the immediate impact of the pandemic. This also applies to the recommendation on dividends. We have been pleased to see that banks broadly adhered to the recommendation.

On the basis of the latest macroeconomic projections and our supervisory work on capital strength, we find banks' capital projections to be more reliable, allowing us to assess their payment plans on an individual basis. Therefore, in the absence of materially adverse developments, we plan to repeal our recommendation as of the end of the third quarter of 2021 and return to reviewing dividends and share buybacks as part of our normal supervisory process, based on a careful forward-looking assessment of each bank's individual capital plans. We expect distribution plans to remain prudent and commensurate with banks' internal capital generation capacity and with the potential impact of a deterioration in the quality of exposures, also under adverse scenarios.

We allowed banks to make use of their capital and liquidity buffers to mitigate the impact of the pandemic. As already communicated last summer, we will allow banks to operate below Pillar 2 Guidance and the combined buffer requirement until at least the end of 2022. We are monitoring developments in banks' asset quality very closely. If we identify a surge in distressed loans on banks' balance sheets as a consequence of public support measures being phased out, we are ready to extend our timeline. The process of rebuilding bank buffers should not hamper efforts by the banking sector to respond quickly to the expected materialisation of credit risk from the pandemic.

While we are paying close attention to credit risk, we are also making progress on other topics. I would like to highlight three areas where we are continuing to harmonise the supervisory approach at the European level.

First, we have continued our work to harmonise the way in which options and discretions available in Union law are exercised by European supervisors. We published a first set of policies in 2016 and 2017. We now cover an additional set of options and discretions introduced primarily by the 'CRR II CRD V package', and launched another public consultation on 29 June.

Second, in mid-June we launched a public consultation on our draft revised ‘guide to fit and proper assessments’, and the new ‘fit and proper questionnaire’. The revised guide aims to increase the consistency of fit and proper assessments across the banking union, recommends early engagement with supervisors – also in cases where national legislation envisages ex post assessments – and seeks to ensure more diversity within bank boards. At the same time, our assessments are still subject to national laws, and a true single rulebook with fully harmonised provisions is key to levelling the playing field and preventing loopholes in this area of supervision, and I hope you will take the opportunity of the next legislative cycle to address this.

Third, we are currently benchmarking banks’ self-assessments against our supervisory expectations on climate-related and environmental risks. We have already started to work on incorporating these risks into our SREP methodology. Although this year’s findings will not be reflected in bank-specific capital requirements, we may need to impose qualitative and sometimes also quantitative requirements in some specific cases. A full supervisory review, as well as a specific stress test focusing on climate risk, will then follow in 2022. Our most recent assessment shows that banks have started adapting their practices but still have a long way to go to be fully aligned with our supervisory expectations, and there is considerable heterogeneity across banks. All banks need to step up their efforts now, as climate risk is already here and will soon be an integral part of our supervisory framework.

While we are continuing to improve and further harmonise European banking supervision, the completion of the banking union via a clear path towards the introduction of a fully-fledged European deposit insurance scheme remains vital. There is agreement that further progress needs to be made to strengthen the crisis management framework. We have already contributed to the Commission’s recent public consultation on the review of the crisis management and deposit insurance framework, and stand ready to participate actively in this important review.

Let me stress that completing the banking union is not an end in itself, but a necessary condition for reaping the maximum benefits of a fully integrated banking market. This is essential to ensure that European banks can play their role in an interconnected and digital European economy and can compete at the same level as their global peers. This is all the more important in the European context, as around two-thirds of credit intermediation from the financial sector to non-financial corporates is performed by banks in the euro area. This is a much higher share than in the United States, where capital markets play a much more important role, as you know. The remaining segmentation of our banking markets, which is to a large extent driven by legislative constraints reflecting the national nature of deposit insurance schemes, is an important inefficiency that ends up being paid for by bank customers and makes our economy less dynamic.

