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Interim Balance: The European Banking Union

One year of Banking Supervision – Evaluation of a Banking Association

C H E C K   A G A I N S T   D E L I V E R Y

Dear Prof. Kerber,

Ladies and Gentlemen,

I would like to thank you for inviting me to your Academic Workshop "***Interim Balance: The European Banking Union***". I am very honored and pleased to speak at this distinguished event.

Keeping in mind that the Single Rule Book is relevant for all banks in all member states the Single Supervisory Mechanism, the Single Resolution Mechanism and the Deposit Guarantee Schemes Directive are determining the requirements within the euro area - the 19 SSM-countries. Banking supervision by European Central Bank is the key to promote and to foster the resilience of the banking sector.

Ladies and Gentlemen,
my topic is "One year of Banking Supervision – Evaluation of a Banking Association". On the 4th of November 2014, the SSM officially started at ECB's head office in Frankfurt. So it is the right time to reflect what ECB has achieved in this first year and to ask what are the main challenges ahead.

I. Exhaustive Health Check "Comprehensive Assessement"

But first of all I want to look at the months before the 4th of November 2014. Because ECB had started its first request with regard to the so-called Comprehensive Assessment in October 2013. It was an exhaustive financial health check of 130 banks in the euro area (including Lithuania), covering approximately 82% of total bank assets. It comprises of three parts:

1. Risk Assessment System
2. Asset Quality Review
3. Stresstest

As an unique and rigorous exercise it was a major milestone in the preparation for the Single Supervisory Mechanism.

This Comprehensive Assessment had shown very clearly that we would have started into a new age of European Banking Supervision. Time would run out that Europe had many supervisory authorities holding similar responsibilities but operating in different national jurisdictions. This imperfect system should end so that costs of any failures should be payed by tax payers never again.

The Comprehensive Assessment showed each directly supervised bank and banking group what would come up in the next weeks, months and years. The requirements were be very hard and from a German perspective very quantitative. Even more the data collection had to be done in short terms partially from Friday to Monday. We have got a first insight into the different approaches of national

competent authorities with regard to their processes and procedures as well as their interpretations of certain articles of the Capital Requirements Regulation - the CRR.
It was interesting to see that even the banking supervisors themselves struggled for a harmonized supervisory system - and this struggle has not ended yet.

A lot of work had to be done within the banks and we had to learn that the common and traditional organizations had to be transformed into this new age of banking supervision. We had to build up teams to coordinate the different requests and to handle transparent communication lines between a bank to the ECB or our association to the ECB.

Risk Assessment System, Asset Quality Review and Stress-test showed us very clearly the linkages between banking regulation, risk controlling, financial controlling, financial accounting and IT-processing. Data collections, in-depth analyses on risks and stresstesting were tremendous. It was a very hard and roller-coasting job for each employée involved. Thanks to all the bankers who suffered a lot!

But, ECB had done a great job up to the 26th of October 2014 when it published the results of the Comprehensive Assessment. At the end we were very happy that all German banks were successful. It was quite obvious to build up regularly contacts to ECB. Communication lines to the ECB could be established besides individual contacts via the Deutsche Kreditwirtschaft and via our European Association of Public Banks and via a group of interested associations from other SSM-member states.

II. The first year

After the 4th of November 2014 the main topics - from my point of view - were the implementation of the Joint Supervisory Teams (JST) and the first capital ratio driven by ECB, the SREP - ratio.

a. Joint Supervisory Teams

It was quite interesting to learn that a JST was headed by an ECB staff member and included a majority of staff members from the national supervisors - most of them from Deutsche Bundesbank and BaFin. JST's are the core of ECB's supervisory approach and practice.

First discussions between a board and its JST were like a warming-up. Additionally, they interviewed the chair of the supervisory board and the chair of the audit committee. Furthermore, the communication widened up to the second level of a bank's management. Nowadays we have a constructive dialogue from both sides of the table. Internal governance and internal management informations systems play a key role in addition of ICAAP and ILAAP.

Even more, it is important to recognize an ECB's coordinator's knowledge about a Förderbank or the ownership of public banks in difference to the ownership of cooperative banks or public banks. It is quite interesting to discuss with a JST about national GAAP using for supervisory financial reporting purposes.

b. SREP - ratio

Besides the JST's as integral parts of the General Directorates I and II, common standards and methodologies will be developed by General Directorate IV which is responsible for horizontal supervision and specialised expertise. For instance, it drafted a supervisory manual with a common set of work procedures and practices. DG IV is the key to understand what it means a receive a new capital ratio in addition to Core Equity Tier-1 (CET1), which is called SREP-ratio. It is the result out of the Supervisory Review and Evaluation Process SREP. DG IV used all the results of the Comprehensive Assessment to create SREP-ratios for 2014. In 2015, it developed its own methodology for the SREP-ratio. SREP-letters were sent to the banks in these days. The actual capital requirements are higher than last year. According to ECB, on average by roundabout 30 basis points. And the phasing-in for capital buffers requires around 20 additional basis points of capital.

We ask ECB to be more transparent with regard to the new SREP-ratios. A SREP-ratio is much more important in comparison to CET1-ratio or own funds-ratio which we have looked at in the past. **The SREP-ratio is the new most important capital ratio.**

c. My personal evaluation

It is fair to say that the first year of ECB's bankings supervision was a successful start-up. I have no doubt that ECB will become tougher and tougher and will try to harmonize as much as possible. On 10th of November, ECB has started his consultation about national options and discretions OND. It uses its competence and its legal position consequently to set an end to a lot of national discretions within the euro area. We have to look very careful at the ECB's proposals. Its not only because of the bank's capitalization or Return-on-Equity or Cost-Income-Ratio. Even more, we have to look at the consequences which might come up for the financial sector in Germany and the whole economy. Harmonizing banking regulation does not mean harmonizing the economic models of the 19 SSM-member states.

III. Outlook

ECB will force banks to become stronger and more resilient and its no surprise which high level priorities the supervisory board has set for 2015. They are:

1. business models and profitability drivers,

2. governance and risk appetite,
3. capital adequacy,
4. credit risk and
5. cyber risk and data integrity.

We have to be prepared to give the right answers to these priorities and even more we have to be prepared within our medium-term-planning on capital and return. Up to now, we do not know what will come up with the new approach from the Basel Committee on Banking Supervision called Basel IV. Some supervisors call it a review of Basel III. But it is very much more.

Therefore, I see an expectation gap:
A bank cannot fulfill higher regulatory requirements and - at the same time - can rise its profitability in this environment. This will not work. Higher capital requirements in this environment have the potential to foil the intended goals of more resilience within the banking sector. In the long run, banks will lose for the benefit of financial substitutes and shadow banks.

But to remain in the topic of my speech, I would like to pronounce some requests:

1. better and more transparent due processes up to decision processes within ECB,
2. a better combination between the European Banking Authority as regulator and ECB as supervisor,
3. better scheduling regulatory projects for the sake of better planning projects and processes in banks,
4. with regard to evaluating business models being neutral and keeping in mind proportionality.

Ladies and gentlemen,

thank you very much for your kind attention.