European Parliament

Banking supervisory challenges ahead in the Banking Union

This note presents the summaries of four papers requested by the ECON Committee to external authors on "The next SSM term: Supervisory challenges ahead", given the recent appointment of Andrea Enria as Chair of the Single Supervisory Mechansim (SSM). The experts were asked to briefly look back at how the SSM (part of the ECB) has over the past years performed against the main goals it was supposed to accomplish; look forward at the supervisory challenges ahead; and to reflect upon which modified supervisory practices would facilitate the Parliament's scrutiny work.

A shared concern among the external experts was the need to improve market discipline through enhanced supervisory disclosure and transparency, including on SREP outcome and Pillar 2 guidance capital requirements. Furthermore, improving the cost efficiency of the banking sector, through streamlined regulation and supervision, was a point raised by a few of the authors.

Martin R. Götz, Tobias H. Tröger and Mark Wahrenburg

In their paper, these three authors first look at the past developments of banks under direct SSM supervision, and they find in particular that the group of weakly capitalised banks have not seen a notable improvement of key performance indicators under direct SSM supervision. In fact, those weakly capitalised still face elevated levels of nonperforming loans, are less cost-efficient and reduced their share of subordinated debt financing over the last years.

To improve supervisory outcomes within the SSM going forward, Götz, Tröger and Wahrenburg suggest that, firstly, market discipline should be fostered by enhanced supervisory disclosure. Supervisors spend a considerable amount of time analysing and comparing the respective capabilities of individual banks, but their insights are usually restricted to the publication of highly aggregated results. The risk management practices of banks could therefore benefit from more detailed information regarding their individual strength and weaknesses. Moreover, streamlining the administration could improve the cost efficiency of banking supervision. And lastly, given that the efficacy of European bank supervision rests on the interplay with many different institutions, their paper underlines the need for continuing and intensifying coordination among regulatory bodies, namely the SSM, National Competent Authorities and resolution authorities.

Andrea Resti

Andrea Resti identifies in his paper two types of challenges that the SSM must confront going forward. The first is vulnerabilities related to the European banking sector, which could have financial stability implications if not addressed. Those vulnerabilities include the low profitability of banks, the increased role of the shadow banking sector, and conduct risk and poor governance. The second type of challenge is that stemming from the SSM itself.

Andrea Resti first turns to the complexity of the regulatory framework, arguing in favour of more harmonised rules and enforcement mechanisms. Second, the strain on supervisory resources and the potential risks

Economic Governance Support Unit (EGOV)
Author: M. Magnus, R. Segall
Directorate-General for Internal Policies
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associated with the use of external consultants is highlighted. Lastly, his paper recommends increased accountability and transparency. Accountability and transparency can be enhanced, e.g., through greater disclosure on resources and objectives, SREP and other internal methodologies, and on decisions taken by the SSM's Administrative Board of Review. In addition, Resti argues that the European Court of Auditors should be entitled to assess the soundness of the SSM's processes, without interfering with individual supervisory decisions.

Harry Huizinga

Harry Huizinga's paper focuses on two ways in which overall bank supervision and oversight can be improved in the next SSM term. Firstly, the ECB could encourage more effective market discipline of banks by disclosing additional information on SREP outcomes. To improve market discipline, the ECB should consider facilitating the publication of additional bank-specific supervisory information. Harry Huizinga in particular suggests that the ECB could require banks to disclose their Pillar 2 guidance capital requirements that banks currently often do not reveal. In addition, the ECB could enhance its cooperation with the EBA to increase the coverage of SSM banks in the EU-wide transparency and stress test exercises, regularly assess the quality of banks' Pillar 3 reports as part of its supervisory review, and could potentially use market information on banks' valuation and cost of funding to inform its supervisory work.

Moreover, Harry Huizinga recommends revising the current SSM guidance on the corporate governance of banks promoting shareholder-friendly boards, arguing that shareholders tend to promote excessive risk taking vis-à-vis other stakeholder, as bank shareholders tend to benefit more from excessive bank risk taking than other stakeholders.

Brunella Bruno and Elena Carletti

Brunella Bruno and Elena Carletti argue in this paper that the European banking system appears healthier and sounder than in the pre-SSM period, yet they see challenges for the future supervision of significant banks. First, they find that more should be done to foster financial integration. Second, accountability and transparency can be strengthened, for example, by disclosing more information on the SREP process. Third, complexity in the supervision framework should be minimised to reduce compliance costs. Lastly, it is argued that supervision should not lose sight of its ultimate goal - supporting economic growth. In support of this aim, more nuanced supervisory decisions, supported by stronger empirical research to reduce the risk of unintended effects is recommended.

For a overview of Baking resolution challenges ahead in the Banking Union, please see this separate EGOV Briefing.

Contact: egov@ep.europa.eu

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