I would also like to point out that the new legislative cycle could provide an opportunity to review the treatment of European branches of third-country banks. These branches are currently subject to national supervision based on national requirements. Even if third-country groups must set up an intermediate parent undertaking in the EU, individual branches belonging to a third-country group will only be subject to national supervision. Specific booking models allow third-country groups to transfer assets and risks within the group, which means that it may be extremely difficult for us to gain a comprehensive perspective on the overall risks and risk-management practices at group level. While third-country banking groups should be free to choose to enter specific markets within the EU via branches or subsidiaries, greater harmonisation of the regulatory and supervisory framework is warranted, also to ensure a firm-wide view of risks and risk management and a level playing field within the banking union.

While we now seem to be on a path to normality, the ECB will maintain a strong focus on mitigating credit risk. At the same time, the ECB is making progress in other risk areas, as I mentioned.

We hope that tangible progress on strengthening and completing the banking union can be made in the very near future, to provide the same level of protection to depositors across the European Union, to all European citizens, and to foster a genuine integration of markets within the banking union, to benefit European households, small and medium enterprises, and corporates.

Thank you very much for your attention. I stand ready to answer your questions.

1-005-0000

Chair. – Thank you very much. So now we start our Q&A session. Let me remind you that you have two minutes for the questions and three minutes for the answer.

1-006-0000

Danuta Maria Hübner (PPE). – Good morning again Andrea. I would like to ask you three brief questions.

One is whether you have started to look already now at the consequences, or what a digital euro would mean for banks, and just anything you can share with us at this stage.

My second question is also do you look at the capacities or do you assess the capabilities of the banks you supervise when it comes to their understanding of the consequences for them of further withdrawal of the supportive measures that would go beyond the banks? So withdrawal for households, withdrawal of the measures for the corporate sector which are clients of the banks. Do you also have this assessment or this view on where the banks are with the capacity to assess also the second wave of withdrawal of the supportive measures?

And the last thing, on the digital transformation you have been always telling us that there are banks who invest a lot and who are in the vanguard with this transformation and then there are banks for whom it is also an expensive investment and they are not investing sufficiently quickly to become more competitive. We have heard from experts who prepared studies for us that there are indeed smaller banks that are unable to invest and they are even feeling that there is pressure on them to merge with larger banks. So do you see this category of banks also as part of your consolidation process? And do you prepare also, or do you think of preparing, kind of macro-prudential policy guidelines that would help the banks to prepare, to address the risk that might come from the reliance on the IT technology?

1-007-0000

Andrea Enria, *Chair of the Supervisory Board of the European Central Bank***. –** Thank you very much for your questions. Well, on your first point on the digital euro and the potential effects on the banks, this is something which is indeed very much at the attention of the team, which here at the ECB is studying the issue. Of course, the last thing we would like to have is a digital euro becoming, especially in a situation of stress, a sort of safe harbour and possibly driving a deposit flight from commercial banks and deepening, potentially the stress at banks.

So in any case, if the ECB eventually will decide to make steps in the direction of the introduction of a central bank digital currency, then we will have to study measures such as limits or penalty rates for exceeding certain thresholds that would prevent, let’s say, these sort of destabilising dynamics.

And definitely the digital euro should not be seen as a direct competitor to commercial bank deposits. I mean, the ECB has already made clear that it doesn’t intend to provide front-end services or engage with clients directly, and it will be the commercial banking sector that will take all that aspect.

But you're right, these are topics that will need to be carefully assessed if we decide to move forward to design the specific features of a digital euro.

The second question you put is very relevant to us and actually at the very core of our attention. We have been identifying a number of potentially weak practices at some banks, which kept relying on backward-looking indicators of credit risk, so looking at payments or indicators or ratings or things that do not yet reflect the potential developments when the support measures are withdrawn – not only direct support measures going through the banks' balance sheets, like guarantees to loans, but also the direct measures to the customers, the borrowers, so the furlough schemes, the lay-off bans, or the direct measures – grants to SMEs or other corporates.

