European Parliament ECON Committee Meeting - Public Hearing on new Banking Legislation Package - 25/04/2017

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- I am very pleased to be back here at the ECON Committee to share with you some insights and personal views on my experience as a member of the Board of Directors of Banco de Portugal responsible for prudential banking supervision, and as a Supervisory Board Member of the SSM, for almost a year now.
- The setting up of the new institutional framework [Banking Union] within such a short period of time is a commendable success. The ECON Committee Members, Daniele, Andrea, Elke and Dominique are, among others, to be congratulated for their valuable contributions for such success.
- Notwithstanding the immense achievements of the Banking Union, the on-going review of the legal acts represents a pivotal opportunity to reinforce some of its core elements.
- In fact, with the benefit of hindsight it is now clear that there are several missing links and stabilizing elements in this project - as many of us, in this Committee, have feared from the beginning – which one might compare to a car running with a flat tire, which leads to an unbalanced functioning, prone to accidents.
- Banking Union was anchored on a steady state assumption of an overall macroeconomic recovery, which we are far from having achieved collectively. Proof of that is the lengthy debate over how to address important crisis legacy issues for which the adequate tools are no longer available.
- In the present framework, the harsh conditions for any State intervention imposed by BRRD [for Precautionary Recapitalisation] and by State Aid rules, accompanied by the supervisory and regulatory demands for extra capital and loss absorption instruments, amidst low profitability, low interest rates and high levels of NPLs, are conducive to significant transfers of wealth and

the destruction of economic value, that may seriously jeopardize financial stability.

- This is all happening at a time when financial stability is still a national concern and responsibility, despite the much more limited ability for the usage of national tools to safeguard it.

- All of this speaks in favor of carefully but urgently fine-tuning the current legal framework and completing Banking Union or, at a minimum, ensuring a flexible application of the existing rules.

- The European Parliament and the ECON Committee, which were so engaged in the introduction of a review clause on the BRRD, have now the opportunity and responsibility to act decisively to preserve the purpose of the Banking Union project and to ensure financial stability, which are otherwise at risk.

- Missing elements encompass, firstly, and as was known from the beginning, a common safety net for depositors' protection (EDIS) and a backstop for the Single Resolution Fund.

- Indeed, we need to work decisively both on risk sharing and risk reduction measures - and not only on the later - in order to create a truly functioning Banking Union and to guarantee a decision process rightly balanced.

- The resolution framework may well function in a steady state when loss absorption capacity has been built up. However, the present legacy issues with a systemic nature call for the fine-tuning of important elements such as:

    - (i) the conditions for the use of the precautionary recapitalization (article 32(4) of the BRRD),

    - (ii) the conditions for the use of the Single Resolution Fund (articles 44(5) and 101(2) of the BRRD), and

    - (iii) the MREL setting.

- The fact that the use of the Single Resolution Fund is conditional on a bail-in of 8% of total liabilities and own funds, and the amount to be drawn is limited to 5% of total liabilities and own funds, make its use virtually impossible.

- As a consequence, financial stability is endangered, particularly in the case of banks with insufficient loss absorption capacity - for example due to non-compliance with the MREL requirements in the current build up phase - or with liabilities based mainly on deposits, whose participation in loss absorption would dramatically endanger the continuity of critical functions in the bank but also adversely impact the whole financial system. Likewise, the design and implementation framework of MREL - which is an essential tool for the resolution authorities - are not without faults.

- BRRD failed to fully take into account the fact that banks would not be able to comply with MREL targets immediately after its entry into force. This is true for banks in general, but all the more so for traditional banking business models relying mostly on deposits – these banks will only be able to issue MREL-eligible instruments at a high cost amid severe market access constraints.

- I fully share the view that institutions' losses must be borne by its shareholders and creditors, and not by public funds. However, in a context where we are still in a building up phase of loss absorption instruments eligible for MREL, it is important that a proper transitional period for the implementation of MREL targets is provided.

- Moreover, at the international level, it cannot be ignored that the scope of the MREL requirement goes beyond that of the TLAC. Whereas TLAC applies only to G-SIBs, MREL requirement applies to all credit institutions in the EU, regardless of their size. Proportionality and flexibility are thus crucial, in order not to compromise the level playing field.

- Additionally to the revision of the BRRD and CRD, there are other "stabilization elements", not necessarily foreseen in the initial project – which the ECON Committee, given its relevance for financial stability, must address. The most urgent one is, probably, the Non-Performing Loans (NPLs) situation in the Euro area, which remains a key priority. In this regard, I praise Andrea's public call for an EU solution and also the work conduct by the SSM in this regard. It is crucial that this issue is tackled in a coordinated way, avoiding a fire-sale environment and negative spill-over effects.

- Other elements are also noteworthy, namely the need for a fast-tracking procedure with regard to the establishment of a transitional provision on the impacts arising from the application of IFRS9 [which will become mandatory in the EU as from 1 January 2018].
- I feel confident that the European institutions, and the EP and the ECON members in particular, will contribute actively to ensure a safer and more resilient banking sector, completing and fine tuning Banking Union so that it delivers the expected results: protecting depositors and taxpayers, safeguarding financial stability and guaranteeing the conditions for appropriate lending to the real economy.