So it's clear that we want the banks to look through these measures and make sure that they have a proper assessment of the sustainability of the counterparts in the longer term. And if they think that this will not be the case, they need to engage early with the customers to provide solutions to ensure restructuring, rescheduling of the loans to improve the viability of their customers. So this is very much the focus of our attention.
We've done a deep dive on the accommodation and food services sector. We are now doing a second deep dive on the commercial real estate sector, and we are generally pushing banks to improve their capacity in this area of looking through the public support measures and ensuring a proper assessment of credit risk.

On the digital transformation it is true that if you really want to take up the challenge, investments are necessary on digitalisation. And these investments could be indeed a steep challenge for smaller banks. But we have seen also initiatives by groups or networks of banks, that they've been able to overcome these obstacles. So it is not necessarily a push for consolidation. But indeed it could be what I would identify as welcome wake-up calls for some banks that have very low profitability, not a sustainable business model in the longer term, are unable to invest in new technologies. I mean, these banks actually probably need to find an industrial partner and to step up their game. So in this respect, yes, consolidation could also be a solution to be considered.

1-008-0000

Jonás Fernández (S&D). – Welcome, Mr Enria. I will ask my questions in Spanish. I have three questions.

State support measures, essentially to businesses and consumers, have so far, in a way, been obscuring an increase in non-performing loans (NPLs). The Commission presented an action plan at the end of last year which, in my view, was very conservative, and for now we are still without a European response that would enable us to tackle this increase in NPLs in the coming months. I would like to ask you – because you were also very involved in this debate – how you see such a potential increase in NPLs, how far this will go, how it could affect the stability of the banking sector and whether we should not continue considering more ambitious options?

My second question is on the implementation of the Basel Accord. As you know, the Commission is working on the legislative proposal, which we hope to see in the coming weeks or months, and I would like to ask for your views on the debate on how to implement the 'output floor' in Europe. I understand the view of the European Banking Authority, which does not see the proposal for a 'parallel stack' as complying with the Basel recommendations, and would like to know if I share that view. I would also like to know what you think about the current debate on whether capital requirements, the output floor, should be calculated on a consolidated basis and on an individual basis for each of the banks, as is done with the other capital requirements, or only at a consolidated level, as is also being discussed. I would like to know your opinion, because this also involves other considerations on the depth of the Banking Union, which one should discuss.

Finally, we also expect there to be a review of bank crisis management by the end of the year. I would like to ask you whether you agree with the need to improve access to European funding to prioritise strategies for the sale of banks and, as I say, to facilitate such access to the various funds that would help minimise the destruction of value during resolution and liquidation processes?

1-009-0000

Andrea Enria, *Chair of the Supervisory Board of the European Central Bank***. –** Thank you very much for the very relevant questions. I hope I will manage in three minutes. You're right, NPLs are not increasing for the time being and our expectation now is that the figures that I floated one year ago were reflecting a severe scenario which is now considered much less likely, so we don't expect the likelihood and the severity of the materialisation of NPLs is probably at lower levels than we previously expected. But this doesn't mean that there couldn't be a significant increase in the level of NPLs and I think that we need in any case to stand ready.

The best way of course as I said is to take preventive measures so as to avoid the bailout of NPLs in the first place, so to be more proactive in terms of engagement with the customers in terms of proper classification and management of distressed customers. So that's the most important point.

We do have policies which I think are proving effective in terms of managing and containing the development in NPLs. I'm talking about calendar provisioning and the like, I think that these will be very important cornerstones of the policies going forward. But eventually I've always argued that if the numbers go high you also need instruments to clean up the balance sheets maybe faster than would otherwise be the case to put the banking sector in the position to support the recovery.

The tools, we know them, they're already in place in several countries. There are asset management companies, securitisation, which is sometimes assisted by government guarantees, so the tools are there. I've always argued that the more we have a European framework to support these tools the better, and I stand behind my previous statements. Even if you go through national solutions, which seems to be the case, for instance in the Commission action plan both on securitisation and on asset management companies, it would be important to have some European ingredient of the solutions that makes sure that banks can benefit from the same type of support to address the issue irrespective of the flag which is on their headquarters.

On the point of Basel III and the output floor, the output floor has been the outcome of a very lengthy negotiation at the global level, which has seen especially the US but also several emerging markets asking for a very high floor. We have eventually landed in a zone which is, in our view, manageable also for European banks. The fact that the output floor is more impactful for European banks, we have always to remind ourselves it is because the previous output floor that was already in the Basel framework has not been implemented properly in European legislation and has enabled an implementation which was not Basel-compliant. This is also, let's remind ourselves, a requirement that kicks particularly hard some banks which have been very aggressive in the use of internal models to lower their own capital requirements, so that's why my recommendation in line with what the EBA suggests is to have a fully compliant implementation of the Basel approach to avoid the so-called parallel stack. The parallel stack is also very complex because it would be based on two different notions of risk-weighted assets that would be applied to different requirements. It would increase the complexity of a framework which I can tell you is already complex enough. Instead I would be more in favour of application of this floor at the consolidated level rather than the individual level, because the models actually are developed on a group-wide basis generally, and rolled out towards the subsidiaries, so I think that could be an element in which we could consider the points raised by the industry.

On the last point on the crisis management and deposit insurance package that the Commission is discussing, indeed I think that it would be important to have harmonisation of the way in which deposit guarantee schemes can be used in supporting the smooth exit from the market on the least cost basis. Of course this might need also to reconsider the super priority which is now attributed to deposit guarantee schemes. But that would be an important element, and of course this could be and should be actually in my view a building block of the role that tomorrow the European deposit insurance scheme (EDIS) could play for all the banks across the European Union, enabling, as in the US, for the FDIC, a smooth exit from the market which doesn't create any damage, any concern for banks' customers, both depositors and borrowers.

1-010-0000

Billy Kelleher (Renew). – Two questions: firstly, in view of the fact that the ECB may start unwinding support at some stage in the near future, unwinding of the general escape clause by the European Commission and national governments unwinding their pandemic support at Member State level, and then you say Mr Enria that two out of five banks were still falling short, for example, by failing to recognise early on loans that were unlikely to be repaid – in other words, bad loans. So two out of five banks across the European Union are not sufficiently recognising the potential for bad loans.

You then go on to state in the same article the ECB's intention to lift, in September, a recommendation that caps banks' dividends and buybacks. So I suppose the question I'm asking is, is there an incentive across some banks in the European Union not to delve too deeply into their balance sheets and their loan books to assess potential bad loans due to the fact that you are lifting the cap in September on dividend payments and buybacks?

And then question number two: with regard to the ECB's November 2020 Financial Stability Review, it found that euro-area banks have increased their exposure to domestic sovereign debt by almost 19%. In view of the great risk of potential bad loans across the European Union due to the pandemic and the fallout from same, is there a concern, particularly that publicly owned banks are investing heavily in domestic bonds, and that sovereign-doom loop risk is being increased dramatically? So if I could have your views on that as well.

1-011-0000

Andrea Enria, *Chair of the Supervisory Board of the European Central Bank***.** – Indeed the figure you mentioned – two out of five or 40% of the banks – was made and it is a finding of our analysis of the position of banks vis-à-vis our expectations. But let me clarify what this means. This doesn't mean that these are banks with a very high level of credit risk. Some of these banks actually have very low levels of risk. We distinguish in our supervisory assessment the risk levels and the risk controls. Sometimes banks that have a low level of risk might have weak risk controls which are not in line with our expectations. That's why we are taking action, because risk controls are definitely what make the safeguards to avoid the surge in NPLs tomorrow and that's why in this supervisory risk cycle we are paying particular attention to risk control. So the two out of five doesn't mean that we have 40% of our banks which are blowing up and will have their balance sheets full of NPLs tomorrow. It's a more subtle point that maybe I didn't make clear enough in my interview before.

The link with dividends is interesting. The recommendation on dividends was basically grounded on the radical uncertainty we were facing last year, where, even with banks that have very comfortable capital positions, we didn't know whether the peculiar risks raised by this pandemic and some concentration or exposure to some sectors heavily impacted by the crisis could have jeopardised the capital position of those banks as well. So this radical uncertainty supported a one-size-fits-all type of requirement. Now that the fog is lifting, we are more able to assess individual plans so we can lift the overall recommendation. This doesn't mean that we will not review, on a bank-by-bank basis, the dividend plans and the payment plans and intervene if we think these are not prudent enough.

On the point on sovereign debt, there has indeed been an increase in sovereign exposures recently. It's also true that the level of risk is more contained because the spreads are very limited, but I would like to remind you that this is not something which is totally out of our radar screen. Actually we cover sovereign debt risk within the stress test, for which the EBA and we ourselves will publish results soon. This is also something that we cover within our process, especially when there is a very large concentration of exposure. So the supervisory focus is also on this issue.

1-012-0000

Stasys Jakeliūnas (Verts/ALE). – Good morning Mr Enria. Let me focus my questions – actually my concerns – on the banks' exposure to crypto-assets. Do you follow that or compile statistics of this specific category of commercial banks under your supervision, but also under your licensing on direct and indirect exposure, be it lending to customers, but also the exposure to the reputational risk?

So here in Parliament we're discussing now the *MiCA* regulation proposal, which we'll see where it takes, but regardless of that, there are for us requirements to account for intangible assets and that's what probably that is. The Basel Committee proposals or considerations to put, to differentiate and also put the risk weights over 1 000% on certain crypto assets at least. So the global institutions are a bit overcautious and may be sceptical of these assets. And now that the ECB issued some opinions or some positions, which is on the cautious side.

And to be more specific, let me move to a specific example. As recent as yesterday afternoon, I received solicitations from one of the banks of where I'm not an active client, where it promotes seven crypto-assets and proposes to invest in them, and this specific institution was licenced a couple of years ago also by the ECB.

So is this activity promoting and incentivising investments, or speculation I would rather say, within the limits of the ECB-issued banking licence? So what views do you have, statistics on the exposure, direct and indirect, and is the banking license compiling activities as I mentioned, which is more similar to the advertising platform rather than banking institution?

1-013-0000

Andrea Enria, *Chair of the Supervisory Board of the European Central Bank***.** – Thank you for your question. Well, indeed, the crypto-assets, stablecoins, are all considered from our side as a form of speculative investment and volatile investment. They are not a form of payment, so we treat them as investments in risky, volatile assets.
To date, I don't have specific data to give you, but let's say the assessment which has been done for significant institutions under our supervision is that the overall exposure to crypto-assets is very limited. But we monitor indeed the risk that banks take in this respect.

I remember when I was at the EBA, the EBA even advised, issued a sort of opinion in which it recommended that banks did not engage at all with these type of assets, either in terms of investment or in terms of the distribution of these products. This is not one of the most heeded, let's say, recommendations that I've seen, but I remain convinced that there should be some sort of separation between the banking sector and this area of activity.

Indeed the Basel Committee has recently provided important guidance. I personally strongly support the need to have a prudential treatment that fully acknowledges the risky features of these assets.

In terms of banks contacting customers and playing a role in the distribution of these products, again this happens for every other product that could be also high risk. It is not something that we definitely scrutinise. It's more something just to do with the role of banks in their, let's say, engagement with customers, so it's more under the market regulations. But indeed, it's important banks try to be prudent also in the way in which they distribute risky products to customers.

We've seen in the past that potentially they might be considered liable if they've not correctly alerted customers to all of the risks that are intrinsic to certain products. And eventually this could end up in lawsuits, sanctions which eventually might have feedback also on the prudential position of the banks. So we generally encourage banks to be very cautious and very attentive to clearly portray the risks of these investments if they ever engage in the distribution of these products to their customers.

1-014-0000

Francesca Donato (ID). – Chair, Mr Enria, the EBA's 2020 report on the convergence of national banking supervision practices in the single market has shown that supervision priorities have been revised owing to the impact of the pandemic crisis. Attention has focussed on the most critical sectors, including specific ICT risk areas relating to information technology and operational resilience.

I would like to know whether, among these areas in the ongoing process, an assessment has been made of the technological and IT risk associated with a possible shortfall in electricity supply because, as we know, the increase in electricity consumption, particularly in certain periods of the year, namely the warmer seasons, and the growing electricity dependency of our economies, is expected to increase due to action to combat climate change and to the energy transition.

This poses a problem in terms of security of electricity supply. Is the potential damage to IT systems owing to brownouts and their operational capacity in the event of prolonged blackouts being sufficiently taken into account?

My second question is what is your opinion on the risks arising from the increase in the cost of raw materials and semi-finished products as a result of the precautionary supply measures being taken by big countries outside Europe and the disruption of production chains as a result of the crisis, and what impact do you see there being on the economic sustainability of European companies and, consequently, on financial stability?

1-015-0000

Andrea Enria, *Chair of the Supervisory Board of the European Central Bank***.** – It is true that the pandemic drove a significant shift in the priorities of the ECB supervision. We focus very much on credit risk, as I mentioned, on business model sustainability – but as you correctly highlight, also IT and cyber risk were very much a top focus of our supervisors. We have a tool that we use, which is an incident-reporting framework that provides us with details of cyberattacks, for instance, against banks or major failings in their infrastructures. And we use this to sharpen our supervisory tools and also regularly publish the results of our findings so that these could disseminate that knowledge and enable banks also to upgrade their systems and strengthen their security.

We are also doing regular campaigns. The inspections have been impaired by the pandemic for us as well, because our inspectors cannot travel and go on site anymore. So that has been a bit in the fridge for the moment. But this remains and we are eager to resume our onsite activity also to follow more closely these aspects and looking ahead – it is on your table actually, the DORA (Digital Operational Resilience Act) proposed by the European Commission will probably be a very important piece of legislation that would enable us to go even deeper in this area and maybe also crystallising legislation, some good practices that we have developed so far.

On commodities, I do not see direct impact from the commodities market, but of course, sometimes banks are heavily involved in the financing of transactions, also in commodity products and commodity derivatives. So, of course, as with any other type of product there's, heavy, let's say volatility, in these type of products that could affect also bank risks and this is an area which is regularly monitored under our framework.

1-016-0000

Michiel Hoogeveen (ECR). – Thank you, Mr Enria, for answering all these questions.

I would like to follow up on one of the questions you answered before concerning the non-performing loans and the fact that banks have set aside record levels of provisions to deal with the wave of non-performing loans expected to flow from the COVID-19 pandemic. However, as was analysed by the European Central Bank back in March 2021, it seems to suggest that further loss recognition is required. If this ECB analysis is correct, banks seem to underestimate the level of potential losses they face in the future as governments phase out the COVID-19 support measures, especially in countries with high impaired loans such as Greece, Ireland, Italy and Portugal. You stated that these non-performing loans are not as severe as you stated back in October 2020, where the severity of the non-performing loans would be as high as at the level of the 2008 financial crisis. So could you please elaborate on why you think the severity is not as high as you thought it was back then.

My final question is on the long-standing negative interest rate policy of the ECB. It hurts savers and pensioners but it keeps the yields on government bonds of the Member States low. However, many economists expect a rise in inflation due to factors of various kinds. So do you agree with economists that the ECB should, or could, hike the interest rate next year, as proposed by Federal Reserve Governor Christopher Waller on Tuesday? I am interested in your opinion on that.

1-017-0000

Andrea Enria, *Chair of the Supervisory Board of the European Central Bank***. –** Thank you for your question. Well, indeed the level of provisions in 2020 spiked significantly. We have the cost of risk, which is the ratio between provisions and loans that basically doubled in the course of 2020.

We are not saying that the overall level of provisions is inaccurate. We have seen that several banks might not have been doing a proper job in terms of identifying the specific classification of loans and recognising a significant increase in credit risk so, at loan-by-loan level, they might not have been accurate enough, but many of them have used the so-called overlay, so that they put on top of the provisions determined on a loan-by-loan basis also an additional layer of discretional provision. So the overall level of provisions might not be inadequate, but there is an issue in terms of measuring the credit risk on a customer-by-customer basis, which is of course essential for us in terms of risk controls, in order to have early signals of distress and take proper actions where things start to deteriorate.

My main point is not that the level of provisions is inadequate but is that, if you don't do the analysis on a borrower-by-borrower basis, you might be surprised down the road and find that the NPLs are higher than you originally expected. So that's where we are putting a lot of emphasis right now.

Why is the severity reduced with respect to our estimates last year? If you look at last year, the baseline scenario that the ECB projected, and that we used for the vulnerability analysis that we conducted in the summer of 2020, was worse than it is right now so basically we expected not to reach the pre-crisis level at the end of 2022, while now our projection is that the rebound will be so steep that the pre-crisis level will already be reached in early 2022.

Second, the severe scenario that we used to estimate the potential downfall of NPLs was much more severe and distant from the baseline on the negative side than it is right now. So the distance between the baseline and the severe scenario has narrowed. These two elements make our expectations now for a much lower downfall of NPLs. It is still very difficult to make a precise quantification so I will refrain from doing that, but what is important for me is that banks are alert to that.

On the interest rate policy, let me say that the evidence is that the interest rate policy applied by the ECB has of course, to be honest, also had an impact on banks in terms of the compression of the interest margins, but it has also had a positive effect on banks via an increase in bank lending, in the extension of loans to households, small businesses and corporates, which is actually supporting the steep recovery that we are discussing right now. Also the criteria which have been adopted by the ECB have reduced the impact on the banking sector, especially the tiered system in terms of remuneration of reserves and the TLTRO facilities have been strongly supported. So, to some extent, there has also been an important impact that needs to be mentioned in terms of supporting lending and supporting the recovery, which is also benefiting the banking sector.

1-018-0000

Georgios Kyrtsos (PPE). – I have two questions for Mr Enria, whom I would like to thank for his presentation and his overall contribution. First of all, we have a record increase in house prices in the United States and in certain European countries. How does this affect the functioning of the banking sector, housing loans, financial stability? Do you think this trend is going to continue and what actions to control the overall situation do you have in mind?

And the second question has to do with the fact that the ECB highlighted in its supervision newsletter of February 2021 that the COVID-19 pandemic exposed weaknesses in banks' recovery plans. You have a critical assessment and you concluded that a considerable number of banks rely on a very limited number of recovery options. How are you going to tackle this situation in order to make the system more safe?

1-019-0000

Andrea Enria, *Chair of the Supervisory Board of the European Central Bank***. –** Thank you Mr Kyrtsos for your question. On the point of house prices, indeed there is now evidence of different developments actually. So there are some Member States in which indeed the property market is becoming more exuberant and prices are going up, others in which instead do not experience these developments.

This could be also an effect of the very accommodative monetary policy, and in our European framework, it is generally the macro-prudential tools that serve in this respect to limit the exuberance in some property markets when these are up, as indeed some authorities are taking or are considering measures in order to tackle this issue.

I would also mention, as I already hinted before, the commercial real estate market also is an area of concern also because with the significant move to remote working that we have seen at many firms and organisations, more generally, it might be that the commercial real estate market could be structurally affected by the pandemic. So this is an area also on which we are focusing our supervisory attention and doing a specific analysis.

As to the weaknesses of bank recovery plans. Indeed, as you mentioned, the fact that banks were relying on a few, sometimes even one only or two only, recovery options is an area of concern that we highlighted. In some cases banks just tell us that if there is a problem, they will raise capital in the market. Well, of course if the market at that time will be open and willing to support the bank, which is a big if, I would say.

So it is important for us that there are a variety of options that the banks have in their drawers to rely on in case of stress. And we have been pushing and through different cycles we have achieved significant improvements in the recovery plans of banks. But we are not there yet for many banks and we will keep insisting through our letters, through our feedback, to strengthen the recovery plans.

Recovery plans are very important also for ensuring that even within the group, especially cross-border groups, that there is clear understanding on how support would flow between the parent, the subsidiaries, so we view them as also an important element in view of supporting more integrated operations of banking groups across the banking union.

1-020-0000

Alfred Sant (S&D). – Two queries from a general perspective, please, firstly regarding – and you've already mentioned it – DORA, the Digital Operation Resilience Act, which is at present being set up to cover the protective measures that all financial institutions in the EU should take against attacks or failures in the ICT systems. DORA as you know is intended as a *lex specialis* that should streamline and integrate under one structure all approaches intended to counter the threats to ICT integrity. It has increasingly been signalled, cybersecurity, as a top priority for European banks among others. In its opinion on DORA, which came rather late, the ECB endorsed the project but then seems to be making recommendations which would undermine the concept of central oversight from a single rulebook. Could you please explain how strategically from a supervisory perspective you believe that DORA should bring under its wing all or not all ICT operation resilience functions for banks across Europe?

And secondly, I go back to the points about national exposure to sovereign debt exposures and to NPLs. From a crystal-ball perspective though, not from the number crunching and data presentation, from your perspective as a very experienced banker, do you think that the post-COVID-19 economy will have structural changes to it that will affect banking structures and NPL and sovereign debt exposures in a temporary way, in a permanent way, and what could these structural changes be and their effect on these exposures? Not number crunching please, but your hunches.

1-021-0000

Andrea Enria, *Chair of the Supervisory Board of the European Central Bank***.** – Thank you very much for your question. On DORA, I don't know, maybe I missed something important here, but my impression is that the ECB has been pretty supportive of the effort to harmonise and streamline existing rules on ICT risk management and incident reporting. Actually, as I mentioned before, we have been active ourselves even in the absence of specific legal requirements in terms of our supervisory actions to get this incident-reporting framework in place, so we are very happy that this will now be inserted with a strong regulatory basis.

One of the important questions that DORA puts is how broad the scope of supervision should be. And there are very fundamental questions which are, for instance, banks are outsourcing their cloud services for instance to important players that are not supervised today, so should we expand some form of supervision to providers of cloud services and who should do the supervision there? Well, there we might be a bit hesitant to understand whether it should be the bank's supervisor to do this job, but anyway we stand ready to participate in a discussion and to have proper discussions. I personally am strongly in favour of course of having a fully and strongly integrated European approach in this area, and this is something which is absolutely in the interest of European supervision.

On sovereign debt exposure, NPLs, will there be structural changes? I think that actually the work we have done also in terms of legislation and supervisory practices on NPLs, but also sovereign debt exposures to some extent, are already changing the way in which banks deal with these assets. On the NPL side I must say I am very proud of what has been achieved. I mean when I started at the EBA 10 years ago we didn't even have a common definition of NPLs at the European level. Now we have a common framework for not only measuring but managing NPLs, running them down, cleaning banks' balance sheets after crises. We have legislation, we have supervisory practices and they work. We've shown that they work and they are effective.

So this has been radically changing the way in which banks manage. We also have developed an effective and liquid secondary market for NPLs, we have securitisation for NPLs and the current legislation recently issued will be another important piece of the puzzle, so I think that there the way in which I expect things to change is that banks will be much more effective in managing their NPLs, actually managing their distressed customers ex ante, avoiding piling up on NPLs and actively managing NPLs when they materialise in their books.

On sovereign debt exposures, I think we still have an issue of the lack of a European safe asset. I think that's the major loophole that we have. I personally, and I think also the ECB, have been very vocal in the past, supporting also initiatives to establish a European safe asset, the so-called ESBies. It was a proposal of the advisory and scientific committee of the European Systemic Risk Board. I am very supportive of that. I think that would be very helpful for the sector as a whole, having a common asset for the whole sector and this would also help dealing with what they see now, which is an excessive concentration of bank exposures vis-à-vis the national sovereign issuer. This maintains a potential adverse loop between banks and sovereigns at the national level which was the issue that the Banking Union was supposed to address.

1-022-0000

Chair. – Thank you very much, Mr Enria, for your availability. We've finished our hearing and I also thank all the MEPs who participated in the debate.

(The hearing closed at 11.10)